

RESEARCH PREVIEW SESSION

THE OUTSOURCING PROCESS: AN OVERVIEW

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This is a combination of a review and conceptual paper providing the reader with a framework for a successful management of the outsourcing process. The framework has been developed through a literature review of the outsourcing phenomenon. Particular attention has been given to a more thorough analysis of earlier contributions – in particular frameworks more or less explicitly incorporating different phases of outsourcing. The proposed outsourcing process framework incorporates issues of previous frameworks proposing the outsourcing process of a cyclic nature and managed holistically.

Key words – outsourcing, process, framework

1. THE OUTSOURCING PROCESS

After more than twenty years of utilisation in industry, many practitioners have realised that successful outsourcing is based on a deeper understanding of the different processes characterising the phenomenon. In addition a more structured approach following distinct phases seems to improve results. However, this has only to a limited extent been mirrored in the outsourcing literature. Despite an impressive research intensity of the outsourcing process, there are only few frameworks depicting the actual stages and the layout of the overall process of outsourcing. In Figure 1 (see below) we have presented an overview of some of the frameworks. One of the first efforts to capture the outsourcing process was presented by a consultant, Maurice Greaver, in 1999. He suggested that an outsourcing process should be conducted through seven stages. One of the key characteristics of his model is that it assumes that project teams should be established to justify management's decision to outsource or to challenge that decision with strong arguments. Three years later Jesper Momme (2002) presented six generic phases of the outsourcing process, with built-in key activities performance measures and expected output. Momme has augmented the model by adding the contract termination phase, thus emphasizing that the process is time limited. Shortly after, Sara Cullen and Leslie Willcocks (2003) developed a cyclic outsourcing process framework, thus further emphasizing that outsourcing process is not finished after contract's expiration. The eight stages process is distributed over three general phases: architect, engage and govern. They have developed a series of tools that may be used within the stages of the process. Franceschini and colleagues (2003) proposed the outsourcing process in accordance with the principles of total quality management. The approach is supported by different decision and analysis tools like benchmarking techniques, multiple criteria decision aiding methods, etc. Michael Corbett (2004) suggests a five-stage outsourcing framework. In addition to the stages, Corbett provides us with the questions to be answered, the decision makers and the time lines associated to each of the stages. He emphasises that the outsourcing process demands a closed loop linking stages and teams. Click and Duening (2005) use a five stage model, but ignore termination issues of the outsourcing project. McIvor (2005) provides a comprehensive framework for outsourcing. The process consists of six stages, where the emphasis is on careful planning of the process. Again, the process is seen as a straight-forward process, neglecting its recurrent characteristic.

It is obvious that different frameworks do not provide unique view of the outsourcing process. Is there a generic model that could embrace all proposals? Probably not, but we can learn something from analysing the evolution of the outsourcing process framework (See Figure 1 below):

- Majority of the stages are concentrated in the first general phase, where strategic decision regarding whether to outsource or not should be made.
- There are more general phases that emphasise *how to outsource* instead of *whether and what to outsource*.

1.1 Preparation

The first phase should reflect the **underlying philosophy** of an outsourcing agreement that reflects the objectives of the principal architects of the agreement, along with the set of beliefs that led them to conclude that outsourcing would be an effective and appropriate way to proceed (Shepherd, 1999). Quinn and Hilmer (1994) coined the term “strategic outsourcing” to emphasise distinction between what is the strategic core of the firm and those other activities which are necessary to attain the firm’s strategic goals. As Willcocks et al. (1995a) argue taking a strategic approach to outsourcing means recasting the question “to outsource or not to outsource?” into a more useful question: “how do we use, if at all, the opportunity to see what is available on the market to leverage business advantage?” The issue then becomes not outsourcing, but *rightsourcing*.” In contrast to that, Greaver (1999) proposed as the first stage the formation of cross-functional teams to study and implement outsourcing initiatives. The project team should have really strong arguments to reject top management’s prior decision to outsource.

The major task in this phase is to explore strategic sourcing options, and significant number of tools has been developed over the time to assist management in making the right decision. The main debate is that companies should keep core activities in-house, while those not important may be outsourced.

Alexander and Young (1996) suggest four meanings of core activities, as perceived by companies:

1. Traditionally performed activities
2. Activities critical to performance
3. Activities creating competitive advantage
4. Activities driving growth and renewal

Those activities enable competitive advantage, should therefore be retained in-house. Willcocks et al., (1995) developed a framework for IT sourcing decision based on six contextual factors from market: business positioning impact, link to business strategy, future business uncertainty, technology maturity, level of IT integration and in-house vs. market expertise. Almost ten years later Willcocks, this time with Plant (2003), proposed five different sourcing paths an organisation may step on: the in-house development path, the cheap sourcing path, the outsourcing part, the insourcing/partnering path and mixed development paths. Jenings (1996) and Hadaya et al. (2000) used value chain approach for sourcing decision. Baden-Fuller et al. (2000) brought arguments that outsourcing of core skills can be very beneficial for firms providing the right approach is taken. Situations when outsourcing the core skills is suitable are: catch-up, changing value chains, technology shift, and emerging markets. Momme (2001) proposed four sourcing strategies: make or buy - produce in-house or purchase from suppliers; outsourcing; insourcing; and strategic sourcing. Process of determining whether to provide products or services in-house or through an extended supplier network. Leavy (2004) proposed four outsourcing strategies: focus, scale without mass, disruptive innovation and strategic repositioning. McIvor (2005) developed a matrix for sourcing decision, based on activity importance and relative capability position.

The debate in outsourcing gradually moved from whether and what to outsource towards how to outsource, thus fructifying the outsourcing process development by adding the relational dimension i.e., defining the outsourcing approach. Once the **outsourcing philosophy** is set, the **outsourcing approach** should be determined. The outsourcing approach reflects this philosophy and determines the basic shape of the outsourcing agreements concluded (Shepherd, 1999). Cullen and Willcocks (2003) draw strengths and weaknesses of three outsourcing approaches:

- Big bang – significant portions of all activities are outsourced at one time
- Piecemeal – each activity is outsourced independently over time and with a variety of suppliers used
- Incremental – one or more suppliers are selected for pilot project(s) with planned escalation of outsourcing. Escalation occurs if preceding outsourcing is successful

Organisations should also determine what kind of configurational arrangements they are up to. Cullen et al. (2005) introduced the concept of information technology outsourcing (ITO) configuration defined as: a high-level description of the set of choices the organization makes in crafting its IT outsourcing portfolio. They have defined seven attributes that affect the outsourcing configuration as key descriptors of an organization’s ITO configuration: Scope Grouping, Supplier Grouping, Financial Scale, Duration, Pricing, Resource Ownership and Commercial Relationship. Kakabadse and Kakabadse (2000) found the following outsourcing arrangements:

- Assets being transferred are not significant
- The vendor will invest little in start-up costs

The contract length will affect the types of providers that are asked to respond to the Request for Proposals (Greaver, 1999). Among other things, the length of the contract is determined by the degree of specific organisational knowledge required by the vendor, hence the investment required by the organisation to instil such knowledge (Cullen and Willcocks, 2003). Before writing the request for proposal (RFP), outsourcer has to explore existence and characteristics of potential vendors, both within domestic and international markets. International outsourcing is a consequence of a firm's ability to search and evaluate foreign suppliers, which is co-determined by its size, multinationality, and frequency of cross-border communications (Mol et al., 2005).

Modelling future outsourcing relationship reflects the roles to be played by each of the parties once the agreement is in place. Essentially, it is the implementation of the philosophy within the outsourcing approach (Shepherd, 1999). Preparations that an organisation makes before developing the relationship influence forthcoming management and success of the outsourcing relationship (Willcocks and Choi, 1995).

Finally, it is suggested (Cullen and Willcocks, 2003) that outsourcer shall draft the service level agreement (SLA) and contract in the preparatory phase. This would put the outsourcer in a good position for drafting the criteria for choosing the vendor and negotiating. SLA is the definition of what successful service will be. An SLA imposes a service commitment on both sides—the supplier to provide defined services with defined performance, and the customer to use those services within defined parameters. The main benefit of the contract is not so much having a signed contract as it is the process it forces the parties to undergo in defining responsibilities, expectations, protocols, etc (Cullen and Willcocks, 2003).

All different strategic options, sub-options, and activities should be benchmarked amongst each other in order to make the final decision that should consist of answers for the questions: *Whether, What, When, Where* and *How* to outsource; or as Willcocks et al. (1995a) suggested that organisations need to pursue in-house improvements first, identify full costs and establish performance benchmarks, pursue further in-house improvements, and only then make in-house vs. outsourcing comparison.

1.2 Vendor(s) Selection

Vendor selection has become increasingly important phase of an outsourcing process. This importance is stemmed from a tendency of outsourcing organisations to engage in more collaborative and relational oriented outsourcing arrangements (McIvor, 2005). If vendor scanning activities from the preparation phase didn't reveal the final candidate for entering the negotiation process, then vendor selection shall be carefully designed. It shall follow more or less pre-determined path, consisting of writing the request for proposals (RFP), determining evaluation criteria, evaluating and selecting the vendor, negotiating and finalising the contract. The outsourcing company shall choose partner(s) that it will be tied for some period of time, sharing good and bad, or as Vice President of a multinational company said "When partner experiences difficulties, you experience difficulties. It's like a marriage with well-defined point of divorce" (see Perunovic and Christoffersen 2005).

RFP is not the only way to seek for the vendors. Actually, with growth of more collaborative outsourcing arrangements, more collaborative approach in seeking and selecting the vendor is emerging (Corbett, 2004). However, in transactional outsourcing arrangement it is still prevailing way to find appropriate partner. Michael Corbett (2004) mentions a few critical principles that can be neglected in the process of writing the RFP:

- Need to focus on objectives and results, not resources and methodologies.
- The RFP answers two questions: What results does the organisation seek? How will the organisation determine whether or not those results are being achieved?
- Describe all of the factors that will go into evaluating the vendors' proposals, and even the relative weight that will be applied to each.
- Specify the information and format required so that the proposals can be readily compared to each other.
- Define the current problems and costs associated with the existing process.

- Service Level Agreement
- Price and payment terms
- Liability
- Contract termination
- Flexibility

Flexibility of contracts is an emerging characteristic of contracts which is being explained by the theory of incomplete contracting. Robustness of the contract is very important and they should serve as effective mechanism in the case of activities for which complete information exists and future uncertainty is manageable. Ronan McIvor (2005) illustrates numerous methods of incorporating flexibility into a contract through incomplete contracting, thus ensuring that the outsourcer is not locked into a relationship with an uncompetitive partner. These mechanisms include Price flexibility, Renegotiating, Contract length, Early termination.

The vendor(s) selection phase should provide an answer on the question: *Whom to* outsource.

1.3 Transition

When decided to outsource, specified the outsourcing arrangement, chosen the vendor and signed the contract, the outsourcer has to finally secure that it really let go its function, process, product, and/or service. As Greaver (1999) points out “It is like sending your child off to college or military service, you say goodbye with a tear in your eye”. Without doing that, the vendor cannot start to provide the service.

The transition phase makes all planned activities to start happening. Its goal is to secure efficient mobilisation (Cullen and Willcocks, 2003). The transition phase is typically focused around transferring assets, people, contracts, hardware and software, information and projects that the vendor will have responsibility for in the future (Greaver, 1999; Cullen and Willcocks, 2003). This process embraces the change management. The performance of the transition phase may be measured by the ability to implement change process (Momme, 2001). Effective change management process requires the following (Click and Duening, 2005):

- Compelling vision of the outcome of the change process
- Visible leadership from top management of organisation
- Extensive communication and opportunities for employee feedback
- Ability to deal with job loss and changeover
- Ability to maintain business continuity and benchmark performance

Regardless of whether the process remains on-site or is moved off-site, there will be a need to transfer process-related information, knowledge, and controls. In addition, during the transition phase it will be necessary to establish information exchange and data interface protocols that mesh the existing standards and information management architectures of each firm (Click and Duening, 2005).

Very sensitive topic is how to handle employees who need to move to the vendor, or those whose employment is going to be terminated. The workflow has to undergo substantial reengineering and establishment of new interfaces (Momme, 2001; Cullen and Willcocks, 2003), since some activities are performed in the new setting. Therefore, internal protocols and procedures need to be specified.

The transition phase imposes another *How* question to be added on our list of the outsourcing process questions.

1.4 Managing Relationship

Outsourcer and vendor may be engaged in four generic types of relationships (Pinnington and Woolcock, 1997) reciprocal, client dominant, vendor dominant, or preferred vendor. Some relationships may evolve over the time, from short-term contractual obligations, to even strategic alliances (Willcocks and Choi, 1995), although only in case of

be terminated before expiring as the result of changes in control of the supplier, for convenience, insolvency, offence, breach, or default (Cullen and Willcocks, 2003). Sometimes it is not necessary to have some particular reason for terminating the contract. It is called voluntary termination. The third option is pure expiration of contract.

Outsourcers should use this time to put together two and two and see whether they have done successfully or they have failed, and to decide what shall they do now. As far as common logic allows us to say, there are three possible options (Cullen and Willcocks, 2003):

- Continue with outsourcing with the same partner
- Continue with outsourcing with re-tendering the supplier(s)
- Backsource (it is correct to use the term Insource, as well)

The first to options may be conducted by retaining, decreasing or increasing the level and scope of outsourcing arrangement.

Second option in the reconsideration (changing the supplier) is threatened with high potential switching costs. In buyer-supplier relationships, switching costs are defined as an overall cost or difficulty of switching i.e., additional costs and efforts in changing suppliers (Whitten and Wakefield, 2006). Switching costs are further divided in to the following costs: uncertainty costs, post-switching behavioural and cognitive costs, set-up costs, hiring and retraining costs, management system upgrade costs, lost benefit costs, search and evaluation costs, and finally, sunk costs (Whitten and Wakefield, 2006).

2. CONCLUSION

In the present paper the aim has been to provide the reader with a more simple and operational model for successful outsourcing. We have developed it on the basis of a more through analysis of earlier contributions – in particular frameworks more or less explicitly incorporating different phases of outsourcing. One of the advantage of working with phases is in our view the ability to separate a very complex phenomenon (where overview is easily lost) into “time-zones” with distinct tasks.

However contrary to many of the earlier contributions we do see outsourcing as a cyclical rather than a linear process. In particular if one is to conduct successful outsourcing the cyclical nature of the different phases provides a good opportunity for managers to be able to reflect on past experiences and use these experiences in new initiatives, leading (hopefully) to more successful outsourcing outcomes in the longer run. This could also work as a tool for companies, to improve past performance rather than just leaving the field with a failure.

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