

# Outsourcing IT Projects:

A public sector case study

Edwin St Just

# Purpose of research paper

- Gain insight into designing IT sourcing arrangements
- Specific focus on IT projects
- Identify unique challenges faced by managers in the public sector

# Research Approach

- Examine four recognised sourcing options:
  - Private Public Partnerships
  - Insourcing
  - Selective Sourcing
  - Joint Ventures
- Apply two relevant academic frameworks
  - Core Competencies Theory
  - Transaction Cost Economics
- Case Study: Ministry of Justice, Evidence Recording & Transcription Programme (ERT)
  - Objective: Create centralised transcription service centres.
  - Deployed improved audio systems, transcription software and workflow management tools

# Case Study: Ministry of Justice

- Project:
  - Insourced key roles
  - 3 external suppliers
    - 1 x Partnership arrangement
    - 2 x Fixed Price Contracts (1-2 years)
- Had the potential to operate under joint venture model

# Why do firms choose to outsource?

Certain activities are better coordinated by the marketplace than the firm

Coase (1973)

# Benefits sought vs potential effects



Drivers for Outsourcing 	Potential effects from outsourcing 
Cost reduction	Vendor selection costs
Improved cost control	Transition and management Costs
Improved service	Legal contract costs
Focus business on core competencies	Loss of intellectual assets and organisational competencies
Access to new technologies and technical talents	Service debasement
Improved flexibility (adjusting to demand conditions)	Loss associated with lock in as a result of investments in human and physical capital
Mimicking management trends	
Political drivers	

Table 1

# Introduction to academic framework

- Core Competencies Theory seeks:
  - Achieve production efficiencies through specialisation:

Firm's focus energies on own core competence  
and leveraging those of outsourced relationships

- Transaction Cost Economics seeks:
  - Minimise Transaction Costs:

To minimise transaction costs certain activities are better coordinated by the market place  
while others should be coordinated from within the firm  
(ie costs related to search, negotiation, monitoring, and enforcement)

- Firms should therefore seek to economise the sum of production and transaction costs

Sartorius & Kirsten (2004)

# Predicting asset ownership – value maximizing asset arrangements

Contract	Ownership	Impacts
Infrequent transactions	Frequent Transactions	Costs increase through repeated transactions and re-negotiation.
Short Duration	Long Duration	Costs to foresee and contract for all relevant contingencies increase as contract duration increases.
Standardised Goods (utilities)	Complex Assets	Complexity creates challenges in identifying appropriate residual claimants of non-financial returns. This distorts the effects of incentives. Complexity increases the need for internalised controls.
Low asset Specificity	Specific Assets	Specificity increases dependency of one party on the other creating the possibility of opportunistic behaviour. This risk increases the cost of contracting.
Low levels of uncertainty	High levels of uncertainty (i.e. nature of goods transacted, information asymmetry, low commitment by parties)	Uncertainty increases costs required to ensure commitment. Increased uncertainty increases risk (and the risk premium charged) Additional costs are required to address all foreseeable contingencies. Concerns over reputation can reduce the risk of post contract opportunism as a result of uncertainty.

**Table2**

*Sourced from Milgrom & Roberts, 1992; Sartorius & Kirsten, 2004*

# Private Public Partnerships

## Features

- Relational
- Loose contracts based on trust
- Long term
- Leverage vendor efficiencies
- Assume equal power sharing

## Issues

- Vendors - contract becomes the source of obligation  
VS  
Purchasers assumes additional services included  
– results in “excess fees”.
- Unequal power sharing
  - limited suppliers / many purchasers
  - Hold-up when locked in by contract
- Differing incentives  
(vendors profits = customer's costs)
- Visible versus invisible “defections”

# In sourcing

## Features

- Sourced internally
- High degree of control
- Transaction costs reduced through standard employment contracts

## Issues

- Achieve control by insourcing key management roles
- Require specialist knowledge
- Need for knowledge retention
- Often perceived as less efficient in public sector
  - Internal cost savings can be achieved via good management practices
  - Large firms can have same buying power as vendors
- Certainty

# Selective Sourcing

## Features

- Combining insourcing/outsourcing
- Potential for smaller, more specialised contracts
- Retain key services in-house

## Issues

- Contract Size does matter
  - Semi-monopoly vs competition)
  - Risk
  - Satisficing vs best-in-class

# Joint Venture

## Features

- Shared risks/rewards
- Aligned incentives through shared ownership
- Additional revenue stream where a market demand exists

## Issues

- Lengthy establishment
- Changing terms
- Exiting

# Other findings as a consequence of case study: Unanticipated holdup in fixed price contracts

- Public sector firms often have a desire to fix price contracts – passing risk to vendor
- Transaction costs introduce a switching cost which can lead to hold-up
- Case study example: fixed price contract to deploy and configure an off the shelf product

# Recommendations

- Define an insourcing/outsourcing strategy for delivering IT projects & designing organisation boundaries. Identify:
  - Critical business functions where ownership/control is important
  - Key knowledge and control roles to be retained in-house (build that capability)
  - Identify candidate technologies/capabilities more efficiently/effectively outsourced
- Invest in a skilled IT purchasing capability (to match that of your suppliers)
- Size contracts that allow “best of breed” sourcing and encourage competition, while manage transaction costs
- Design contracts so that parties bear their real risk, discourage mutual holdup and encourage competition