Association for Information Systems
AIS Electronic Library (AISeL)

AMCIS 2005 Proceedings

Americas Conference on Information Systems (AMCIS)

2005

Exploring the Downside of IT Outsourcing: Outsourcing Tactics, Layoffs, and Organizational Outcomes

Christina N. Outlay
University of Illinois at Chicago, coutla2@uic.edu

C Ranganathan
University of Illinois at Chicago, ranga@uic.edu

Follow this and additional works at: http://aisel.aisnet.org/amcis2005

Exploring the Downside of IT Outsourcing: Outsourcing Tactics, Layoffs, and Organizational Outcomes

Christina N. Outlay
University of Illinois at Chicago
coutla2@uic.edu

C Ranganathan
University of Illinois at Chicago
ranga@uic.edu

ABSTRACT

The beginning of the new millennium has been characterized by increased outsourcing and off-shoring of IT work. One outcome of this spurge has been massive layoffs of IT workers, with different companies following different approaches to downsizing IT workers. There is very limited empirical research examining layoff approaches accompanying IT outsourcing decisions and resultant organizational outcomes. Addressing this gap, this research study seeks to: (i) understand downsizing approaches accompanying IT outsourcing efforts and propose a conceptual typology for IT personnel layoffs, (ii) identify key factors that determine a firm's choice of layoff approach while carrying out their IT outsourcing initiatives and, (iii) examine the organizational outcomes that result from IT outsourcing and accompanied IT personnel layoffs. We discuss our conceptual model linking outsourcing, layoff approaches and organizational outcomes and present details of our on-going research project.

Keywords

IT outsourcing, off-shoring, downsizing, layoffs, IT personnel, IT human resource management.

INTRODUCTION

Information Technology (IT) outsourcing has become an issue of great importance in academic and business circles, especially after the economic downswing in 2001 and subsequent recovery. Though the practice of IT outsourcing started in late 1980s, the nature and complexity of this phenomenon has changed since its inception, affecting both core and peripheral IT operations and even the entire IT function. With several US companies trying to engage offshore technology vendors to take care of their IT operations, IT outsourcing has evolved into a truly global phenomenon (Clott, 2004; Currie, 2000).

The surge in IT outsourcing has triggered a volley of academic as well as practitioner articles on this topic and has included research on potential benefits of global IT outsourcing (eg: Carmel and Agarwal, 2002; Kaiser and Hawk, 2004), prescriptions and frameworks to guide IT managers in IT outsourcing initiatives (eg: Rottman and Lacity, 2004), and financial performance following outsourcing decisions (Gilley, 2000). Most of the extant research on IT outsourcing has focused on the positive outcomes, largely ignoring the potential negative fallouts. In recent times, IT outsourcing and off-shoring has become a matter of intense public debate and great concern in the United States, especially in light of the large job losses experienced by IT workers. While there is recognition that outsourcing has led to significant number of IT worker layoffs (Pfannenstein and Tsai, 2004), limited empirical research has been undertaken to examine the nexus between outsourcing, layoffs and the resultant organizational outcomes. Our paper seeks to address this important and critical gap.

IT OUTSOURCING AND LAYOFFS

Downsizing is a direct consequence of IT outsourcing efforts in many organizations, aligned with a cost-cutting rationale behind several IT outsourcing efforts (Earl, 1996). Organizations tend to follow different kinds of downsizing approaches while carrying out their IT outsourcing efforts. Some firms eliminate the IT employees, and some others turn them over to the IT vendor for re-employment (Slaughter and Ang, 1996). It is not clear if there are differential outcomes associated with these different downsizing approaches. While layoffs resulting from outsourcing could directly translate into short-term cost savings, it could also negatively impair employee morale and motivation (Barthelemy, 2003). Addressing these uncertainties and limitations in our extant knowledge, our research study has the following objectives:

(i)   To understand the downsizing approaches accompanying IT outsourcing efforts and propose a conceptual typology for IT personnel layoffs.

(ii)   To identify the key factors that determine a firm's choice of layoff approach while carrying out their IT outsourcing initiatives.

(iii)   To examine the organizational outcomes that result from IT outsourcing and accompanied IT personnel layoffs.

We empirically investigate how IT layoffs occur as an outcome of outsourcing decisions. This research differentiates from previous research in three ways. First, there are no published studies to date that investigate the direct impact of outsourcing decisions on IT worker layoffs – although previous studies have examined disadvantages of outsourcing, including social impacts on remaining employees (Barthelemy, 2003; Clott, 2004), very few studies have looked directly at the circumstances and impact of the actual downsizing decision. Second, we integrate downsizing literature and IT outsourcing literature to provide an integrated understanding. Prior research on downsizing has not explicitly focused on IT workers and extant literature on IT outsourcing has not addressed the issue of layoffs surrounding IT outsourcing. Third, we examine the organizational outcomes that are produced both by outsourcing decisions and accompanied layoffs. In this vein, we consider IT worker layoffs following outsourcing decisions as a moderating factor.

CONCEPTUALIZING LAYOFF APPROACHES FOLLOWING IT OUTSOURCING DECISIONS

Downsizing researchers have proposed different typologies for layoffs. Freeman and Cameron (1993) distinguish between convergence and re-orientation approaches to downsizing. Convergence represents incremental approach where downsizing drives redesign. In contrast, reorientation is a discontinuous process where redesign drives downsizing. Dewitt (1998) proposed a three-way classification – retrenchment, downscaling and downscoping. Retrenchment tactics focus on maintaining a firm's current scope while increasing output efficiency through measures such as process re-engineering, consolidation and realignment of organizational roles, and alteration or reduction of supplier relationships. Here, a firm might choose to replace or reallocate its employees to other units rather than completely laying them off. Downscaling represents permanent cuts in human and physical assets of the organization. Under this approach, the employees are completely de-linked from the firm after the layoff decision. The third approach, downscoping, differs from downscaling and retrenchment by reducing the firm's current scope, but incorporates elements of both through permanent reduction of human and physical resources combined with simplified organizational processes. Here, a firm reduces its resource base by pruning its product line, withdrawing from markets, or by closing selected customer accounts. In this approach, a firm might resort of partial employee or asset layoffs.

Drawing upon the aforementioned research, particularly adapting Dewitt's (1998) typology, we propose a conceptual typology for layoff approaches that accompany a firm's IT outsourcing initiatives. We propose 3 categories of layoffs following IT outsourcing initiatives, namely – *re-placement*, *dis-placement* and *out-placement*. *Out-placement* represents a complete elimination of selected personnel where the employees' relationship with an organization is terminated. The downsized employees are forced to leave the organization and seek employment outside. D*is-placement* represents reassigning the downsized employees to an external party such as the outsourced IT vendor. In many situations, the IT vendor could assign these employees to work on the client's IT projects, and the former employees become contractors to their old employer. In *re-placement* approach, the downsized IT employees are moved to other business units in the enterprise or to other functions. This approach represents re-allocation of IT human resources to other parts of the enterprise.

LINKING IT OUTSOURCING, LAYOFF APPROACHES AND ORGANIZATIONAL OUTCOMES

Our conceptual model is shown in Figure 1. This model suggests an association between key IT outsourcing variables and a firm's choice of layoff approach for its IT workers, an association between layoff approach and subsequent organizational outcomes, and a direct link between IT outsourcing factors and organizational outcomes. In subsequent sections, we explain our key constructs and provide arguments for proposed relationships.

IT Outsourcing Factors

Based on literature review, we identified two variables that we believe are likely to influence a firm's choice of layoff approach following IT outsourcing. These variables are outsourcing rationale and nature of IT project outsourced. *Outsourcing rationale* represents the fundamental reason behind an organization's IT outsourcing initiative. Empirical research and market-research reports have pointed out tactical cost reduction as one of the primary drivers of IT outsourcing decisions in organizations. However, researchers have also identified larger strategic motives. For instance, DiRomualdo and Gurbaxani (1999) analyzed over 50 outsourcing deals and proposed three strategic intents behind IT outsourcing: IS improvement, business impact, and commercial exploitation. *Nature of IT project outsourced* represents the types and importance of internal IT activities that a company turns over to an external vendor. Gilley (2000) suggested that outsourced IT projects fall into two generic categories – core vs. peripheral activities. Peripheral activities are typical routine activities performed by the company that are not considered to be integral to the firm's main business focus. Core activities are

activities deemed essential for the firm's long-term success by directly affecting a firm's fundamental production activities and that are directly related a firm's business strategy.
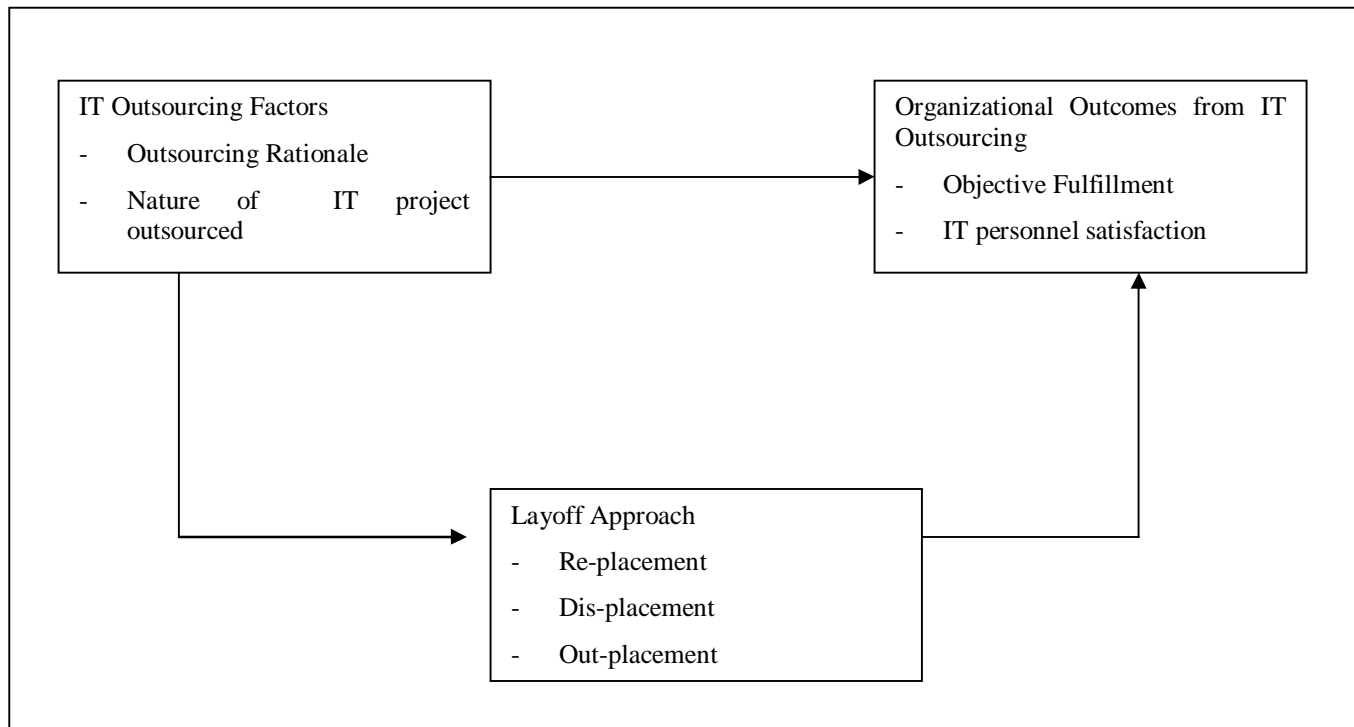

Figure 1: Conceptual Model

IT Personnel Layoff Approaches

As explained earlier, we identified three kinds of layoff approaches: displacement, replacement, and outplacement. *Displacement* occurs when company employees are transferred to the vendor company hired to perform the work, and become contractors to the firm doing the outsourcing *Replacement* occurs when company employees are released from their current roles but are offered other positions within the company, usually in another department or office location. The third, and most significant, type of layoff is *outplacement* and occurs when employees are permanently released from the company with no alternate offer of employment.

Organizational Outcomes

IT outsourcing researchers have used a number of variables to assess the outcomes of sourcing efforts. Grover, Cheon and Teng (1996) examined outsourcing success as the extent to which the outsourcing projects realized their intended objectives. Extending this work, Lee and Kim (1999) examined outsourcing outcomes from business and user's perspectives. They suggested examining both business outcomes such as attainment of objectives and the perceived levels of satisfaction by users in the organization. Building upon these studies, we propose to use two variables for assessing organizational outcomes from IT outsourcing efforts: (i) *Objective fulfillment* which assesses the intended goals of the IT outsourcing project and the extent to which these goals were attained after outsourcing, and (ii*) IT Personnel satisfaction* which assesses the extent of satisfaction among retained IT workers.

PROPOSED METHODOLOGY

Given the limited knowledgebase on this topic and the exploratory nature of our research, qualitative approach was considered most appropriate. We are in the process of gathering qualitative data through semi-structured interviews with selected organizations that have undertaken IT outsourcing efforts. We have already completed pilot interviews with seven companies in Midwestern USA. Our primary respondents for these interviews are senior IT executives and managers who directly participated in the IT outsourcing decisions. Wherever possible, we also try and interview HR managers to get an account of layoffs and how they were effected. We also gather additional data through archival sources such as company

records, documents, emails and minutes of meetings. We hope to present our detailed methodology and preliminary findings from these interviews at AMCIS 2005.

CONCLUSIONS

This paper describes an on-going research project that examines the association between IT outsourcing, layoffs accompanying these outsourcing events, and subsequent organizational outcomes. We believe this research is important and timely for several reasons. First, extant research on IT outsourcing has largely ignored the layoffs that invariably accompany large outsourcing deals. Second, the unprecedented increase in outsourcing activities and layoffs has triggered an intense debate about these issues even among common public. These issues figured prominently during the US presidential elections in 2004. Despite such public interests, this topic has not been explored adequately in academic research. Third, we hope our research will make some contributions to both theory and practice of IT outsourcing. Through a better understanding of the linkages between outsourcing, layoffs, and outcomes, managers could make more human-centered decisions while formulating their IT outsourcing strategies.

REFERENCES

1. Ang, S. and Straub, D. (1998) Production and transaction economies and IS outsourcing: a study of the U.S. banking industry, *MIS Quarterly*, 535-552.

2. Barthelemy, J. (2003) The seven deadly sins of outsourcing, *Academy of Management Executive*, 17, 2, 87-100.

3. Budros, A. (1999) A conceptual framework for analyzing why organizations downsize, *Organization Science*, 10, 1, 69-82.

4. Carmel, E., and Agarwal, R. (2002) The Maturation of Offshore Sourcing of Information Technology Work, *MIS Quarterly Executive*, 1, 2, 65-77.

5. Cascio, W.F. (1993) Downsizing: what do we know? What have we learned? *Academy of Management Executive*, 7, 1, 95-104.

6. Clott, C.B. (2004) Perspectives on global outsourcing and the changing nature of work, *Business and Society Review*, 109, 2, 153-170.

7. Currie, Wendy. (2000) The supply-side of IT outsourcing: the trend towards mergers, acquisitions and joint ventures, *International Journal of Physical Distribution and Logistics Management*, 30, 3/4, 238-254.

8. Davis, J.A., Savage, G. and Stewart, R.T. (2003) Organizational downsizing: a review of literature for planning and research, *Journal of Healthcare Management*, 48, 3, 181-201.

9. Dibbern, J., Goles, T., Hirschheim, R. and Jayatilaka, B. (2004) Information systems outsourcing: A survey and analysis of the literature, *The DATA BASE for Advances in Information Systems*, 35, 4, pp. 6-102.

10. DiRomualdo, A. and Gurbaxani, V. Strategic intent for IT outsourcing, *Sloan Management Review* (39:4), 1998, 67-80

11. Dewitt, R.L. (1998) Firm, industry, and strategy influences on choice of downsizing approach, *Strategic Management Journal*, 19, 1, 59-79.

12. De Meuse, K.P., Bergmann, T.J., Venderheiden, P.A. and Roraff, C.E. (2004) New evidence regarding organizational downsizing and a firm's financial performance: a long-term analysis, *Journal of Managerial Issues*, 16, 4, 155-177.

13. De Meuse, K.P., Vanderheiden, P.A. and Bergmann, T. (1994) Announced layoffs: their effects on corporate financial performance, *Human Resource Management*, 33, 4, 509-530.

14. Earl, M. (1996) The risks of outsourcing IS, *Sloan Management Review*, 37, 26-32.

15. Freeman, S.J. and Cameron, K.S. (1993) Organizational downsizing: a convergence and reorganization framework, *Organization Science: A Journal of the Institute of Management Sciences*, 4, 1, 10-29.

16. Gilley, K. M. and Rasheed, A. (2000) Making more by doing less: an analysis of outsourcing and its effects on firm performance, *Journal of Management*, 26, 4, 763-790.

17. Grover, V., Cheon, M. J. and Teng, J. T. C. (1996), "The Effect of Service Quality and Partnership on the Outsourcing of Information Systems Functions", Journal of Management Information Systems, Vol. 12,No. 4, 89-116

18. Kaiser, K., and Hawk, S. (2004) Evolution of Offshore Software Development: From Outsourcing to Co-Sourcing, *MIS Quarterly Executive*, 3, 2, 69-81.

19. Lacity, M.C. and Hirschheim, R. (1993). Information systems outsourcing: Myths, metaphors and realities, Chichester, England: Wiley.

20. Lacity, M., and Willcocks, L. (1998) Practices in Information Technology Outsourcing: Lessons from Experience, *MIS Quarterly*, 22, 3, 363-408.

21. Lee, J.N. and Kim, Y.G. Effect of partnership quality on IS outsourcing success: Conceptual framework and empirical validation. Journal of Management Information Systems 15, 4 (1999), 29-61

22. Pfannenstein, L.L. and Tsai, R.J. (2004) Offshore outsourcing: current and future effects on American IT industry, *Information Systems Management*, 72-80.

23. Rottman, J. and Lacity, M. (2004) Twenty Practices for Offshore Sourcing, *MIS Quarterly Executive*, 3, 3.

24. Slaughter, S. and Ang, S. (1996) Employment Outsourcing in Information Systems, *Communications of the ACM*, 39, 7, 47-54.

25. Smith, M.A., Mitra, S. and Narasimhan, S. (1998) Information systems outsourcing: a study of pre-event firm characteristics, *Journal of Management Information Systems*, 15, 2, 61-93.

26. Wayhan, V. and Werner, S. (2000) The impact of downsizing on financial performance: a longitudinal perspective, *Journal of Management*, 26, 2, 341-363.