Risk Factors in IT Outsourcing and the Theories Decision Makers Use to Resolve Them

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ABSTRACT

In this paper the Risk Factors (RFs) in IT Outsourcing (ITO) theories from a service buyer perspective are explored. A comparative study about how Transaction Cost Theory (TCT), Core Competency Theory (CCT) and Agency Theory (AT) cover the RFs has been performed. A framework describing, how the theories cover the RFs has been developed and tested using a case study research methodology. The interviews with companies for testing the framework have been used to get an indication about which ITO theories the decision makers are using in their ITO. This study shows that TCT fully covers all RFs, AT covers almost all and CCT has the lowest coverage. The theories, which are used by the ITO decision makers, could only partially be answered. Risk handling could not be entirely mapped to the theories. Risk and risk mitigation were the main concerns for some of the interviewees, CCT for some others. This study recommends using both TCT and CCT for a successful ITO.

Keywords: Agency Theory (AT), Core Competency Theory (CCT), IT Outsourcing (ITO), Risk Factors (RFs), Transaction Cost Theory (TCT)

INTRODUCTION

Lacity and Hirscheim (1993) define IT Outsourcing (ITO) as a “decision conducted by an organization to delegate various IT functions and activities such as operations, support, development or maintenance to suppliers, who in exchange provide those services for revenues within an agreed period of time”. This definition covers all the important parts and, therefore, it has been used in this paper. The ITO should support an efficient use of IT in all business areas for the service buyer organization, the focus in this study.

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There is no doubt that ITO is an established business solution. About 58% of the companies in Sweden have outsourced their IT and about 76% in Denmark (Ohnemus, 2007). Rådmark (2010) predicts an increase of ITO in the European countries and smaller companies are expected to increase their ITO at a rate three times higher than so far. In contrast, Wallström (2012) reported in April, that the global ITO has declined by 22% and that only one megadeal has been performed in the first quarter of 2012. The author supposed that this is a result of the global economic crisis. This study assumes that such a variation in the ITO trade is temporary and does not diminish the overall need of knowledge in ITO.

Risk Factors (RFs) play an important role for ITO success and numerous researchers (Earl, 1996; Aubert et al., 1999; Overby, 2003) have studied how to handle them. Many authors use the RFs as predictors of the probability of different unwanted outcomes. Some even argue that risk factors are the main drivers of undesirable consequences in ITO! Anyhow, the RFs have to be managed to avoid jeopardizing the ITO. Hodosi et al. (2012) showed that risk mitigation positively influences the relationship between the service buyer and the service provider.

**RESEARCH GOALS AND QUESTIONS**

Several researchers describe how ITO theories have been used in scientific publications. Dibern et al. (2004) developed a survey of the ITO literature and found nine theories that have been used. Perunović (2007) mapped eleven theories to the different outsourcing lifecycle phases. Gottschalk (2006) describes eleven ITO theories and discusses the possibilities and limitations of the theories both theoretically and empirically.

So far, no studies have been found that describe how the different ITO theories cover the risks that could occur with ITO. To fill this gap is the first goal with this paper. The second is to explore which ITO theories the decision makers actually use. As this second topic also has not been found in the study of the research literature, this paper attempts to fill this gap. It is not possible to discuss all the different theories. Therefore, Transaction Cost Theory (TCT), Agency Theory (AT) and Core Competency Theory (CCT) have been selected. How the choice of theories was performed, is described in the next section.

The following Research Questions (RQs) have been raised:

**RQ1:** How are Risk Factors represented in Transaction Cost Theory, Core Competency Theory and Agency Theory?

**RQ2:** Which are the theories that IT outsourcing decision makers use when they plan to outsource IT or not, or manage their ITO?

To answer the RQs, a framework has been developed that describes how the ITO theories cover the selected RFs. This facilitates comparison of how the RFs are supported by the theories. The framework has to be tested in a real environment, which means interviews with different ITO decision makers.

To avoid a “knowledge test” of the decision makers, RFs have been discussed. In this way, the expectation was to observe their argumentation and to map them to the three ITO theories. This study is not capable of determining the knowledge the decision makers have of the theories, rather it is an overall “practiced philosophy” what could be observed. Figure 1 displays the used methodology.

This study starts with the exploratory part, the literature review. The objective is to find what other researchers have contributed in this field and use their experiences. The gained knowledge is mainly to identify the RFs and the theories used in ITO. The second step is to build the framework based on the acquired information. Propositions are defined about how RFs are covered by the three used ITO theories. The third activity is to prepare the interviews based on the developed framework and to perform them.
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