

Outsourcing Information Technology in Australia

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INTRODUCTION

Outsourcing information technology (IT) has been defined as passing IT functions previously performed in-house to outside contractors (Hancox & Hackney, 2000). Outsourcing has spawned variants, especially insourcing—two departments of one organization formalizing their supply relationship.

Lonsdale and Cox (2000, pp. 445-449) summarize the history of outsourcing, noting that it substitutes for once fashionable enthusiasms for conglomeration, horizontal integration, and vertical integration. Williamson and Winter (1993) stress the role of transaction costs in all business decisions asking: Given that the market allocates resources efficiently, why do firms exist? They introduce the “asset specificity” concept; some assets have a narrow range of applications and have few or no potential buyers or sellers. The assets are inoperable without a cluster of peripheral assets, and high levels of skill and knowledge in the firm and its suppliers. There is no perfect market for such assets; investment in them is only practical in a planned environment that provides a guaranteed market for a high volume of very specific outputs and guaranteed supply of specific components.

Dealing in imperfect markets involves costs (such as identifying appropriate vendors, verifying their competence, communicating changing requirements to them, and monitoring their performances) and risks (of vendors failing or being unable to meet specifications). Deciding whether to outsource depends on comparisons of the long-term costs and risks of different modes of supply. A long-term outsourcing relationship with a trusted vendor (incorporating some price signals) may be preferable to securing supply by backward integration or developing an in-house capacity (possibly creating administrative complexity). An organization will always outsource some activities (water and electricity supply), but retain others such as strategic planning.

BACKGROUND

Outsourcing information processing (IP) functions has been facilitated by Web technologies that make it easy,

quick, and cheap to transfer internal data (e.g., payroll data or delivery instructions) to a vendor. The vendor can analyze data and instantly transmit results to the client, employees' banks, and the tax office, eliminating time delay problems. Physical locations of the vendor and client are irrelevant for IP tasks; some kinds of outsourcing can be performed in low wage countries and/or a centralized facility that provides economies of scale. This is exemplified by the Asian call center and the payroll specialist whose volume (derived from many clients) allows exploitation of a high fixed-cost, low variable-cost technology and expensive expertise.

These fundamental considerations are manifest in many different motivations for outsourcing. A small organization might outsource a payroll application primarily to reduce costs by accessing economies of scale, but IT outsourcing decisions can be complex because IT applications tend to be integrated with each other and permeate the firm, touching most activities performed. The criteria used to evaluate outsourcing decisions may be multidimensional and intangible; besides cost savings (sometimes hard to ascertain), the firm must consider possible effects on customer service and its own staff; the potential advantages of access to expertise; and whether it might become uncomfortably dependent on the service provider (Kern & Willcocks, 2000) or hamper adoption to a changing environment.

THE AUSTRALIAN MARKET

In 2003, IDC (Allen & Langby, 2003) estimated that the Australian IS outsourcing market was approximately AU\$3.85 billion in 2002 and would be AU\$5.5B in 2007, a compound annual growth rate (CARG) of 7.4%. IT outsourcing represents “...over 10% of the total IT market and is growing faster than the total IT market.” The market leaders—IBM GSA, EDS, and CSC—accounted for approximately 65-75% of the Australian IS outsourcing services market. Growth has slowed, the market is becoming more mature and competitive, clients are seeking shorter contracts and outsourcing specific tasks instead entrusting all their IT activities to a single vendor. Motivations include lower costs, higher quality, and focus on

core competencies. Clients considering outsourcing were inhibited by potential loss of control, possible inability to resume running applications in-house, the complexity of protracted negotiations, loss of intellectual property, and security issues.

In 2001, Gartner predicted that (i) the value of the Australian IT services market would grow from \$AU20 billion in 2001 to \$AU 50 billion in 2004. (ii) By 2005, 25% of Australian organizations will not own their IT services or infrastructure, and (iii) the value of the Australian business process outsourcing market was \$AU5.5 billion in 2001 and will grow to \$AU15.4 billion by 2004 (Brown, 2001).

Robertson (2001) opined that “revenue from the Australian IT outsourcing market was \$A1.3 billion in 1997, and projections to 2004 will push it up to \$A5.3 billion, a CAGR of 16%.” The increased use of IT outsourcing in Australia is exemplified by recent outsourcing decisions, some of which are listed in Table 1.

In 1998 the Australian federal government decided to force government departments to outsource their IT requirements. This initiative was a failure (Connors, 2001); the suppliers did not meet the users’ requirements (wanting to apply one template to similar but distinct applications); the costs were excessive and the initiative was at least temporarily abandoned. In 1995, the South Australian state government initiated an ambitious “whole of government” 10-year/\$AU1 billion IT outsourcing project with EDS. There are different views of the direct and indirect benefits of this contract to the state, but the consensus is that great effort from both parties produced marginal benefits. The more experienced state govern-

ment would expect more benefit from any future outsourcing contract (Connors, 2004).

The few academic studies of Australian IT outsourcing include: Hurley and Costa (2001), a set of Australian cases; Costa (2001), an outsourcing literature review set in an Australian context; Beaumont and Costa (2002), a report on IT outsourcing; and Beaumont and Sohal (2004), a report on outsourcing in general. The author recently interviewed 10 senior executives of Australian vendors; insights from these interviews are used in this article.

REASONS FOR OUTSOURCING

Many writers have proposed research frameworks (Hancox & Hackney, 2000), criteria (Mamaghani, 2000; Smith & Rupp, 2003), and schemes for analyzing or assessing outsourcing (Bazinet, Kahn & Smith, 1998). Earl (1996) stresses the importance of considering intangible and tangible criteria in major business decisions. Some commonly cited reasons for using IT outsourcing are given in Table 2. Reasons for not using IT outsourcing and risks inherent in IT outsourcing are summarized in Table 3. Barthelemy (2001) and Barthelemy and Adsit (2003) give more details. The most common cause of outsourcing project failure is *project risk*. Problems arise when potential users of outsourcing do not carefully define their requirements, do not properly prepare for negotiations with potential vendors, or do not put enough effort into monitoring the outsourcing arrangement. An Australian contract with a call center did not specify some of the services that the client offered its customers. Another

Table 1. Some recent outsourcing contracts

Client	Vendor	Tasks Outsourced	Total Value (AU\$)*	Duration (years)*
Commonwealth Bank of Australia (King, 1998)	EDS	IT	5B	10
Bank of Queensland	EDS	IT, call centers, and credit card processing	480M	10
Telstra	IBM GSA		4B	
Australian Taxation Office	EDS	IT	490M	
Five Government Agencies	CSC	IT	160M	
Two Government Agencies (Beer, 1999)	IBM GSA		351M	
Qantas	Oracle/ IBM GSA	IT	200M	
AMP (McFarlan & Nolan, 1995)	KAZ	IT/Insurance	70M	6
BHP-Billiton	CSC	IT	1B pa	10
South Australian Government	EDS	IT	700M	10
Westpac	EDS	IT	1B	10

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