

EVALUATION OF IMPACT OF OUTSOURCING ON EFFICIENCY OF PUBLIC SECTOR ORGANISATIONS

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—Abstract—

According to rough estimates, the amount of outsourcing projects in the Slovenian public sector have doubled in recent years and during the present economic and financial crisis, reach tens of millions of Euros. Outsourcing projects ought to reduce costs and help organizations to focus on core business processes which should consequently improve service provision and quality. Past experience and recent research carried out in the public sector show that outsourcing can indisputably bring many benefits to the organizations which master the art of devising, deploying, and maintaining outsourcing relationships, but for many organizations, these benefits remain elusive. The research focuses on in-depth analysis of the essential factors within the concept while examining the current situation in the field of outsourcing in the Slovenian public sector and eventually presents research findings on outsourcing of information technology projects (IT-projects) at the municipal level. The article analyzes the methodological, substantive, procedural and other relevant factors within the process of outsourcing and summarizes the results of our own empirical research on outsourcing of IT-projects in the Slovenian public sector. Paper finally provides guidelines for quality selection as well as effective and efficient implementation of outsourcing projects in the public sector.

Key Words: *IT outsourcing, New Public Management, outsourcing effects, public sector, Balanced Scorecard.*

JEL Classification: M15

1 INTRODUCTION

Concept of New Public Management (NPM) has had undoubtedly a major impact on development and functioning of Slovenian public sector in the last more than one decade, however it should be noted that apart from positive results, many negative, unexpected effects have been experienced as well. The first phase of its implementation was very promising in the field of improving the effectiveness and efficiency of public sector, which was indisputably true to some extent. Problems came later when the euphoria gave way. NPM started straying to the growing and increasingly less justified outsourcing of public services, leading to a completely opposite effect than expected and desired. Despite the high expectations, subsequent experience has shown that outsourcing cannot be a panacea for the majority of problems in the public sector, which most frequently occur due to poor long term strategy, or even lack of it. While on the other hand, regardless of the long term strategies and goals, public sector often acts uncontrollably, indiscriminately and non-critically while implementing and pursuing somehow non-reflectively set objectives.

Furthermore, significant problems are charted in movement to the wholesale use of competitive tendering and positioning outsourcing as a strategic tool of public management. Over the last two decades external provision of IT projects (outsourcing) has become a principle in most parts of public sector, which caused uncontrolled “brain drain”, outflow of vital professional knowledge and loss of core competencies in public sector. It is evident that situation has escalated to the point that some government departments completely lost control over preparation, development and realization of planned projects, which consequently results in weak control over increasing costs and reduced accountability for services. Furthermore outsourcing very often means absolute dependence on external providers. This issue is currently a very hot topic and represents one of the fundamental problems of cost-effective while long-term successful and user-oriented public sector.

Objective evaluation of outsourcing projects should be based on appropriate indicators and evaluation frameworks rather than intuitive, often political criteria, used in many countries today. The latter statement provides a basis for the main

hypothesis in this research paper which argues that future planning, implementation of outsourcing projects should be based on critical and objective evaluation, which could significantly facilitate and improve decision making process while minimizing risk and reducing project costs.

Thus the main objective of this paper is to highlight implications of outsourcing on achieving long-term goals, human resources management, provision of quality public services and cost effectiveness of public sector organizations. Given the theoretical foundations of foreign and domestic authors and the results of our own empirical research, the paper is focusing primarily on the following research questions:

- [1] Identification of positive and negative effects of outsourcing in public sector with particular emphasis on outsourcing of IT-projects and services.
- [2] Organizations in the Slovenian public sector are largely unaware of the long-term implications of outsourcing of IT-projects to their continued operation and reorganization of human resources.
- [3] Decision making process on outsourcing of IT-projects in Slovenian public sector organizations is conducted largely without the use of appropriate indicators or evaluation frameworks.

The following paper is based on various theoretical issues, our own empirical research and presents a useful platform for decision-making process, planning and implementation of outsourcing projects in the public sector, which inevitably requires a multidisciplinary approach and involvement of different stakeholders in all stages of decision making process.

After a brief introduction, the second chapter of this paper presents the concept of outsourcing and an overview over the relevant literature while outlining its contextual considerations and implications of sourcing alternatives. The third chapter reveals the characteristics of our own outsourcing research, its results and their synthesis, as well as offers guidelines for successful implementation of outsourcing strategy. The fourth chapter contains the evaluation of the presented approach, discussion on its practical applicability and description of its positive features and limitations, and subsequently submits the final arguments and observations regarding the outsourcing phenomenon.

2 OUTSOURCING - THE CONCEPTUAL DEFINITION, IMPLICATIONS AND LITERATURE REVIEW

Ellram and Maltz (1997) argue that outsourcing is a contractual transfer of organizational activities and responsibilities to other (external) business entity. They emphasize that the volume of outsourced activities depends on their content and the needs of the parent organization. Kubr (2002) defines outsourcing as a contractual elimination and transfer of the activity, for which the organization decides not to perform it itself in future, to the external business entities. Such an operating strategy in his view, allows the efficient allocation of resources. Literature presents a wide range of different definitions, ranging from the most consistent and accurate up to superficial and partial definition of the phenomenon. We think that the most useful and versatile is its most widespread and widely accepted definition, which reads as follows: Outsourcing is a contractual transfer of certain activities and business processes from the parent organization to the external contractor (Greaver, 1999).

Outsourcing within the concept of NPM since 1980's can be seen as a business strategy in which the organization is striving to improve business performance and primarily cut back costs as well as focus on its core functions and core activities. These public sector reforms have been driven both by budgetary pressures requiring reduced government spending and by the influence of economic theories about public administration and its function. In Slovenia the use of competitive tendering and contracting out has been growing rapidly. Some studies report considerable positive effects, savings and increased efficiency; in general they outline positive impacts of outsourcing while others find no benefit or even increased costs resulting from tendering and contracting out.

Bešter (2000:72) and our research of IT outsourcing in Slovenian public sector revealed positive effects of outsourcing which are divided into four categories and presented below:

1. Organizational and corporate effects:

- focus on core business and activities,
- increased business flexibility in changing social conditions,
- restructuring the organization,

- creating higher added value products/services, increased customer satisfaction and generate greater returns to capital investments.

2. Increased efficiency effects:

- improving operational efficiency that may result in better quality, greater productivity, shorter investments cycle, increasing returns,
- access to knowledge, experience and modern technology,
- improved governance and control processes
- minimizing risk when operating in house,
- access to innovative ideas and solutions.

3. Financial effects:

- reduced future investment in assets that can be provided by external vendor,
- focus on in house investments,
- increased market share and exploitation of business opportunities offered by a network of partner organizations,
- faster growth of the organization - possibility of using the partner's capabilities, processes and systems.

4. Cost effects:

- reduced costs due to the external vendor's performance and price of products or services,
- transformation of fixed costs into variable costs,
- decreased costs due to the large reductions in the value of fixed assets.

However, non-critical and over abundant implementation of outsourcing projects has led to some unforeseen problems in public sector as well. Slovenia has encountered problems with outsourcing especially in the last five years and ongoing financial and economic crisis just revealed its magnitude. Seeking short-term solutions on account of the NPM philosophy and lack of experience in this field as well as neglecting all other organizational aspects except costs (even cost-effectiveness of some outsourcing projects is very doubtful in the long run) has led some public sector organizations to difficult situation. Because of a variety of

negative implications caused by outsourcing, some public sector organizations found themselves in a vicious circle. In fact, their continued operation is no longer possible without external contractors, while on the other hand, outsourcing is undermining their organizational foundations such as control over costs, human resources and future development.

Considering the above assumptions and international research (Bongard, 1994; Chapman and Andrade, 1997; Greaver, 1999; Jensen, 2007) as well as our own research, the potential negative consequences and impacts of outsourcing are highlighted as they follow:

1. Organizational performance

- reduced quality of services,
- reduced accountability for services.

2. Human resources

- loss of core competencies,
- “brain drain”.

3. Organizational risks

- loss of control over the most important organizational functions,
- loss of control over preparation, development and realization of planned projects,
- complete dependence on external contractor,
- collusive tendering and other tendering problems.

4. Costs

- loss of control over increasing costs,
- hidden costs,
- unexpected costs.

The continuation of this paper will present up to date literature and research concerning the outsourcing phenomenon, which have been trying to resolve the

problems addressed above and facilitate more objective and comprehensive decision making in this field of public sector.

2.1 Overview of the literature and recent research

The first systematic and scientific research of outsourcing can be found in the late 80's and early 90's of the last century (Ford and Farmer 1986; Due, 1992; Willcocks and Lacity, 1995 etc.). Thorough scientific studies of the impact and importance of outsourcing are still rare. Authors are most often focusing on a rather narrow perspective, usually costs and other particularly financial benefits, but do not provide sufficiently comprehensive answers regarding the advantages and disadvantages of outsourcing strategy. Experts in this area (Corbett, 2004; Jensen, 2007) claim that the phenomenon of outsourcing gained so much importance over the last twenty years due to global social change and transformation as well as the booming public sectors worldwide.

Previous research of outsourcing (Quinn and Hilmer, 1994; Johnson, 1997; Lonsdale and Cox, 1997; Wasner, 1999; Jacobides, 2005) is largely exploring the financial implications of outsourcing and mainly presents parent organizations dissatisfaction with the ongoing projects which are often terminated before expected (Kavcic and Tavcar, 2008). Despite the growing interest in the phenomenon of outsourcing, which have recently raised increasing attention among researchers in the most propulsive economies over the past few years, namely the authors in India (Pandey and Bansal, 2003) and China (Choy et al., 2005), it is difficult to trace a comprehensive strategy for preventing or resolving problems of outsourcing projects. Studies (Thoms, 2004; Schniederjans et al., 2005; Taylor, 2006) often reveal the hidden costs as the most problematic segment of outsourcing, in which problems usually occur when organizations are already heavily involved in the outsourcing projects and the termination of contract in that phase would inflict large financial losses for both sides. Surprisingly, research is rarely dealing with the other negative consequences that may pose a potential threat.

On the other hand, outsourcing literature (Barney 1991; Peteraf, 1993; Nellore and Soderquist, 2000) deals with separate aspects of the parent organization and the external contractor and rarely addresses the outsourcing projects in an integrated manner in which attention is focused to the whole project, rather than individual business entities within the project (Kavcic and Tavcar, 2008). Here it should be noted that the substantive and formal criteria presented by the most

literature, which should form the basis for quality decision making in the process of selection and implementation of outsourcing projects, are extremely vague and arbitrary and consequently prevent organizations to adopt comprehensive and objective evaluation of such projects. Previous research (Kern et al., 2002; Linder, 2004; Power et al., 2006) is mainly focused on a small number of criteria, which consider only short-term and partial aspects of business cooperation and do not address long-term, strategic implications of outsourcing projects.

In analyzing the suitability and viability of outsourcing strategy, multidisciplinary method which includes structured and balanced approach in addressing the overall problem, is essential. The presented empirical study used the Balanced Scorecard (Balanced scorecard, Kaplan and Norton, 2001) to achieve conceptual and long-term solutions. Balanced Scorecard facilitates analysis of dynamic criteria and quantifies the important strategic elements of organization. The method used will help generate effective long-term strategy and align organizational goals with four perspectives: Financial, Customer, Internal Business Processes and Learning and Growth.

3 RESEARCH OF OUTSOURCING PROJECTS AT THE MUNICIPAL LEVEL

The survey was conducted during the first six months of 2010 at the Institute for Informatization of Administration at the Faculty of Administration (University of Ljubljana), in a sample of 85 municipalities (212 municipalities in Slovenia, which means that the sample covered 40.09% of all municipalities). 64 municipalities responded to the survey (75.3% response rate of the sample, which means that the realized sample amounted 30.18% of the total number of municipalities in Slovenia). The questionnaire consisted of qualitative and quantitative indicators, adjusted for objective and comprehensive ex ante evaluation of the outsourcing projects in public sector organizations.

The purpose of the research is thorough and comprehensive analysis of the situation in the field of outsourcing at the municipal level in Slovenia, with special emphasis on the analysis of organizational factors within the Balanced Scorecard. Methodology within the survey focuses particularly on the financial, organizational, developmental and human resources perspective. The findings obtained will enable the development of concrete guidelines and recommendations for an integrated outsourcing strategy and the development of a

comprehensive model for outsourcing of IT-projects in the Slovenian municipalities.

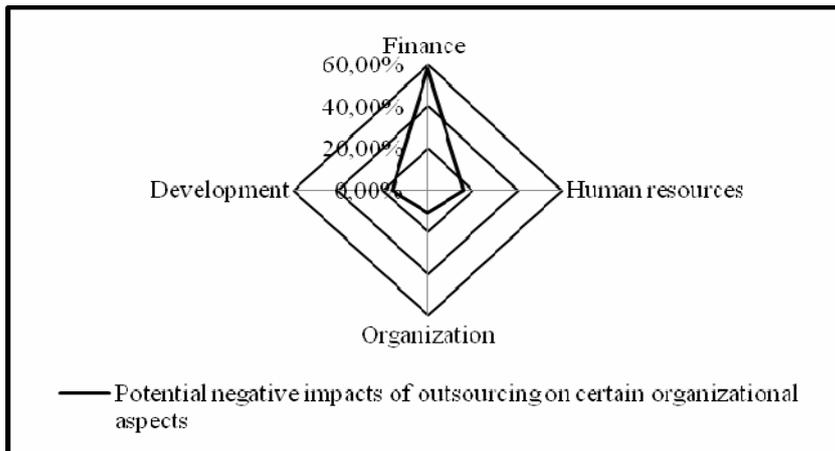
3.1 Results of empirical research and their synthesis

The results of empirical study presented below provide answers to second and third research questions. Paper focuses on a comprehensive and systematic classification of the results and in-depth content analysis.

The survey results, which are directly related to the second research question showed that as many as 51 (80%) surveyed municipalities believe that outsourcing cannot negatively affect the organization and its human resources. The study has also revealed that 64% of the surveyed municipalities are not familiar with the long-term impacts of outsourcing which are directly linked to loss of competencies, quality human resources and staffing problems, and are consequently unaware of potential risks which they are exposed to, when signing an outsourcing contract. Furthermore, the results showed that 37 (57.82%) municipalities believe that the financial sector is most exposed to potential negative impacts of outsourcing in the long run, 10 (15.63%) municipalities believe that human resources and development are compromised because of outsourcing, while 7 (10.92%) municipalities believe that outsourcing poses the biggest threat to the organizational aspect of municipalities (Figure 1).

The latter results directly reveal the need for better strategies, more responsible decision making and in particular, a better understanding of this complex phenomenon, whose negative consequences, especially in the long run, affect almost all aspects of organizational performance.

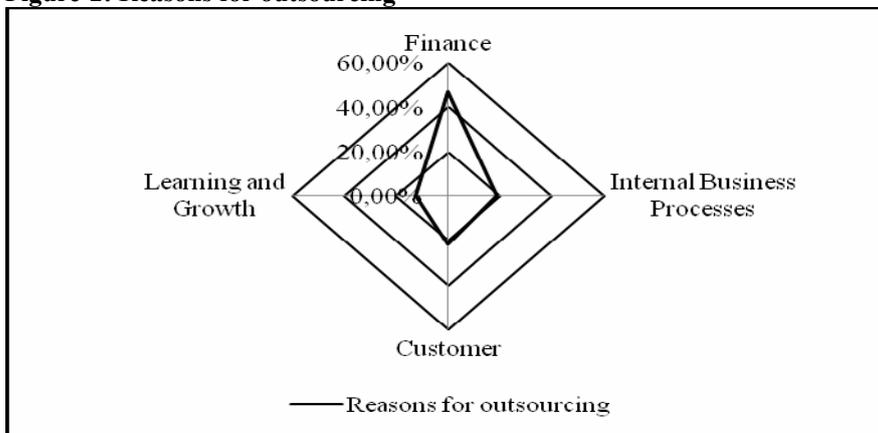
Figure-1: Potential negative impacts of outsourcing on certain organizational aspects



Source: Vintar and Stanimirovic: 2010.

Concerning the third research question, results revealed that the municipalities do not use formal methods including evaluation frameworks and indicators in the process of decision making on outsourcing projects, thereafter, it was confirmed that their decisions to outsource are based primarily on short-term financial benefits. The latter was confirmed, while as many as 46.90% of municipalities surveyed, identified financial reasons as the main argument for the selection of external providers (Figure 2).

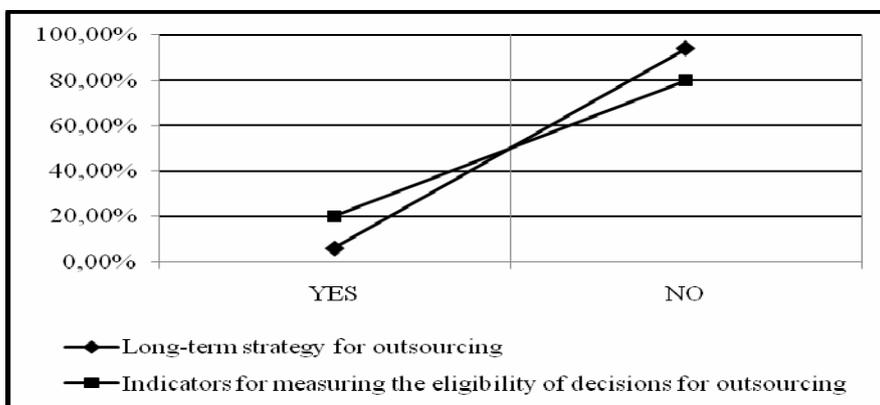
Figure-2: Reasons for outsourcing



Source: Vintar and Stanimirovic: 2010.

The survey also revealed that 60 (94%) municipalities do not have comprehensive long-term strategy in the field of outsourcing (Figure 3). In addition, research showed the vast majority of surveyed municipalities (80%) have no actual evaluation framework, including objective criteria or a system of indicators to measure the eligibility of outsourcing decisions (Figure 3). The latter results indicate that the municipalities' decisions on outsourcing are mainly based on intuition and the inertia of previous years, rather than pre-established objective criteria and measurable indicators. This kind of decision making allows a multitude of speculation. The issue requires a sustainable and comprehensive solution, which is not possible without considering modern concepts of management in public sector organizations and professional attitude of the management.

Figure-3: Long term strategy and indicators for outsourcing



Source: Vintar and Stanimirovic: 2010.

3.2 Guidelines on conducting outsourcing projects in the public sector

In surveyed municipalities following problem areas can be identified and highlighted:

- Non-defined core and non-core activities in municipalities.
- The excessive and indiscriminate outsourcing and lack of strategy in the field of outsourcing.
- Unawareness of the potential long-term negative implications of outsourcing projects.

- Utilization of human and other resources and the synergies within the public sector organizations.
- Lack of vision and strategic objectives of organizations within the public sector, exceeding a period of government mandate.

Unfortunately, research results cannot always be easily transferred into action, especially when the poor performance of the organization is related to several areas. Such situation requires a detailed analysis and preparation of solutions, which often necessitate a radical systemic change in the organization.

Bellow will be presented guidelines that could bring improvement to the areas of particular concern and risk, which were disclosed by the results of the survey:

- Definition of core and non-core activities in the functioning of municipalities.
- Formulation of outsourcing strategy, creation of formal multi criteria decision-support making models and indicators for decision making in outsourcing processes.
- Assessment of the potential long-term negative implications of outsourcing projects.
- Utilize human and other resources as well as hidden potential and synergy within numerous public sector organizations.
- Formulate a vision, strategic objectives, and precise tactics as well as provide funds for achieving long-term organizational goals, beyond a period of government mandate.

4 CONCLUSION

The obtained results of the survey indicate a partial, but a valuable insight into the outsourcing of IT-projects in the Slovenian public sector. Partial, because the survey sample covered 85 municipalities of the 212 municipalities in Slovenia, this is 40.09% of the total population. 64 municipalities responded to the survey, which represents 30.18% in terms of the total population. Relatively small sample precludes generalization and prevents application of the obtained results to the entire public sector, but is nevertheless a good indication of the particular problems faced by municipalities and, consequently, the entire public sector.

Even more, the objective and critical approach to the selection and evaluation of outsourcing projects and its impacts should, regarding the context and magnitude of given problems, receive greater support from all stakeholders and become a

necessity. Current practice in this area is based on inertia, intuitive decisions and primarily on the fabrication of studies evaluating such decisions much unilaterally and without regard to long-term effects of outsourcing strategies in public sector organizations.

The scale of the studied area and numerous factors that affect the quality of decision making confirm the multiplicity and complexity of outsourcing and its wide range of implications in many areas of organizational activity. The latter substantiates the need for broader and deeper insight into the background and content of overall business strategy of Slovenian municipalities. Search of primarily short-term solutions and inadequate business strategy as well as uncritical approaches in recent years have brought municipalities in a very complex situation, so it is high time for more critical reflection on their role in the future and mechanisms that will have to ensure selection of appropriate business strategies, effective spending of budget funds and the successful achievement of long-term goals.

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