Chapter 6.6
Business Strategies for Outsourcing Information Technology Work

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INTRODUCTION

Firms pursue various strategies to exploit resources and capabilities and gain a competitive advantage (Porter, 1996). Interfirm relationships are collaborative agreements between organizations (Chakrabarty, 2006a; Whetten, 1981), and firms need to be careful in adopting suitable strategies to deal with interfirm relationships (Chakrabarty, 2007b). Interfirm relationships represent a sort of trade-off that organizations must make, whereby, in order to gain resources of other organizations, an organization must relinquish some its independence because the relationship also brings certain obligations with it (Whetten, 1981). Top management strategists might find their commitments to other firms as a sort of liability, and therefore, a serious evaluation of whether the benefits from the interfirm relationship outweigh the inevitable costs is needed before entering into interfirm relationships (Whetten, 1981).

Outsourcing is an Interfirm Relationship Between a Customer Firm and Supplier Firm

Work is outsourced to suppliers by a customer firm. A customer firm is therefore a firm that is in need of services, and a supplier firm is a firm that provides those services. The common synonyms for "customer" firm are either "client" firm or "buyer" firm. The common synonyms for "supplier" firm are either "vendor" firm, "consultant" firm, "third-party", or external service provider. This chapter will provide a useful summary of some strategies that customer firms can use for outsourcing information technology work to a supplier firm (Chakrabarty, 2006b, 2006c). For further information, readers are encouraged to refer to Chakrabarty (2006c) for real life case studies, and refer to Chakrabarty (2006b, 2007a, 2007b) for a deeper understanding of the advantages and disadvantages of various outsourcing strategies.

BACKGROUND

This section will provide some basic background information on outsourcing. Lacity and Hirschheim (1995) categorized the primary strategies of sourcing work into a continuum that ranges from total outsourcing at one extreme to total insourcing at the other extreme, and had selective sourcing as an intermediate strategy. *Total outsourcing strategy* is the strategy of a customer firm to outsource at least 80% of its information technology (IT) budget to suppliers. *Total insourcing strategy* (the opposite of outsourcing) is the strategy where a customer firm formally evaluates outsourcing but selects its own internal IT departments' bid over external supplier bids, and thereby allocates over 80% the IT budget to its internal IT department. *Selective outsourcing strategy* is the strategy whereby the customer firm opts to use suppliers for certain IT functions (representing around 20 to 60% of the overall IT budget, typically around 40%), and retains the remaining work for its internal IT department (Lacity & Hirschheim, 1995).

Further, Gallivan and Oh (1999), categorized the strategies for outsourcing on the basis of number of customers and suppliers into dyadic, multisupplier, cosourcing and complex outsourcing as follows. In a *dyadic outsourcing strategy*, there is just one customer and one supplier, that is, a customer firm uses only one supplier for a given activity, and the supplier in turn performs the given activity only for that customer firm. In a *multisupplier outsourcing strategy*, there is only one customer but many suppliers, that is, a customer firm uses many suppliers for a given activity. In a *cosourcing strategy*, there are many customers and only one supplier, that is, many customer firms jointly sign an outsourcing contract with a single supplier firm. In a *complex outsourcing strategy*, there are many customers and many suppliers; that is, it involves combining multiple customer firms and multiple supplier firms into a single contract (Gallivan & Oh, 1999).

Chakrabarty (2006b, 2006c) described how the location of the supplier to which work is outsourced can vary (see Figure 1). When a *domestic-outsourcing strategy* is adopted, both the customer and the supplier are located in the same country (this is also termed as *onshore-outsourcing*). In contrast, a customer and supplier can be located in different countries, and this known as a *global outsourcing strategy.* Though the term global outsourcing is widely referred to as offshore outsourcing, it can also be further classified into nearshore-outsourcing versus offshore-outsourcing. When a *nearshore-outsourcing strategy* is adopted, the chosen supplier located in a country that is geographically close to (but not the same as) the customer's country. When

Figure 1. Location of supplier in outsourcing