

# IT Outsourcing in the Public Sector Local Government: Experiences of the management and selection of IT service providers

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**Abstract:** This paper looks at issues in Information Technology (IT) outsourcing in public sector local government in the UK, to determine how successful they have been and to establish any best practice. This is important because, whilst outsourcing has become a significant issue in the restructuring of organisations and is increasingly used within both the private and public sectors, there has been a lack of research into IT outsourcing in the public sector and particularly within local government. This paper provides an in-depth study into how outsourcing is managed in local councils and how successful it has been; especially considering its sometimes controversial nature and the mixed press results it receives. This paper focuses in particular on an analysis of the risks of IT outsourcing and the management of the outsourcing contract. The research shows that a thorough risk assessment must be completed before an outsourcing contract is agreed. Local government tends to adopt a very cautious approach to outsourcing based on risk minimisation. Hidden costs are one of the greatest risks when outsourcing. Hidden costs occur in selection, managing the contract, and making changes to the contract, all of which can offset any cost savings identified at the start of the outsourcing contract. The research shows that local councils recognise the importance of the contract and that it has the largest single impact on the success or failure of the outsourcing agreement. Having a well written contract is necessary to minimise the risks posed by outsourcing. However, the local government bodies recognised that it is impossible to cover every detail in the contract, particularly where needs are fluctuating, and that an element of trust is required to manage the contract successfully. The research suggests that contracts need to be strict enough to motivate the provider but should be realistic and achievable so that they do not inhibit the development of a working relationship. The paper also addresses issues in the selection of outsourcing providers and more recent developments since the new UK government's austerity programme. The study concludes that, whilst councils recognise that both the contract and trust are important to ensure that outsourcing is successful, the culture of risk aversion in the public sector tends to lead to a 'play it safe' mentality resulting in an overemphasis on the contract. This can lead to a short-term focus that could make it difficult for the council and the provider to work together to meet long-term goals. The councils were generally skeptical of developing partnerships; however, the research reveals that councils who focused predominantly on the contract were less successful than those who developed partnerships with their providers. The authors therefore recommend that, in order to achieve greater success, councils should develop partnerships and focus on best value and long-term strategic goals when outsourcing IT.

**Keywords:** Information Technology (IT); Information Systems (IS); outsourcing; public sector; local government

## 1. Introduction

The use of outsourcing, although not a new phenomenon, has increased in recent years as firms seek to lower costs and increase efficiency in response to higher levels of global competition. Child (2005, p.179) describes outsourcing as "the contracting out of activities that need to be undertaken on a regular basis, which otherwise would be conducted within an organisation". Kern and Willcocks (2000, p.322) define IT outsourcing as "a decision taken by an organization to contract out or sell the organizations IT assets, people and/or activities to a 3<sup>rd</sup> party supplier, who in exchange provides and manages assets and services for monetary returns over an agreed time period". Outsourcing has become a significant issue in the restructuring of organisations and many commentators agree that it is currently "one of the fastest-growing" and most important activities in business (Burnes & Anastasiadis, 2003, p.355; Weinert & Meyer, 2005, p.1).

Outsourcing offers numerous advantages; however there is also evidence that outsourcing often fails. The potential benefits include cost savings, efficiency gains, improved flexibility, access to world-class expertise and focus on core competencies. However, outsourcing also poses numerous risks that must be managed in order for outsourcing to be successful (Kremic, 2006, p.467).

Outsourcing is identified in two categories; outsourcing of core value-chain operations and outsourcing of support activities. The core value-chain operation is the outsourcing of supply chain activities such as distribution, whereas outsourcing of support activities includes HRM and facilities

management (Child, 2005, p.181). Outsourcing initially involved the outsourcing of non-core activities to reduce costs and improve efficiency and had a relatively short-term focus. However, more recently outsourcing has been used more strategically as firms increasingly seek partnerships to become more efficient by focusing on areas where they can achieve competitive advantage (DiRomualdo & Gurbaxani, 1998, p.1). However, some theorists suggest that you should not outsource your core competency, whilst others argue that it can be difficult to define what is core and non-core. Alexander and Young (1996), cited by Que'lin and Duhamel (2003, p.648), distinguish between activities that "are critical to performance" but only support the core and those that actually provide competitive advantage.

This is a notable problem when outsourcing IT because, whilst some consider it a non-core activity, IT is becoming critical to service delivery. The fact that IT is complex and affects all activities within an organisation make it one of the most important activities outsourced (Weinert & Meyer, 2005, p.1). Lacity and Willcocks (1995, p.226) note that IT changes rapidly and switching costs to new technologies or suppliers can be high because IT demands high investment costs. They suggest this makes IT outsourcing unique compared to the outsourcing of other activities. This will have implications for how IT outsourcing is conducted and managed.

### **1.1 Outsourcing in the public sector**

The public sector has followed the trend set by the private sector and IT outsourcing is now one of the most important outsourced activities that by "1996 had led to contracts worth £2 billion" (Lacity & Willcocks, 1997, p.85).

In the 1980's the government introduced Compulsory Competitive Tendering (CCT), this "involves government or firms using a competitive bidding process to help decide who should have the right to produce or deliver goods or services" within the public sector (Rimmer, 1994, p.79). This process was driven by "marketing and political trends" with the aim of making the public sector more competitive (Marco-Simó, et al, 2007, p.51). It was assumed that market-based competition would be able to provide improved efficiency and lower cost whereas public monopolies provided no incentives to improve performance (Besley & Ghatak, 2003). However, traditional outsourcing contracts in the public sector were often granted to the lowest priced bidder, which can lead to lower quality provision. Thus, the government updated CCT in 1998 to focus on best value rather than simply lowest cost, whether internally or externally (Butler, 2003).

However, whilst outsourcing has become one of the most important tools in public sector management, failures tend to attract greater publicity, due to political accountability, whereas successes often go unnoticed (Maughan, 2003). These failures have led to an increasing interest in how outsourcing is managed in local councils and to what extent it has been successful.

## **2. Literature review**

Much of the literature available deals with IT outsourcing in general without specifically addressing cases within the public sector or local government. Indeed, Vilovsky (2008, p.337) notes that the available research is "limited and fragmented". De Looft (1996) finds this interesting since he shows that in the Netherlands 30% of IT outsourcing is accounted for by the public sector, a figure not too dissimilar to the UK. However, despite this, Marco-Simó et al (2007, p.52) note that outsourcing in the public sector "has not produced a level of research interest proportional to its economic importance". This has led to an increased interest in how outsourcing is managed within the public sector; especially considering the increasing use of IT outsourcing within the public sector the mixed press results it receives.

The lack of research in this area can be problematic for making comparisons. However, it does provide an opportunity to explore a gap in the literature and to discover if anything can be learnt from how outsourcing is managed in local councils. This is important because whilst the private and public sectors share some similarities they also have some notable differences. Vilovsky (2008, p.338) notes that the public and private sectors are divided both "ideologically and operationally". Both have similar values in terms of "responsiveness, honesty and accountability" but the public sector is not motivated primarily by financial performance. Thus, public sector managers may adopt a different mindset to outsourcing, based on goals and values other than cost efficiency, whilst being further constrained by political accountability. This could result in a more cautious approach to outsourcing

based on minimising risk. Burnes and Anastasiadis (2003, p.365), in their comparison of a police force and an insurance company, further highlight differences in supplier selection, contractual arrangements and in the management of the relationship between the public and private sectors. One major difference is that public agencies are legally required to outsource any activity that can be done cheaper by outside contractors, as long as they meet the minimum specifications (Burnes & Anastasiadis, 2003, p.359). The private sector, in contrast, has more choice over whether they outsource and to whom and can therefore do so more strategically and approach the best suppliers directly (Lin, et al, 2007, p.164).

Currie (1996, p.226), in a comparison of the experiences of IT outsourcing in the UK's private and public sectors, shows that IT outsourcing poses significant challenges to both and should not simply be seen as a "quick-fix" solution. Lacity and Willcocks (1997, p.106) investigated two case studies in the US public service. They have previously suggested that the UK has had "long standing problems" with outsourcing and that the results have often fallen short of expectations. In this article, they suggest that politicians often believe that outsourcing will automatically save money whereas in reality outsourcing either has failed or has yet to show any real benefits.

Frederick (1994), however, contends that CCT has been successful and has produced both cost savings and increased efficiency. Indeed, Maughan (2003) suggests that the public sector is better at managing outsourcing relationships than the private sector because they devote staff exclusively to managing the relationship whilst the private sector generally does not which can create a lack of focus and clarity. He also states that the public sector benefit from having clear guidelines and a lengthy procurement process, which allows for multiple tenders, imposed upon them by legislation. Vilovsky (2008, p.342) contends that public sector managers often find legislation and guidelines "a legal constraint rather than an aid" which may create inflexibility and lead to contracts being awarded to the lowest cost bidder rather than the best quality. Despite this, Burnes and Anastasiadis (2003, p.365) argue that the private sector could learn from the public sector's structured approach. They suggest that government guidelines can create a greater understanding of outsourcing requirements and may produce more stable relationships. This research explores these issues further.

### **3. Methodology**

This research takes the form of a multiple case study. Creswell defines a case study as "a single, bounded entity, studied in detail, with a variety of methods, over an extended period" (Maylor & Blackmon, 2005, p.243). Marco-Simó et al (2007, p.59) have argued that we need more "real cases" before "we can generalise the findings". A case study approach was chosen because this type of research is useful when 'how' or 'why' questions are being asked (Saunders et al, 2007, p.139).

The case study allows an in-depth examination to develop an enhanced understanding of the subject area and develops areas for further research (Flyvbjerg, 2004, p.420). Commentators agree that this method allows for a greater understanding of complex issues and is more comprehensive than surveys, due to its ability to "come closer...to the complexity of real organisation setting" (Maylor & Blackmon, 2005, p.242). Yin (1984), cited by Gable (1994, p.113-115), believes that a single case study is useful in areas that are under-researched and require exploration, whereas multiple case studies are used to test for patterns and draw comparisons. The purpose of this research was to explore a complex issue in-depth and to identify some common trends rather than to present a generalised industry view. Indeed, Flyvbjerg (2004, p.420) argues that the case study is a reliable method in itself due to its ability to incorporate multiple data collection methods.

#### **3.1 Case studies**

The case studies are based on four local government councils in the south of the UK. The results of a more recent interview at a different local council are included towards the end of the article in order to update the thinking on the most recent developments.

#### **3.2 Data collection methods**

To answer the research questions semi-structured interviews were conducted at four local councils. The interviews were held with the heads of IT at the councils. The interviews were the primary data collection method and allowed the authors to explore the interviewees' experience and attitudes towards IT outsourcing. This paper presents a summary of the data collected.

## 4. Analysis of results

### 4.1 Summary of responses

Table 2 summarises the main issues as described by the four interviewees at the four councils.

**Table 1:** Description of the cases

Council	Description
A	Council A is a district council that serves a population of around 110,000 people. IT supports the council's everyday operations and is critical to business performance and service delivery. IT is one of the most important activities outsourced at this council. A budget report meeting in 2008 revealed that the contract for IT services is the second most expensive contract at the council, at over £700,000 per year. The ICT strategy at the council is not only to improve the efficiency and effectiveness of the service but also to increase its accessibility to all. The Council signed a 5-year contract with their service provider in 2005, worth £2.5 million. This contract was to provide the council with a full IT managed service that included desktops, servers, infrastructure and applications support.
B	Council B is a unitary authority that serves a population of around 200,000 people. Council B chose to outsource to one supplier in a 10-year contract. This contract included not only the provision of IT but also related services such as HR, payroll, Customer Service, local taxation and benefits, procurement and property services. The council sought one strategic partner to ensure greater integration between the councils services but also because greater cost reductions could be achieved by outsourcing many services to the same provider. The main reason that the council opted for a long-term agreement was because of the high investment needed at the start of the agreement. This meant that the council needed to allow sufficient time for the provider to recoup their investment costs.
C	Council C is a unitary authority that serves a population of 150,000. This council outsourced for seven years. The council outsourced its entire IT department. Services provided include procurement, technology refresh, network development and support, offsite server hosting support and offsite mainframe services, as well as application support and management, 24x7 services monitoring and helpdesk.
D	Council D is a district council that serves a population of 110,000. Council D do not outsource IT.

**Table 2:** Summary of responses

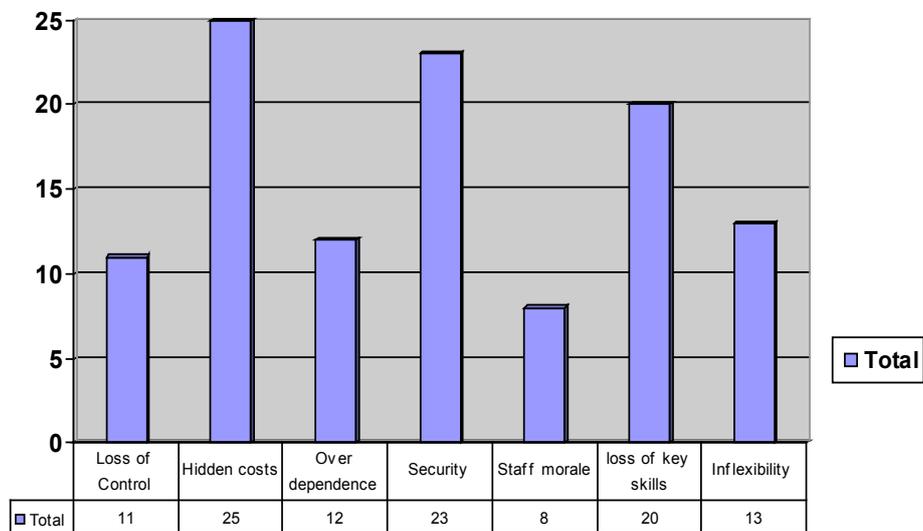
Council A	The council considered the loss of key skills, hidden costs, and security the main risks. Hidden costs occurred over interpreting the contract and when changes were needed. The provider also did not have all the necessary skills on-site and charged extra to bring them in. They also believe it is difficult not to become over-dependant.
Council B	The council argued that security and hidden costs are the only very important risks to consider. This is offset by writing a complete contract but admitted that hidden costs had occurred regardless. Loss of control was considered the third most important; this is offset by the retention of an in-house team tasked with monitoring the agreement.
Council C	The council considered hidden costs, loss of key skills, security and over-dependence important risks. The council should retain staff with the ability to monitor and evaluate the contract. Hidden costs occur when changes are required thus you need to write a complete contract but also develop good relations to make the provider more open to changes.
Council D	The council believes the greatest risk is knowledge management because you have no control over how the provider conducts activities. Thus, you should only transfer staff you do not need and retain skilled staff. Whilst everything else should be documented in the contract, hidden costs and security are still very important risks to consider. The council need to write a complete contract and develop trust because it can be difficult and costly to make subsequent changes to the contract.

The interviewees from the four councils were asked to rank the seven motivational criteria (7 being the most important, 1 the least). Table 3 and Figure 1 illustrate the responses.

**Table 3:** Interviewees ranking of main risks

	Interviewee A	Interviewee B	Interviewee C	Interviewee D	Aggregate Score
Loss of Control	2	5	3	1	11
Hidden Costs	5	6	7	7	25
Over-dependence	1	3	5	3	12
Security	6	7	4	6	23
Staff Morale	4	1	1	2	8
Loss of key skills	7	2	6	5	20
Inflexibility	3	4	2	4	13

**The Risks of Outsourcing IT**



**Figure 1:** Summary of individual rankings

In Table 4 and Figure 2 the interviewees from the four councils were asked to state whether the motivations were: *Very Important, Important, Unimportant or Irrelevant* to their decision to outsource.

**Table 4:** Interviewees categorization of risk factors

	Interviewee A	Interviewee B	Interviewee C	Interviewee D
Loss of Control	Important	Important	Unimportant	Irrelevant
Hidden Costs	Very Important	Very Important	Important	Very Important
Over dependence	Important	Important	Important	Unimportant
Security	Very Important	Very Important	Important	Very Important
Staff Morale	Important	Unimportant	Unimportant	Unimportant
Loss of key skills	Very Important	Unimportant	Important	Important
Inflexibility	Important	Important	Unimportant	Important

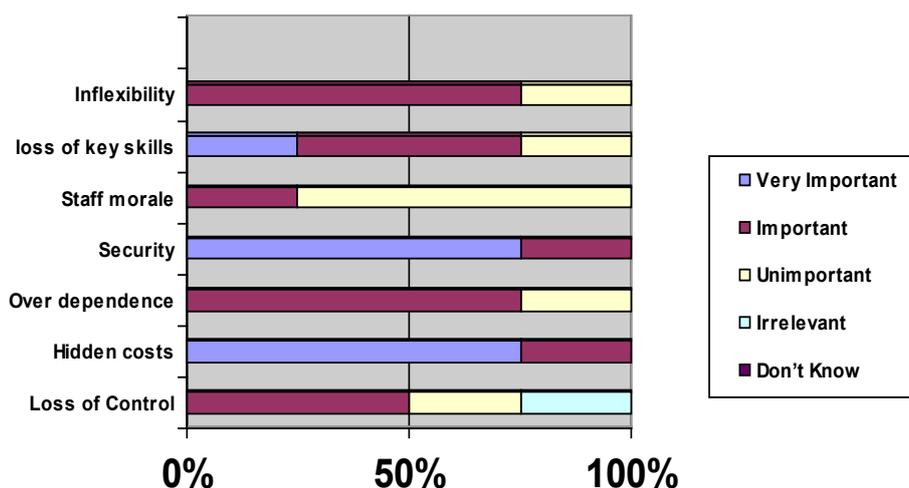


Figure 2: Importance of risk factors

## 4.2 Discussion

### 4.2.1 Hidden costs

Hidden costs were considered the most important risk of outsourcing IT and three of the four Interviewees considered it very important. Interviewees A and B both noted that hidden costs had occurred in their contract.

Hidden costs are the most important risk to consider because any costs that arise later may offset any savings from the agreement (Barthelemy, 2003a, p.93). The research has shown that councils should not underestimate the high costs incurred during selection and from managing the contract. Additionally, the provider will give you only what you ask for in the contract and will charge additional costs for anything unspecified. Therefore, the council need to understand every aspect of the service and the requirements before outsourcing and write a complete contract (Barthelemy, 2003a, p.93). However, as Interviewee A observes, writing a completely “fool proof” contract is difficult due to the fast changing nature of IT. Interviewees C and D argue that developing good relations maybe more important. Council A may have suffered hidden costs because they had focused too much on price. This suggests that a more balanced approach to outsourcing and the development of trust could reduce this risk.

### 4.2.2 Security

Security was the second most important reason and three of the four IT managers considered it very important. This is because councils deal with highly sensitive information, which they need to keep protected. Thus, councils need to be able to trust their provider, which could explain why councils require references.

### 4.2.3 Loss of key skills

The loss of key skills was considered the third most important risk to consider when outsourcing although one Interviewee considered it unimportant.

Burnes and Anastasiadis (2003, p.364) argue that public sector agencies retain less knowledge concerning the outsourced activity because they consider it a low-grade activity that needs only minimal management. Furthermore, Holzl, Reinstaller and Windrum (2006, p.1) argue that outsourcing could have a negative long-term impact on organisational innovation. However, whilst the Interviewees expected outsourcing to take less time to manage, three Interviewees considered the retention of key skills vital to manage and evaluate the outsourcing agreement, to focus on strategy and to develop new ideas. This also reduces their dependence on their provider and allows them to recommence IT in-house at the end of the contract or in the event of failure. Indeed, Council B only considered the loss of key skills unimportant because transferred staff continued to work on-site and the council retained key staff.

#### *4.2.4 Inflexibility*

The research has illustrated the difficulties of writing a flexible contract. Indeed, whilst Council C achieved flexibility, the others, including Interviewee D, argued that flexibility could only be gained at extra cost. The risk of inflexibility led Council A to opt for a 5-year contract and even Interviewee C is recommending a shorter agreement the next time his council outsource.

#### *4.2.5 Over-dependence*

Three Interviewees considered over-dependence an important risk although it was considered less important than the other risks. The interviews conclude that it is difficult not to become over-dependent because the provider needs full control of the servers. Thus, as Interviewee D argues, you need to fully commit to outsourcing to achieve the benefits. To reduce the risk of over-dependence the councils all retain in-house teams.

Similarly, only two Interviewees considered the loss of control important. This is because when you outsource IT you are passing the responsibility for running the service to the provider and therefore the councils were more concerned that the results were achieved rather than keeping control.

Interviewee B, however, did consider loss of control and over-dependence important. This is probably because Council B signed a long-term contract. These agreements can offer greater benefits in terms of cost savings, strategic support, and investment. However, as Willcocks and Currie (1997, p.107) observe, they could also contain higher risks in terms of over-dependence and inflexibility. This is why Interviewees A and C believed that long-term contracts were too risky.

#### *4.2.6 Staff morale*

Three out of the four managers classed this as unimportant. Thus, whilst Barthelemy (2003a, p.87) argued that you should not overlook personnel issues, the Interviewees did not consider this as important as the other risks. The councils believed staff morale was maintained through legislation that guarantees transferred staff the same terms and conditions.

### **4.3 Contract and management**

This section assesses how local councils manage outsourcing to determine the importance of both the contract and trust to success.

#### *4.3.1 Contract*

The research supports Barthelemy's (2003a, p.90) conclusion that the contract is integral to set expectations and has the largest impact on the success or failure of the outsourcing agreement. The Interviewees all argued that it was difficult and costly to make subsequent changes to the contract and therefore you need to write a complete contract to minimise the risk. Indeed, even at Council B, which was billed as a 'strategic partnership', the contract was extensive. Interviewee D further notes that, whilst developing a partnership is the key to success, you will receive nothing more than is documented in the contract. A common conclusion drawn from this research is that unless the contract is black and white then hidden costs will occur over its interpretation.

The importance attached to the contract means that councils retain an in-house team and a contracts manager exclusively devoted to monitoring and evaluating the outsourcing agreement and managing the contract. The contracts include precise performance measures and numerous Service Level Agreements (SLA), which include financial penalties to motivate the provider to meet targets. Furthermore, councils retain the right to cancel the contract in the event of sustained service failures to prevent them from being locked into an unsuccessful agreement. Interviewee A notes that these measures can have a debilitating effect on the relationship but are necessary to keep the provider on track.

#### *4.3.2 Trust*

Despite writing detailed contracts, the interviews highlight the difficulties of writing a "full proof" contract due to the fast changing nature of IT and showed that hidden costs occurred regardless. Indeed, Interviewee B notes that writing a complete contract is one of the greatest challenges of outsourcing. Thus, as Trott (2008, p.235) suggests, trust maybe necessary to ensure the provider

remains flexible to changing needs because, as Interviewee A notes, it is very difficult to negotiate subsequent changes to the contract. However, the fact that only Council C achieved flexibility whilst the other two councils who outsourced IT reported hidden costs suggests that these councils focused too much on the contract rather than on developing trust.

However, whilst Maughan (2003) argues that the councils' hands on approach to managing the contract makes them better at managing outsourcing agreements, the interviewees acknowledged that over-relying on the contract would create tension and make it difficult for the council and provider to work together (Sabherwal, 1999, p.81). Although the councils recognise the need for financial penalties, they support Gareiss's (2002) conclusion that using penalties for every minor default would have a negative effect on the relationship. Interviewee A, for instance, noted that the council did not hold the provider to every contract detail if they were performing well overall. Thus, the interviews support Hart's (2008) conclusion that the contract should provide mutual benefit and targets should be fair and achievable to get the best performance.

The councils saw the benefits of creating a working relationship, facilitated by regular meetings, to improve service delivery and resolve any problems. Thus, whilst the contract is important and sets the expectations for the relationship, the interviews suggest that councils believe that trust is essential to put the contract into practice. This suggests that both trust and the contract are the "key to success" (Barthelemy, 2003b, p.539) although the exact balance will depend on what is outsourced and the context of the agreement.

#### *4.3.3 Partnership model*

The example of Council C shows that councils can be successful if they put the contract aside and develop a partnership with their provider based on high levels of trust. This is emphasised by the fact that they were the only council to achieve flexibility and subsequently won the partnership of the year award. This is supported by Interviewee D who, in his experience, found that the partnership model led to greater success and believes that the contract should be set aside after the first six months. Partnerships encourage the provider to be flexible and committed to the councils needs beyond the contract and allow both sides to work together to improve service delivery (Sun, Lin & Sun, 2002).

However, two of the three councils who outsourced argued that, whilst trust was important, the contract still formed the basis of the relationship. Interviewees A and B support Lacity and Hirschheim's (1993, p.259) conclusion that partnerships do not exist in outsourcing and believe the contract is the only "mechanism to ensure that expectations are realised". Council A signed a short-term contract and therefore may have focused on the contract because the pressure to meet short-term goals can inhibit the building of trust. However, the contract still took precedence at Council B who signed a long-term 'strategic partnership' with their provider. A council report noted that the contract was meant to come secondary to resolving problems through cooperation. The council had outsourced many services in a long-term agreement and therefore could easily become over-dependent without trust. DiRomualdo and Gurbaxani (1998, p.6) note that partnerships work better in long-term contracts because there "is more uncertainty about requirements". Similarly, as Council C shows, long-term agreements can generate higher levels of trust because relationships evolve over time. However, despite focusing on long-term goals, Interviewee B argued that after initial difficulties the relationship reverted back to a contractual based agreement. This supports a report by Nineveh Consulting (2007) that argues that most partnership agreements in the public sector are little more than "traditional client/contractor relationships". Indeed, the fact that both Interviewee A and Interviewee B were sceptical of partnerships because the provider and council have different drivers could support Head's (2005) findings that agreements are labeled partnerships "purely for political expediency".

This shows that local councils recognise the value of trust but still appear reluctant to put aside the contract and therefore adopt a more short-term focus. This could be because councils focus on minimising risk or because they lack experience in developing long-term relationships, which could make them more comfortable managing the contract. This overemphasis on the contract, however, could explain why Councils A and B both reported that hidden costs had occurred and found that it took longer than anticipated to manage the contract and deal with problems and were less successful than Council C whose partnership agreement appears to have proceeded more smoothly.

## 4.4 Selection

### 4.4.1 The Selection Process

The Interviews confirmed that councils are legally required to conduct a “rigorous and open selection process” (Burnes & Anastasiadis, 2003, p.362) and contracts over a certain size must go through the EU tender process. The open invite can lead to a high number of responses, which the councils reduce to a more manageable number by using pre-qualification questionnaires. The final shortlist of providers are then invited to give presentations, before the preferred provider is chosen.

The tender process is lengthy and detailed, ranging from 18 months to 3 years in this research. The open invite means that councils must evaluate and respond to all bids. This means councils must set clear requirements to enable companies to bid for the contract and make evaluation easier, which enables them to gain a more thorough understanding of the outsourcing requirements and make more informed decisions (Burnes & Anastasiadis, 2003, p.365). This structured process, as Interviewee A argues, can allow the council to achieve best value through competition and write “fool-proof” contracts to minimise risk.

However, the long tender process results in high costs to the council because of the time and energy needed to evaluate all bids and to keep the contract up-to-date. This, as Barthelemy (2003a, p.93) observes, is a very important hidden cost to consider and Interviewee D considers the process a waste of taxpayer money. Thus, whilst this process is necessary for transparency and fairness and can produce best value, Interviewees C and D do not believe the procurement process is beneficial to councils. Indeed, Interviewee D supports Burnes and Anastasiadis (2003, p.362) conclusion that the private sector has the advantage of being able to go directly to the best companies and can therefore conduct the process faster and cheaper. Thus, as Interviewee C argues, there should be an optimal time period for the process that would provide structure but avoid excessive costs. Council A may have preferred a structured process because they focused more on the contract and cost efficiency, whereas Council C and D may have found the process too rigid and inflexible, which could make it more difficult to select companies who can support the councils’ long-term goals.

### 4.4.2 Selection Criteria

Legislation stipulates that public sector agencies must make selection decisions based on best value rather than lowest cost (Butler, 2003). However, Burnes and Anastasiadis (2003, p.362) observe that local councils are legally obliged to outsource to the lowest cost bidder as long as they meet the minimum specifications for the contract.

**Table 5** - Criteria for Selection Decision

	Interviewee A	Interviewee B	Interviewee C	Interviewee D
Capabilities	Yes	Yes	Yes	Yes
Price	Yes	Yes	Yes	Yes
Size of the company	No	No	No	Yes
Number of deals the provider has had	No	No	Yes	Yes

All the Interviewees considered price and capability important and sought to achieve best value (see Table 5). However, political accountability and budget constraints can lead to an overemphasis on price. For instance, although Interviewee A argued that bids were evaluated on a 60:40 quality to cost ratio, the research suggests they focused too much on price, which resulted in the provider cutting back in other areas and led to hidden costs. Similarly, Interviewee D argues that price is essential and forms 60% of the decision.

Indeed, even at Council B who focused on best value, a report stated that the most “economically advantageous” bid should be chosen. However, Council B also had to choose a provider who had expertise in a wide range of business functions. This research shows that councils try to achieve best

value although the need for cost efficiency can result in a short-term focus, whereas the private sector do not necessarily have to opt for lowest price and can focus more on strategy when outsourcing (Lin et al., 2007, p.164).

Table 5 also shows that the provider's size was only important to one council whilst the number of previous deals was important to only two. However, the interviewees noted that councils require references before they accept their provider. Council A chose a provider who had previously had a successful relationship with another council, Council B chose a provider who accounts for over 20% of Strategic Services Partnerships with local councils in the UK and Council C selected a provider with whom they had a long-term relationship. This allowed Council C to develop a successful partnership with their provider.

This approach allows councils to select companies who have previously had successful deals in the public sector and can therefore be certain of their capabilities, thus minimising the risk posed by outsourcing. However, whilst it could be argued that the need to re-tender at the end of the contract can inhibit the building of trust (Burnes & Anastasiadis, 2003, p.362); the requirement for references to gain future contracts could create greater commitment from the provider. This, however, may reduce the number of companies considered for a contract and make it difficult for firms to enter the market thus reducing the councils' ability to get the most cost-efficient deal.

## **5. Developments**

In 2010 the UK formed a coalition government of Conservatives and Liberal Democrat parties. In their first budget (June 2010) a series of austerity measures were introduced in an attempt to reduce the accumulated budget deficit (The Cabinet Office, 2010). These included reductions in grants made to local government and this has understandably impacted on Information Systems and local council's views on outsourcing. The following discussion is a [limited] update on the situation following a recent (March 2012) interview with the IT manager at one of the local councils.

The council does not currently outsource its information services but the situation is under constant review. Although the claimed potential savings from outsourcing are always tempting, the IT Manager raised a number of concerns that irrespective of central government austerity measures still mean that that outsourcing is not necessarily a panacea.

### **5.1 Lack of Expertise**

There is a fear factor that the outsource provider holds all the cards. By definition outsourcing is what the outsourcer does and they have a high level of expertise and experience in negotiating contracts. By contrast local councils only perform this occasionally and have little expertise. Hence local governments fear that they are negotiating from a position of disadvantage. Without incurring the expense of specialist legal advice, the councils are reluctant to enter into negotiations.

### **5.2 Minimum Contract Period**

Many of the outsource providers will not enter agreements under 10 years. The IT manager felt that given political and environmental uncertainty that this was an excessive period of time for many councils to commit to a contract. The contract may not provide the flexibility that is needed as needs and the political environment changes.

### **5.3 Outsourcing – A Panacea?**

The IT manager felt there were a number of down sides to outsourcing of IT:

Outsourcing doesn't remove all costs. There is still an overhead in managing the outsourcing contract.

Although there is potential for savings there are also potential risks – are the savings worth the risks?

There may be potential for further savings within local government without Outsourcing by implementing Lean policies and measures.

By outsourcing, although the IS provider may change; the systems and software provided may well be the same (for instance software such as Microsoft or SAP).

By outsourcing, services can be dispersed or fragmented which can, paradoxically, lead to a reduction in the quality of the service.

#### **5.4 Shared Services**

Many local authorities have moved to shared services in the last few years. Certainly IT managers across local councils in a region have formed forums and working groups to get together to discuss and collaborate on issues that have common themes, including outsourcing. They are proving successful in reducing the feeling of isolation felt by many of the IT managers. However, the IT manager was again keen to point out that they are not a panacea: The nature, culture and needs of different councils differ, making it difficult to form a consensus on common issues. Also that there is a danger of being forced to work at the pace of the slowest, with more go-ahead councils being held back by those less ambitious or more conservative in their outlook.

### **6. Conclusion**

The research shows that a thorough risk assessment must be taken before you enter into outsourcing agreements. The local councils adopt a very cautious approach to outsourcing based on risk minimisation. The research supports Barthelemy (2003a, p.93) conclusion that hidden costs are one of the greatest risks when outsourcing. Hidden costs occur in selection, managing the contract, and making changes to the contract, all of which can offset any cost savings during the agreement. Indeed, flexibility can only be gained through outsourcing at extra cost to the council or through the development of trust.

Lacity and Hirschheim (1993, p.19) argue that companies need to retain key skills to allow them to effectively evaluate opportunities or move the activity back in-house. The councils, as Barthelemy (2003a, p.92) recommends, all retained an in-house IT team tasked with monitoring the contract, developing new ideas and focusing on strategy, which enables them to reduce the risk of over-dependence and loss of control. However, these risks were considered less important than the other risks because councils must not become over-dependent and must fully commit to outsourcing for it to be successful. Similarly, whilst Barthelemy (2003a, p.87) argues that you should not overlook personnel issues, councils do not consider staff morale to be an important risk when outsourcing.

The research shows that there are benefits to the structured selection process that local councils are required to follow. This allows for a more thorough understanding of the outsourcing requirements and results in more informed decisions. Thus, as Maughan (2003) argues, this allows for a "more carefully planned and managed process" and can make the public sector better at managing the outsourcing contract. However, the tender process is also time-consuming and very expensive for councils and providers. Thus, as Burnes and Anastasiadis (2003, p.364) comment, the private sector can conduct the process cheaper by approaching the best companies directly.

Barthelemy (2003a, p.89) argues that selection should not be based solely on cost but also on skill, expertise, flexibility, commitment and trust. The research shows that where the primary focus of selection was price, the results were not achieved. Indeed, as Hart (2008) notes, hidden costs are more likely to occur where councils focus too much on price during selection. However, despite this, contracts are awarded to those who make the lowest bid, as long as they meet the minimum specifications (Burnes & Anastasiadis, 2003, p.362). A report from Council B, for instance, noted that the most "economically advantageous" bid should be chosen. Despite this, the councils all reported to focus on best value and noted the importance of both price and capability. The use of references also allows councils to reduce the risks by selecting only those who have had successful agreements in the public sector. This can reduce the number of companies considered for a contract thus inhibiting the councils' ability to achieve best value but allows the council to be certain of the provider's capability. However, the need for best value and cost efficiency could result in a short-term focus and therefore, as Lin et al (2007, p.164) note, this could put councils at a disadvantage to the private sector who do not have to opt for lowest cost and can therefore focus more on long-term goals.

Data from a recent interview with a local government IT manager indicates that IT outsourcing is still being looked at as a way of managing IS, but despite recent political pressure to cut costs in local

government generally, IT managers are still very much aware of the dangers of outsourcing and that outsourcing is not always the panacea it is held out to be.

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