Information Technology Outsourcing: Conceptualizing Practice in the Public and Private Sector

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Abstract

This paper employs four conceptual frameworks to assess IT outsourcing arrangements, i.e. core competencies, agency theory, transaction cost economics and partnerships. The frameworks are related to an empirical comparison of the public and private sectors within the United Kingdom, utilizing data from thirteen interviews conducted with IT managers from both sectors. The study suggests that each theoretical approach has its own relative merits in helping organizations to understand strategic practice, particularly in consideration of some aspects not usually addressed in outsourcing studies. Conclusions are drawn to determine the wider benefits of the frameworks towards more successful IT outsourcing decision making.

Key Words: IT Outsourcing, Core Competencies, Transaction Costs, Agency Theory, Partnerships

Introduction

There is general agreement that IT outsourcing involves the carrying out of IT functions by third parties [1] but some authors have been more specific in their definition by emphasising certain aspects. For example Cheon, Grover and Teng [2], Lacity and Hirschheim [3], Apte [4] and Tapscott and Caston [5] mention the movement from in-house to external sourcing. Other definitions (e.g. [6]; [7]; [8]; and [9]) do not imply that the activities were necessarily internal previously. In the computing trade press, articles on outsourcing frequently focus on transfers of assets, in particular, staff. This is a common, but not essential, part of outsourcing [10]. Some authors have defined outsourcing by contrasting it with insourcing. For example, Willcocks, Fitzgerald and Lacity [11] distinguish between "contracts that specify a service and result which the market is to provide ('outsourcing'); and contracts which call for the market to provide resources to be deployed under the buyer's management and control ('insourcing')". However, definitions of insourcing vary (e.g. [12]; [13]; [14]; [3]; [15]) and therefore have limited use in clarifying outsourcing. This study therefore regards IT outsourcing as the third party provision of IT products and services, but acknowledges that sources used have differing interpretations [16].

Outsourcing is a key driving force in business [5], and expenditure on IT outsourcing is considerable (e.g. [12]; [17]; [18]; [19]) with much of it placed with a few companies [20]. For example, four companies have dominated UK local government IT outsourcing, one - CFM - with 43% by value of the market [21]. Further research in outsourcing is justified by the still small (but increasing) number of empirical studies, a feature noted by several authors (e.g. [10]; [22]; [23]; [12]; [24]). In particular, there have been few British studies [10], [25]. Also, several conceptual frameworks are found in the literature, but more empirical work is needed to assess their validity [26]; [27]. Furthermore, most studies of IT outsourcing have involved examination of private sector organisations (PSOs); hence they do not consider the different circumstances which may surround public sector outsourcing, and consequently do not attempt to identify, through the available conceptual frameworks, similarities and contrasts between private and public sectors. Willcocks and Fitzgerald [17] examine some public sector organisations, including some UK local authorities (LAs), as part of a wider study on outsourcing, and Willcocks [28] suggests outsourcing might ease some public sector IT problems. Outsourcing in the UK public sector has been associated with compulsory competitive tendering (CCT), a major government initiative [29]. LAs have been one of the areas of the public sector affected by the policy. Legislation passed by the Conservative Government required LAs to market test 70% of their IT budget, subject to various exceptions, the principal one being a de minimis budget of £300,000 [30]; [31]. Money already spent externally on a wide range of IT products and services counted towards that 70% [32]; [31]. The date by which the market testing had to occur varied, with the first deadline being in 1997. By 1995, over half of LA IT expenditure was with the private sector, up from 40% in 1991, but only 15% of
LAAs had voluntarily market-tested any of their IT function [21]; [33]. The impact of this compulsory element may mean that perceptions and the practice of outsourcing are very different when comparing PSOs and LAAs.

**Context of the Research**

An important feature of the research was that it was concerned with sectoral comparison, rather than in depth analysis of individual organizations. The private sector embraces an extremely large number and wide diversity of organizations. Each of these experiences a unique set of business circumstances. However, it is common in academic and non-academic circles to speak of the private sector as having a meaningful identity, separate from that of the public sector. While there may be some organizations which do not fit neatly into either sector, a division between the two sectors may be based on the source of funding. PSOs receive their income from selling products and services to customers, whereas LAAs, like most public sector bodies, receive much, if not most, of their funding through taxation or other governmental source.

In Britain, LAAs serve to apply central government decisions locally. The Conservative government which came to power in 1979 regarded LAAs as “wasteful, profligate, irresponsible, unaccountable, luxurious and out of control” [36]. Hence, increasing centralization since then has been part of a general drive to streamline public services [37]. There is no current evidence that the recently elected Labour government in the UK (May 1997) will change the fundamental view of how LAAs are managed and controlled. LAAs are fundamentally different from PSOs in many ways, but essentially because they are concerned with government; a local authority is “not merely a provider of goods and services, it is also both a governmental and a political institution, constituted by local election” [38] (p.1 - italics in the original). Compulsory competitive tendering (CCT) and contracting out have been the major reforming techniques in UK local government in the 1980s and 1990s [38]; [39]; [40]. CCT requires the separation of contractor/provider from client/purchaser. The most common approach is to create one or more Direct Service Organizations (DSOs) [41], which tender for work against any external bids. These systems are undergoing constant change with the current Labour government in the UK indicating an alternative approach through so called ‘value-added’ tenders for LA contracted work. It is within this dynamic context that this research into IT outsourcing was undertaken.

**Aims of the Research**

The research involved an exploratory study to investigate the nature of IT outsourcing in the contexts of the private and public sectors of the UK. The motivation for the study was to consider the validity and value of a range of theoretical frameworks which may be helpful to explain and perhaps predict the circumstances of allowing a third party organization to manage and facilitate IT resources. It is clearly not helpful to specify specific research questions for the testing of a hypothesis as the study was intrinsically qualitative and, as noted, exploratory. However, the two main conjectures for the research may be outlined as follows:

1. what are the current theoretical frameworks most commonly adopted to explain IT outsourcing environments which may be derived from a detailed analysis of current literature?

2. is it possible to offer some generalizability of empirical findings through a consideration of these theoretical frameworks for the benefit of IT outsourcing practice in the various contexts?

The intention was to assess the usefulness of the four most common conceptual frameworks for the practices and perceptions of IT outsourcing in PSOs and LA’s. The methodology adopted, therefore, was grounded in both the literature and empirical observation. Thus, the nature of the exploratory analysis avoided the formal testing of a hypotheses and allowed a concentration on a qualitative assessment of the conjectures involved. The four conceptual frameworks used were core competencies, transaction cost economics, agency theory and partnership. They are among the most frequently found frameworks in the literature on IT outsourcing, and this suggests that they may be helpful in empirical studies. Few empirical studies have employed them, however, and it is believed no study has considered all four. Willcocks [27], in particular, appeals for more investigative work on the conceptual frameworks which are frequently considered by academics.

The frameworks were derived from an extensive review of the literature where comparable examples from a number of references were made. It is believed, as noted, that this is the first study of its kind which considers a plurality of theoretical perspectives. It is proposed that this selection of frameworks, and their transposition within current knowledge, may provide a useful determination of existing IT outsourcing practice. The essential contribution for this research, therefore, is the aggregation of the empirical data applied in this
respect and its value in providing explanations for IT outsourcing decisions.

**Methodology for the Research**

The analytical techniques employed for the study involved semi-structured interviews carried out with IT managers in PSOs and LAs to determine their experiences of and attitudes towards IT outsourcing. All of the interviews were audio taped and the general themes for the questioning are noted in Appendix 1. A further analysis of documentary evidence of outsourcing vendors' marketing literature was undertaken, to discover how vendors view outsourcing, and whether they regard the two sectors differently. This method was used because of the report by Lacity and Hirschheim [9] that vendors are unwilling to be frank in interviews, so as not to endanger their relationship with customers. The major source for the construction of heterogeneous samples was the Computer Users Yearbook [34],[35], a major source of information about UK IT installations and service providers. Interviews were restricted to organizations in the north of England. This geographical restriction was reasonable because all LAs are subject to similar external factors irrespective of location, and because of the wide range of industries which PSOs in the North represent. The LAs participating in the study included all the different constitutional types of LA found outside London. They varied greatly in terms of responsibilities, and, like the PSOs, greatly in number of employees, budget and size of IT function. They included councils controlled by each of the two main UK political parties, as well as councils under no overall control. The PSOs were taken from the automobiles, financial services, retail, engineering, chemicals and vehicle parts industries. The outsourcing vendors selected were large ones which featured regularly in trade press reports, because they would have greater experience of outsourcing. There were thirteen interviews, each lasting between 75 and 135 minutes, which were tape-recorded and then transcribed.

**Deriving the Frameworks**

The four frameworks proposed have been discussed by several authors, and have in some cases been used in empirical studies, which suggests they may be useful in helping to understand practices and perceptions of IT outsourcing in different settings [42]; [43]; [44]. If the frameworks are viewed together, it can be seen that they assist in covering a wide range of issues in outsourcing. Core competencies are interesting, because concentration on them may be a motive for outsourcing, and hence the framework can perhaps help to explain why an organization might first consider using third-party provision for an IT product or service. The transaction cost economics framework is interesting because it is concerned with the extent to which organizations are aware of the tangible and intangible costs which market usage can incur and which may outweigh the advantages of any economies of scale which outsourcing may provide. Agency theory may be useful in helping to understand how interests between a particular client and vendor may diverge, and how the relationship between the two parties can be regulated in contractual terms. Finally, the partnership framework suggests that either at its inception or as it progresses, an arrangement between two parties can transcend organizational differences and cause the parties to work for a common purpose which may or may not be expressed in a contract. Although there is some overlap between the frameworks the paper takes each in turn and discusses it in the context of IT outsourcing.

**Core Competencies: outline**

Core competencies theory suggests activities should be performed either in-house or by suppliers. Activities which are not core competencies should be considered for outsourcing; if outsourced, they should be placed with "best in world" suppliers. Some non-core activities may have to be retained in-house if they are part of a defensive posture to protect competitive advantage [45]. Quinn and Hilmer [43] and Prahalad and Hammel [46] detail characteristics of core competencies, including their customer focus, knowledge basis, link to competitive advantage, presence in organizational culture and cross-functional nature. However, "core" has a range of meanings [47], and a practical research approach should not become entrapped in semantics as "most of the literature on this subject is tautological - 'core' equals 'key' or 'critical' or "fundamental"" [43]. Alexander and Young [47] argue that the very acts of specifying and managing supply contracts can themselves give competitive advantage. In addition, an organization may view IT itself as a core competence. Hochstrasser and Griffiths [48] suggest that the most successful companies have a good understanding of IT's potential.

Despite the argument that an organization should retain core activities and outsource only commodities, McLellan, Marcolin and Beamish [49] report that some organizations, at least in the banking sector, outsource IT even though they see it as core and delivering competitive advantage. They claim that this is because the use of external resources increases the IT function's competitive capabilities,
and because IT could be considered core at the corporate level, but some of its aspects, at lower levels, might be commodities. Feeny et al [50] underline the need to keep certain competencies in house: tracking and understanding changes in IT; defining IT needs, and using the market successfully, involving the specification and management of "rightsourcing". Indeed, these may be some of the core IT competencies in an organisation which outsources its IT, whether it be in the public or private sector.

Transaction Cost Economics: outline

In Transaction Cost Economics (TCE), an organization chooses to source via its own hierarchy or via the market, based on relative cost, which has two components: production costs and co-ordination (transaction) costs. Economies of scale, via the market, can reduce production costs. In IT this has been particularly associated with the outsourcing of data centre operations [4], frequently referred to as facilities management (FM). Transaction costs are determined by several factors: asset specificity, transaction frequency, and uncertainty. Asset specificity is "the degree to which an asset can be redeployed to alternative uses and by alternative users without sacrifice of productive value" [51], p. 142. Williamson also identifies three types of transaction according to specificity. Non-specific transactions have low asset specificity, and are associated with the acquisition of commodities. Idiosyncratic transactions have high specificity. Mixed transactions have elements of both commodity and customisation. Transaction specificity can be viewed alongside transaction frequency, a second major construct of TCE, which distinguishes occasional from recurrent transactions [52]. Two frequency categories, multiplied by three specificity types, produce six discrete transaction types. Williamson argues that the market is better for all but transactions which are both recurrent and idiosyncratic. The third major determinant of transaction costs, uncertainty, is found in many aspects of IT [2; [53], and is particularly associated with systems development. Rather than developing specialized client-specific products, vendors may find it cheaper and safer to provide a standard product [54]; [55]. Complex products may be better provided via the internal hierarchy rather than the market [56]. Throughout market usage there is also the danger of opportunism - "lack of candour or honesty in transactions" [57] p.9 - and this is likely to increase if there are only a few vendors able and willing to contract. The difficulties of both market usage and provision via the hierarchy perhaps explains why extremes of vertical integration and spot market transactions are comparatively rare [58], resulting in a range of sourcing options [59]; [20]; [15].

Transaction costs may be reduced by various methods. For example, buying services from different vendors can reduce the damage caused by one bad contract [25]; but this may increase complexity [13] or may be impossible because of a dearth of bidders [3]. Also, outsourcing as little as possible would be expected to minimise transaction costs, given the basic premise of TCE, and various authors suggest ways to improve in-house performance (e.g. [9] [3]; [60]; [61]. De Looff [59] remarks that often the possibility of improvement is ignored. Certainly, identification of areas for improvement, especially via a thorough outsourcing evaluation as advocated by Benko [62], itself carries a cost. Thus some organizations may not allow a formal in-house bid (as opposed to comparison of vendors' bids against existing costs), even though authors such as Lacity and Hirschheim [3] and Willcocks [27] stress its importance. However, the cost of an in-house bid might not be the only reason for such a bid not being invited. In UK local government, for example, of the 15% of LAs which had carried out competitive tendering voluntarily, 60% had not allowed an internal bid, for a variety of reasons including preference for a known vendor and dissatisfaction with in-house performance [21]. Also, as well as market testing costs being increased by the resources needed to assemble a bid, normal service provision must still be maintained. The nature of the work to be sourced may also be important: Leach et al [38] report that for professional services, an LA may prefer a negotiated contract rather than competitive bidding, although this may merely move transaction costs from service specification to contract negotiation.

TCE has been criticised for its simplicity (e.g. [63]; [64]; [65]). Willcocks [27] argues that when problems in TCE are found, they can be explained by the exceptions and ambiguities of the theory, underlining its role as "a high level general theory, its uncalibrated constructs permitting empirical data to be fitted to support the theory all too easily". Nonetheless it offers a perspective on the desirability and practical difficulties of outsourcing. Transaction costs appear to be difficult to avoid, and may be unavoidably greater in some settings than in others. For example, Walsh [39] argues that in the public sector, contract creation and monitoring are more difficult because of the sector’s complexity, and because there are costs associated with bureaucracy and democracy which are hard to allocate to specific functions.
Agency Theory: outline

Agency Theory (AT) is less prominent than TCE in the literature. There is a thin dividing line between the two theories, and agency is sometimes treated almost as part of TCE. The theories share concepts of self interest and bounded rationality, with a rough correspondence between TCE’s hierarchies and markets and AT’s behaviour-based contracts and outcome-based contracts. However, AT is contract-focused and has other features, notably risk attitudes, outcome uncertainty and information systems [66]. The original impetus for AT’s development was large corporations’ separation of control from ownership [67]; thus its focus was never on organizational boundaries, as with TCE theory [68]. Hence the focus of AT is not the decision to source via the hierarchy or via the market. Although “all contractual [sic] arrangements ... contain important elements of agency” [69], AT is essentially concerned with the delegation of work by one party (the principal) to another (the agent) via a contract [66], whether or not they are both within the same organization. The contract governing the relationship between the parties is either behaviour- or outcome-based, the former associated with hierarchy, the latter with market governance. The choice depends on the agency costs [2].

AT holds that human beings act through self-interest, and therefore, as contracting parties, they may have divergent goals. An important aspect of the theory is that both principal and agent wish to avoid risk when dealing with each other. The principal may prefer to place risk with the agent via an outcome-based contract, while the agent may prefer to avoid risk by having a behaviour-based contract [66]. Outcome-based contracts are claimed to reduce agent opportunism because the rewards of both agent and principal depend on the same actions. Behaviour-based contracts need the principal to have sufficient information to identify two possible dangers: first, whether there is adverse selection (the agent does not possess the skills he claims); secondly, moral hazard - “the agent is shirking” [66].

Agency costs also exist in hierarchies, and may be particularly high in the public sector. For example, Walsh [39] argues that problems between agents and principals are greater in tall, complex organizations. Also, Milgrom [70] suggests that non-market organizations are especially susceptible to “influence costs”, where employees pursue their own agenda (a tendency which is counter-acted by the use of bureaucratic rules).

AT, in short, helps to expose problems of divergent interest within both markets and hierarchies.

To promote congruence of interests, therefore, a different approach may be adopted: partnership.

Partnership: outline

Partnership, or strategic alliance, has frequently been noted as a major feature of IT outsourcing (e.g. [71]; [22]; [7]; [2]; [72]; [73]). The influential Kodak-IBM deal had much to do with a sense of honour and a “chemistry” between the parties [74], and changed the common perception of IT outsourcing from an “arm’s length” relationship to one of “strategic partnership” [75]. Partnership’s treatment in the IS literature is largely non-theoretical [76]. Sharing of risk and reward is a feature often emphasised (e.g. [50]; [3]; [77]; [78], and has been advocated in particular when outsourcing is helping a technological migration [79]. Partnership can reduce the risk of inadequate contractual provision [80], but Judenberg [81] counsels caution, while Willcocks and Choi [65] argue that in the relationship between vendor and client the latter is usually overdependent on the former and that goals are not necessarily shared.

The contract may not help to identify whether a partnership exists, other than in stipulating shared profits and/ or savings. Often the literature emphasises intangibles, like trust, comfort, understanding, flexibility, a spirit of co-operation, shared values and culture, good interpersonal relations, shared goals and problem solving, and regular communication (e.g. [81]; [78]; [82]; [20]; [83]; [64]; [49]). Some organizations advertise for partners specifically [78], although a client may be more comfortable if it knows the vendor already (e.g. [84]). This familiarity may allay fears about the possible violation of intellectual property rights or sharing of secret business plans, which may be major concerns (e.g. [4]; [75]). In partner selection, cultural compatibility is vital (e.g. [58]; [75]; [12]; [17]; [85]), and shared values and objectives inform all stages of the partnership development process [76].

Given the wide range of differences which may surface, it is unsurprising that few organizations have succeeded in copying what they perceive to be the strategic partnership in the Kodak-IBM deal [3]. Lacity and Hirschheim question the appropriateness of the term "strategic partner" altogether. They claim that vendor account managers are rewarded according to contract profitability, which is principally achieved through charging the client extra for anything which is not in the contract. This seems to be very much the culture of caveat emptor.

The contract is more likely to favour the vendor because he has greater experience in negotiation (e.g. [17]; [9]; [86]. Saunders, Gebelt and Hu [87] found that clients with “loose” contracts were more likely to
regard outsourcing as a failure; yet more than 50% of respondents in their study used the vendor’s standard contract as a basis for outsourcing agreement; and more than 50% did not use external technical or legal advice. Fitzgerald [88] found that 80% of clients wished they had more tightly defined contracts. Lacity and Hirschheim [9] argue that the client is more realistically a customer than a partner. As IT outsourcing experience grows, clients rely less on trust and more on adequate contracts. While still recognizing the importance of good personal relationships, very few claim to be in strategic partnerships [17]. Clients do not expect outsourcing to be a cost-free exercise, but they have a feel for a "reasonable" profit for the vendor (15-20%) and want to know its source [17]. McLellan and Marcolin [89] suggest that partly the client's view of IT influences its relationship with the vendor, such that firms regarding IT as a core competence capability are more likely to look upon outsourcing as an alliance. Clients who view IT as core are also more likely to be satisfied with the outsourcing arrangements because they negotiate from a more knowledgeable position [87].

Findings

This section outlines the empirical findings for each framework based on the interviews and vendor literature.

Core Competencies: findings

Contrary to vendors' marketing material and to much of the literature on IT outsourcing, the interviews suggest that concentration on core competencies is not a strong motive for IT outsourcing. No organization from either sector had systematically examined its activities to identify core and non-core functions. Generally, neither PSOs nor LAs viewed IT as a monolithic utility, even where total outsourcing was practised. Most organizations seemed to share Lacity et al [90] view of IT as a mix of core and non-core activities. However, there was much disagreement about which elements were core and which were commodities, with the status of systems development being especially uncertain. Another complication was that an activity could be judged as core at one time, and commodity another. One reason for this was the need to master the activity before outsourcing it, such as managing a new mainframe and operating system environment. Another reason was the perceived changing contribution that an activity made to the overall organization; in the financial services organization, automated teller machines and credit card processing were previously regarded as delivering strategic advantage, but not any more.

All the PSOs viewed IT as of strategic significance, but IT functions in LAs were less certain of their position in the organization. Although Boynton et al [91] make the general point that line managers can be reluctant to rely on central IT provision, there seemed particular factors in local government which made the IT function less secure. Several LA managers claimed that IT in local government lacked credibility with the users (who were now far more knowledgeable about IT than they used to be), and bored or confounded elected representatives. Others suggested that in an era of cost-cutting imposed on LAs by central government, local councillors responsible for implementing such cuts concentrated on preserving front-line services - housing, education, social services, etc - and were not too worried about whether IT was outsourced or not. As one LA manager put it, for councillors "their agenda is pretty simple...the vast majority of their interests lie in the health and well-being of their electorate. There are no votes in computers.” This would support Dunleavy's [92] argument about the residualisation process in the public sector, and may mean that, in Leonard-Barton's [93] terminology, IT has become a "non-dominant discipline”.

Despite all this, and despite the fact that competitive tendering was compulsory, most LAs were relaxed about the extent to which they would have to outsource IT unwillingly. Partly this was because over time they had become used to working and surviving in an internal market where other LA functions did not have to use the in-house IT provision if an external source was deemed more suitable. Partly it was because the legislation contained several loopholes about what counted as outsourcing. Partly it was because initial expressions of interest from outsourcing vendors had ceased, the general view among LA managers being that the vendors had realised there was not a great amount of money to be made from LAs. However, as was the case in the PSOs, greater use of the market (internal and external) had required IT managers to acquire new competencies, to accompany the competence of thinking strategically about IT, confirming the work by Feeny et al [50]. For some LA managers, there was concern that vendors, if given the chance, would try to provide standard products and services, and this might compromise the individuality and (limited) autonomy which LAs possessed, therefore frustrating the democratic process. This was obviously not an issue in PSOs. In the private sector, employees and managers sometimes had significant misgivings about outsourcing, but there was no institutionalised power
Transaction Cost Economics: findings

The research suggested that the market was used successfully by both PSOs and LAs, for a wide range of IT products and services. Many of the features of TCE could be identified in the outsourcing arrangements of both PSOs and LAs, perhaps confirming Willcocks’ [27] comments about the theory's ability to accommodate empirical data easily. Some examples of TCE constructs found were: high and low site specificity (in connection with the location of the outsourced activities); high and low physical specificity (regarding the desirability of using packaged off-the-shelf products rather than systems developed in-house); human specificity (related to the type of skills sought from a vendor, with all but one PSO being unconcerned with vendor knowledge of applications and business, whereas several LAs were worried about the lack of experience and understanding of local government among vendors); dedicated investment asset specificity (as shown by some clients’ insistence that vendors made the commitment of accepting the transfer of employees); brand name capital (as indicated by the emphasis in both sectors on dealing with big vendors who had good reputations); transaction types (with non-specific transactions such as day-to-day running of infrastructural elements like computer operations and PC support tending to be outsourced early on); and concern about the small-numbers situation (where the vendor’s power was enlarged by the absence of viable alternatives, especially when the vendor had been dealing with the client for a number of years).

Outsourcing vendors’ marketing literature often emphasised vendor size, experience and reputation as a means of easing potential clients’ concerns about the costs of outsourcing. Specific structures like client charters and independent audits were also mentioned. Some vendors showed awareness that practices in the public sector were different from those in the private sector, and said they could be accommodated. However, both PSO and LA managers recounted tales where they felt the use of the market had been less than satisfactory. LAs, in particular, were doubtful about the degree to which vendors understood the “business” of local government. Both sectors contained managers who doubted the commitment of some vendors, both to individual clients and, indeed, even to the idea of outsourcing. (There was a suggestion that some smaller vendors viewed outsourcing as just another revenue stream which helped them in a poor economic climate. One PSO manager explained that “Lots of companies...were quite happy to take our [processing] load and add it to their own load to help them out...I wanted somebody who was going to be as interested in outsourcing five years into the contract as they were in the heart of the recession.”) Several managers also cited instances of a vendor exploiting the client’s investment in the relationship by making difficult demands or being unresponsive to requests.

However, accountability, culture and legislation imposed transaction costs on LAs which could be substantially higher than in the private sector. This was the case both when outsourcing was practised, and when internal provision was used within the framework of an internal market. Compared with the private sector, there were stricter procedures to be followed; more time was spent in staff consultation prior to large-scale outsourcing involving staff transfer; and more effort was expended in resolving any political difficulties associated with outsourcing, especially when the party of central government did not control the council. In some LAs, there was also the concern that market usage had fragmented the authority so that the IT function was faced with trying to tie together non-standard technologies and applications acquired through devolved budgets. Some LA managers stressed the uncertainty under which they had to operate. This was because LAs had to respond to central government requirements which could involve enormous amounts of unpredictable work, followed by more upheaval when central government changed policies; a major example of this was local taxation mechanisms. Even when outside suppliers were not used, the formality of the quasi-market still imposed higher transaction costs on LAs when they relied on the hierarchy; for example, there was generally more emphasis on formal service level agreements, and there were more complicated charge-out mechanisms than in the PSOs. Generally, the PSO hierarchy tended to work less bureaucratically.

Indeed, these findings are in keeping with Walsh [39] argument about the special costs of the public sector. The already extensive use of the market by LAs, the lack of important application and environmental knowledge by vendors, the rather mixed record of private sector involvement recounted in the interviews, and lack of vendor interest in organizations which may already be lean, all suggested that attempts to impose further market usage may not necessarily improve LAs' IT provision and outweigh the associated transaction costs.
Agency Theory: findings

AT highlights how different interests can impact an outsourcing exercise. In the interviews, it was difficult to find examples of some of the ideas from AT discussed earlier, such as adverse selection and moral hazard, although a minority of both PSOs and LAs had been disappointed with aspects of vendor performance and behaviour. For example, one PSO manager claimed that the vendor’s poor performance “actually impacted the business....We’ve been running mainframes for over twenty years, and we’ve never, ever remotely had the kind of experience we had....In fact, if we had done, I’d have been fired.” Other aspects of AT could be found, such as concern among clients about multi-lateral contracting (one agent acting for many principals and failing to satisfy all of them), and the concept of contracts being either outcome-based or behaviour-based. Most contracts were outcome-based, although there was no clear-cut connection between task programmability and a preference for outcome-based contracts, as suggested by AT. In systems development and support, behaviour-based contracts caused particular frustration because of the extra managerial overhead involved. In both sectors, managers indicated that agency problems could exist within the hierarchy. This was particularly so in the period of uncertainty prior to employees being transferred to an outsourcing vendor, when the original employer wants to retain staff loyalty right up to the moment of transfer, and the new employer wants to capture that loyalty immediately afterwards. A common approach in such cases was to emphasise maintenance of employment conditions and job security with the new employer, with the requirements of the Transfer of Undertakings (Protection of Employment) Act offering a minimum standard upon which the parties could build. Other techniques included offering bonuses and training in sought-after technologies.

In LAs, even though the market was used a lot, the private sector’s profit motive was often seen as decreasing principal-agent congruence, and there was more talk of past and anticipated vendor opportunism. There was considerable concern that vendors did not understand what local government was for, and that they failed to grasp that LAs, by their very nature, had different priorities and ways of working. Conversely, within the LA hierarchy, the congruence between LAs’ commitment to internal service provision, and staff interests in preserving jobs, was reflected in the way services were packaged and figures juggled to avoid CCT and retain work in-house.

Partnership: findings

Despite assurances found in vendors’ marketing literature, most clients were sceptical about partnership, reflecting findings of Lacity and Hirschheim [9] [3], and Willcocks and Fitzgerald [17]. If partnership did exist, it was usually as a collection of some of the intangibles mentioned earlier, rather than as a formalised arrangement. As one PSO manager put it, “It’s about recognising...that you’re prepared to share joint benefits, that you’re prepared to take joint pain now and again, in order to move through and achieve where you want to be.” In both sectors, partnership was more likely to be found in the area of systems development, where vendors needed to have a greater understanding of the organization, than in outsourcing of operations and IT infrastructure support.

In LAs, requirements of public sector probity and the need to safeguard public money meant that there was less consideration of shared risk/reward ventures with vendors. Another aspect found in the LA sector, but not in the PSOs, was the need to consider the political dimension. For instance, one LA was controlled by a political party opposed to the party of central government. There, IT management, while operating “voluntary partnerships” with vendors, was careful not to “make a song and dance over that...because sometimes the notion of working with the private sector can be misinterpreted. It can almost be seen in some eyes as doing the government’s job for it.”

In both sectors, IT managers sometimes stressed that they were partners of their users. Several PSO managers said that part of their job was to help users in their dealings with vendors. In LAs, managers sensed that they had developed closer and deeper relationships with their users, through operating in the internal market and through the influence of CCT. In the internal market, many LA IT functions had introduced formal structures such as service level agreements, customer care initiatives, complaints procedures, customer satisfaction measures and the appointment of marketing officers. These were often the sort of arrangements which a third party vendor would put in place. But some LA managers argued, as did the vendor literature, that partnership was more than just formal structures. For these managers, partnership involved a genuine coming together of minds and a common culture, and vendors simply did not share the local government culture; LA IT functions had more in common with other LA functions than they did with private sector IT vendors. One LA manager argued that his IT function had to “protect our customers from the wolves out there, because the private sector will come in and bid low,
and then screw you on the extras.” Another argued that the in-house LA IT function should “have a passion, because they are part of the body [of the LA]. And we have a common understanding, a common agenda. There is a degree of relationship that you just cannot substitute with a contract.”

If partnership requires empathy between the contracting parties, this cross-functional culture can give an in-house IT department an opportunity to resist unwelcome outsourcing threats, by stressing its knowledge of the environment and its care for internal customers, and using both to improve its performance.

Several authors have been cited as stressing the importance of cultural compatibility between partners, and the research here tends to support that view. Furthermore, if the culture which an IT department shares with customers is different from vendors' culture, and if many of those customers face similar threats, internal alliances can be formed in pursuit of the goal of retaining services in-house. In LAs this was shown by the efforts to massage figures about support costs and the percentage split between internally-provided and outsourced activities, and by the reclassification of some activities from IT expenditure to expenditure in other areas where CCT requirements had already been met.

**Discussion of Findings**

In the exploratory investigations within the organizations, a concentration on core competencies did not appear an important motive for outsourcing, contrary to suggestions in vendor marketing material and in some of the literature. In the PSOs, the main motive was essentially to drive down costs and improve service. This was also the case in LAs, and in the one LA which had pursued total outsourcing for IT, cost problems had overridden the concern of elected members that local government should be a source of employment for local people. In the private sector, IT was generally regarded as of strategically important for the business, while in several LAs this was not the case. In particular, financial constraints had caused councillors to prioritise the purposes of local government, and in this way core competencies of LAs were viewed as the wide range of front-line services which were delivered to citizens.

Many of the key concepts of transaction cost economics could be found in an analysis of IT outsourcing in the participant LAs and PSOs. The TCE perspective indicated that the market is used successfully by both types of organization, but that third party performance is not necessarily better than in-house performance. Where the market is used, formality increases, and thus transaction costs rise, although vendor literature stresses how smoothly vendors operate and liaise with clients. Because of culture, legislation and accountability requirements, LAs are subject to higher transaction costs than PSOs. This is particularly so when a comparison of in-house service provision in PSOs and LAs is made. The provision in PSOs is much less bureaucratic than in LAs, whose IT departments work in a quasi-market which is often regarded as bringing little benefit to compensate for the extra costs incurred.

Some of agency theory's ideas were difficult to find in the organizations investigated.

For example, although there were disagreements between vendor and client, most PSOs and LAs were satisfied with most of the services they received from third parties. There appeared to be little evidence of adverse selection, although sometimes vendor performance had proved disappointing. Thus vendors' literature may not fully reflect the actual situation in organizations where it tends to ignore issues of vendor-client conflict. However, in LAs, there was a greater expectation that some conflict may occur and, it is suggested, this was because of concern about the private sector's profit motive.

Study of vendor literature also suggests that partnership is a concept used to stress vendors' co-operative attitude, flexibility and willingness not to be constrained by precise contractual provision. Only some of the participant organizations regarded their outsourcing arrangements as partnerships, and all were aware of the primacy of the contract. Outsourcing of IT infrastructure support and operations management was less likely to be regarded as a partnership than was systems development outsourcing. It may be argued that this was because of a range of factors, including organizational culture, political leadership and public accountability. Hence, partnership with a vendor appears less likely when the client is an LA. However, in order to compete with external suppliers, LAs' internal IT departments were not just changing their working practices, but were also adopting notions of partnership, as they moved closer to their users, with whom they hoped to share a common culture.

Table 1 shows an overview of the main findings of the research. Each of the four conceptual frameworks is used to sensitise the investigation, to raise issues and to contribute where possible to an understanding of the practice and perception of IT outsourcing. The research has been novel in that it has employed these four conceptual frameworks in one empirical study. However, perhaps more significant is that this exploratory study has attempted a sectoral comparison, rather than detailed examination and associated thick description of individual organizations, as is found in much qualitative
research. It is believed that this has facilitated a consideration of aspects which are often missing from studies of outsourcing, e.g. the element of compulsion imposed from outside the client organization, the fundamentally different cultures and raisons d’etre of organizational types, the tactics employed to frustrate outsourcing, and the political dimension introduced by the involvement of different elected power centres. Finally, it is important to note that no single framework can be distinguished as an ideal. The various components of each need to be considered within the specific contexts to which they are applied.

**Further Research**

Any or all of the frameworks could be further assessed by widening the samples, and particularly varying their geographical spread. With bigger, more widespread samples, different investigation techniques - perhaps questionnaires - might be employed. The extension of the samples might also reveal aspects of outsourcing which have not emerged from the thirteen participants in this study. This might be especially the case with LAs, as voluntary contracting out of local government IT has been concentrated in the south of England. Another avenue may be to discover the views of different types of social actor. Trades union officials, non-managerial IT employees, transferred or redundant staff, non-IT managers and employees, LA council members, and vendors themselves, could bring interesting perspectives. New research among LAs will also, of necessity, be against the background of a change of central government. No longer is competitive tendering compulsory for LAs. Also, the criterion for major sourcing decisions in LAs has changed to embrace a wider and vaguer concept of Value for Money, as opposed to a simpler primary consideration of the money cost of internal and external provision.

**Conclusion**

This paper has brought together conceptual frameworks which, to the authors knowledge, have not been used before in the same piece of empirical research on IT outsourcing. It has also applied those frameworks in a comparative study of different types of organization, one of which has not been a focus of outsourcing research before. It has thus attempted to improve understanding in two areas, the first being the usefulness of some of the main perspectives found in the literature, the second being how outsourcing is practised and perceived in particular organizational settings. The methodology for the study was exploratory and within a qualitative paradigm given the nature of the research conjectures and the relatively few empirical observations. Conclusions have been drawn about the usefulness of the frameworks, and about the characteristics of IT outsourcing in the two sectors under study. It is also concluded that there are many ways in which the research may be extended and built upon. In particular the problem of aggregation of the data has been addressed whereby it is not considered helpful to ‘recommend’ the main advantages of one framework over another without a detailed analysis of the context in which they are applied, some of which have been reported here. The evidence suggests that both outsourcing and the frameworks are potentially fruitful areas for further investigation.
Table 1.
Comparison of local authorities and private sector organizations, via the four conceptual frameworks

<table>
<thead>
<tr>
<th></th>
<th>LAs</th>
<th>PSOs</th>
</tr>
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<tbody>
<tr>
<td><strong>CORE COMPETENCIES</strong></td>
<td>Not a major motive for IT outsourcing. CCT and financial constraints are forcing LAs to focus on front-line services. IT management acquiring new core competencies.</td>
<td>Not a major motive for IT outsourcing. IT management acquiring new core competencies.</td>
</tr>
<tr>
<td><strong>TRANSACTION COST ECONOMICS</strong></td>
<td>Use of market increases transaction costs. Introduction of internal market increases transaction costs, but scepticism about its benefits. Culture, and accountability and legislative requirements suggest transaction costs likely to be higher than in private sector.</td>
<td>Use of market increases transaction costs. When in-house provision used, are fewer transaction costs incurred than in LAs.</td>
</tr>
<tr>
<td><strong>AGENCY THEORY</strong></td>
<td>Market used satisfactorily most of time. Most contracts outcome-based. Not much evidence of major conflict with vendors, but is scepticism in LAs arising from vendors’ primary profit motive.</td>
<td>Market used satisfactorily most of time. Most contracts outcome-based. Not much evidence of major conflict with vendors.</td>
</tr>
<tr>
<td><strong>PARTNERSHIP</strong></td>
<td>Great scepticism about partnership with vendors. IT departments adopting notions of partnership with users, to improve performance and retain work in-house.</td>
<td>Some scepticism about partnership. Partnership less likely when outsourcing operations and infrastructure support than systems development activities.</td>
</tr>
</tbody>
</table>
References


[61] Band, D.C and Scanlan, G Strategic Control through Core Competencies Long Range Planning 28 (2), 1995, pp. 102-114


[88] Fitzgerald, G. The Outsourcing of Information Technology: Revenge of the Business Manager or Legitimate Strategic Option? Inaugural Lecture, Department
Appendix 1

Outline Interview Themes Addressed Within Each Theoretical Framework (audio taped)

General - organizational characteristics, etc.

Motives - initiation and planning for outsourcing, etc.

Evaluation & Vendor Attributes - performance measurement of IT function, chargeout mechanisms used, selection criteria for choosing vendors, etc.

The Remaining IT Function - contract management and controls, role of remaining staff, etc.

Personnel Issues - moralization, incentives, problems, etc.

Contract Types - duration, penalties, review, etc.

Management & Monitoring - vendor/client interactions, experience of disputes, etc.

Contract Options at end of contract - renewals/ change of vendor/ return to in-house, changes to IT management strategies, etc.

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