UNIVERSITY OF NAIROBI
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THE EFFECTS OF ORGANIZATIONAL CHARACTERISTICS ON INFORMATION TECHNOLOGY (IT) OUTSOURCING DECISIONS IN NAIROBI, KENYA

BY
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DECLARATION

I, Esther Nyambura Kamenwa hereby declare that this research project is my original work and has not been presented for a degree in any other University.

Signed.....

Date.....10/11/2010.....

ESTHER N. KAMENWA

This project has been submitted for examination with my approval as University Supervisor;

Signed.....

Date.....10/11/2010.....

DR. KARATU KIEMO

DEDICATION

I dedicate my work to my dad, lovely mum, brothers and sisters, niece and baby;

To dad; Mr. Francis Kamenwa, for your financially support;

To mum; Catherine Njoki, for your unconditional love and prayers, you are my world;

To Milkah, Anne and Margaret; I wouldn't have asked for more than having you sisters by my side.

To Chege, your criticism has made me view things in a different perspective. Thank You.

To Amiani, thank you for being a big brother and your words of wisdom.

To Careena, for brightening my morning with your smile and laughter; you are a God given niece.

Finally to my baby, you may not be here yet, but you motivated me to finish this. You complete me.

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ABSTRACT

It is important to understand the factors that influence the success of IT outsourcing, since IT outsourcing touches the core of organization. This paper presents contemporary evidence of factors influencing outsourcing of IT services in organization in Nairobi, Kenya. The study focuses specifically on organizational characteristics and how they affect organizations as they outsource these services. It provides new insights on how organization's structure, culture, technology and its strategies affects IT outsourcing; how its surrounding environment influence the organization's decision to outsource and also takes into consideration how individuals' experience, knowledge, propensity to take risk, affects their decision to outsource and the kind of services to outsource. It seeks to answer the question 'why some organizations outsource IT services more aggressively than others'.

IT outsourcing has changed fundamentally since its start in the 1960's. Since IT outsourcing services evolve and expand continuously, ways to evaluate IT outsourcing success in organization need to be modified to meet these changes. For these reason, the study develops and conceptually validates a coherent and meaningful framework to measure how organizational characteristics affect the success of IT outsourcing. The conventional benefits (i.e. cost reduction, the ability to focus on core competence, improve efficiency and effectiveness, technological benefits) and risk (contractual difficulties, cultural and social problems, technical constraints) of IT outsourcing are also extensively documented in the literature.

A sample of 50 companies was randomly drawn and questionnaires administered in the various sector; manufacturing/production, financial, communication, healthcare, insurance, educational, hospitality, and NGOs Sector. Presentation and discussion of findings is based on 38 questionnaire received from the respondents. The researcher applied descriptive statistics to the data that provided an equal opportunity of selection for each element of the population and provided a powerful summary that may enable comparisons across the selected sample.

The results suggested the financial sector outsourced the most followed by hospitality sector and the less active outsourcing organizations still outsource at a lower rate and the more IT intensive like the financial sector still outsource at a high rate. The highest percentage of the respondents spends over Ksh. 500, 000 showing that majority of organization have dedicated quite a large parentage of the budget to outsourcing IT services. The findings shows outsourcing can be used to cut cost by the 50% responded agreeing a reduction on the organization's budget. The respondents are benefiting more from outsourcing than acquiring in-house. .there is a positive effect on organizational performance an indication that IT outsourcing has been successful in penetrating through organizations as it positively transform organization's business functions.

Although Kenya currently has infrastructure hurdles that stand between it and IT outsourcing activities, the study indicate that the industry in Kenya proves we have serious intentions that call for the development of training programmes that will facilitate knowledge to support IT outsourcing and formulating a guideline to regulate proliferation of IT outsourcings practices in organization in Kenya. This will ensure that organizations gain the right momentum to successfully stay in course and ensure Kenya gets a sizeable share of the go. This study serves as a fresh vantage point from which to explore new opportunities and challenges of IT outsourcing, beyond the past studies that focuses mainly on financial sectors, and on risks and benefits involved in IT outsourcing, not considering that the organizations its characteristics can be a hindrances to the success of IT outsourcing.

LIST OF ABBREVIATIONS

ASP	application service providers
BPO	Business Process Outsourcing
CRM	Customer Relationship Model
E-Outsourcing	Electronic Outsourcing
ERP	Enterprise Resource Planning
EASSy	The Eastern Africa Submarine Cable System
EVA	Economic Value Added
HR	Human Resources
I.S	Information Systems
ISO	International Organization for Standardization
I.T	Information Technology
ICT	Information and Communication Technology
MS Excel	Microsoft Excel
NGO	Non Governmental Organization
RBT	Resource-Based Theory
ROI	Return on Investments
SPSS	Statistical Package for the Social Sciences
SCM	Supply Chain Management
SLC	Service Level Contract
TCT	Transaction Cost Theory
TEAMS	The East African Marine System
VPN	Virtual Private Network

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CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The roots of IT outsourcing date back to the 1960's and 1970's, in the form of timesharing and facilities management services. Until the late 1980's, increases in IT efficiency were sought from hiring of contract programmers, the use of predefined application packages, and from specialized processing services (Tomi and Mari, 2006). IT outsourcing became highly visible, received a lot of attention, and turned into an established concept after Kodak's decision to outsource their IT functions in 1989. Since then, knowledge and experience concerning IT outsourcing have increased significantly. The focus in outsourcing has widened from technical to services management and relationship management issues. Information Technology has revolutionized the way companies conduct business and outsourcing of business processes is one of the outcomes of the technological advancement. The continuous need to improve efficiency and effectiveness in organization is one of the main driving forces for the development of IT outsourcing services.

Outsourcing has been viewed as a form of predetermined external provision with another enterprise for the delivery of goods and service that would previously have been offered in-house (Kakabadse and Kakabadse, 2000). Outsourcing is also defined as a contractual agreement between the customer and one or more suppliers to provide services or processes that the customer is currently providing internally. The two main actors of outsourcing process are the "outsourced" and the "outsourcer" (Saunders and Gebeit, 1997). The first, i.e. the customer, outsource their processes while the second, i.e. the enterprise, delivers outsourced service (the term 'supplier' 'vendor' or 'agent' are also used). The fundamental difference between outsourcing and any other purchasing agreement is that the customer contracts out a part of its existing internal activities (Fan, 2000). In particular, IT outsourcing is basically buying information technology product and services that could be furnished in-house from one or a variety of sources on the internet. For instance, an organization might hire a web hosting firm to set up and run its

web site, and front-office applications, and an outside security firm to install and maintain a firewall and a virtual private network (VPN). The meaning of IT outsourcing has evolved over time. Traditionally, IT outsourcing often focuses on the area of software development and IT operational activities while the concentration in modern IT outsourcing are on the electronic commerce (e-commerce), Customer Relationship Model (CRM) and Enterprise Resource Planning (ERP). Further, there is a shift from using in-house servers towards dedicated communication network and internet. The significant shift in mode of I.T governance was, in fact, proffered in a prognostic article by Dearden (1987), where the Information Systems organization is argued to be "withering away" as end-users gain greater control of their computing environments and, more significantly, as external software specialist take charge of corporate systems development. This reduces considerably the costs of IT services and at the same time increases its performance.

Three major developments in global market and technologies have forced organizations to focus on their core processes and brought the outsourcing of others processes to the forefront of management's attention:

1. The explosion of the internet and other telecommunication technologies has made real-time, on-line communication throughout the entire supply chain a reality. The Information technologies facilitate considerably the flow of transactions of information required.
2. Increasing customer demands in area of product and service cost, quality, delivery, technology, and cycle time. Customer demands make it difficult for organisations to deal with all aspects of manufacturing and services without outsourcing these processes. Increasingly, companies use outsourcing to gain access to competitive skills, improved service levels and increase their ability to respond to changing business needs. (Lee, 2000).
3. The emergence of supply chain management. Lambert and Cooper (2000) point out that one of the most significant paradigm shifts of modern business management has been that individual businesses no longer compete as

autonomous entities, but rather as supply chain. Managing the supply chain has become a means of improving competitiveness (Lee, 2000). Supply chain management makes it possible for organisations to outsource processes that would be too expensive for them to produce internally. As a solution for successful supply chain management, sophisticated software systems with Web interfaces are competing with Web-based application service providers (ASP) who promise to provide part or all of the SCM service for companies who rent their service.

Recent years shows that the number of outsourcing deals-and their value-have ballooned. It is imperative for organizations to stay competitive through the use of new information technology, tools and innovations (Chen and Soliman, 2002). When IT is not a core process for an organization, outsourcing IT services is a possible route to cope continuously with the growing technological transitions (Akomode, 1998). Outsourcing has emerged as one of the world's fastest growing business sectors with countries like India leading the pack by having between 5-6% global market share and generating revenues of US$ 10.9 Billion from offshore outsourcing and US$ 30 Billion from IT and total outsourcing in 2008. The success of countries such as India, China and the Philippines in outsourcing has led to many countries, including Kenya, investing substantial resources to develop their outsourcing potential (Moses Kemibaro, 2009). In Kenya, businesses that outsource IT functions are mainly the Banks, although other larger organizations with approximately 25 to 1,500 employees are opting to outsource these IT services allowing them to concentrate on their core business activities, freeing resources for other purpose (Daily Nation, 2006).

Although Kenya already has a growing outsourcing sector with over 50 registered companies operational, a boom is expected from this year. The main reason is that in June 2009, the first of three high-speed undersea fiber-optic cables will become operational in Kenya. The first to go live will be the SEACOM cable, followed by the TEAMS cable later this year and EASSy cable (Moses Kemibaro, 2009). The cables, once operational, will give Kenya significantly faster, more reliable and less expensive telecommunications connectivity to the rest of the world.

One report suggests that the Internet costs could drop by as much as 70% which means that a far larger number of Kenyans will be able to go online as it becomes much more affordable. Ultimately, all these factors will make Kenya much more competitive in offering outsourcing services in the global marketplace. The Kenyan Government has also introduced a raft of incentives to make investing in outsourcing businesses a very attractive proposition. In fact, Outsourcing is underscored in Kenya's recently unveiled Vision 2030 initiative as a key pillar and driver of social and economic improvement through job and wealth creation. Some of the key organizations that are driving the Kenya outsourcing agenda include the Kenya ICT Board, Kenya Business Processing and Contact Center Society, Export Processing Zones Authority, Communications Commission of Kenya and the Ministry of Information and Communications. In the outsourcing sector of the Kenyan economy, the largest amount of attention has been centered on call centers. Companies such as Kencall, Skyweb Evans and Ken-Tech Data are some of the better established and successful call centers in Kenya. Setting up a call center requires large financial resources, technical expertise and international business development. For these reasons, this may not be most ideal of the outsourcing opportunities. However, there are many low-cost entry points into the outsourcing sector. One of these is by leveraging online marketplaces that enable individuals and businesses alike to bid for outsourced assignments. Some of the largest online outsourcing marketplaces include eLance , RentACoder , and Guru which enable anyone from a software developer to an accountant to create their service profiles and then bid against competing bidders for assignments from practically every corner of the world.

Currently, customers increasingly expect IT outsourcing to transform IT functions into lean, dynamic groups that respond quickly to business needs and opportunities (Lacity and Willcocks, 2001) and deliver business value. Usually e-outsourcing enables a business to run faster than if it tried to deploy the same technology using in-house staff. Literature suggest that the key strategic factors that influence decisions to outsource are centered on cost reduction (Akomode, 1998; Willcocks, Fitzgerald, and Feeny, 1995).Quinn (1999) finds that a firm could outsource to the best-in-class providers with a lower costs. Despite this, Costa (2001) emphasizes that cost is not the rationale behind all

IT outsourcing. The need to focus on the core activities and technical considerations are other driving forces for IT outsourcing. Other reasons underlying I.T outsourcing include greater efficiency (that is no need for a complex IT network or a specialist IT department), economies of scale which leads to improvement in synergies achieve diversification benefits or streamline services, quality services and flexibility and lastly there is better use of people, that is, staff can concentrate on business critical and value - added operations.

Outsourcing I.T services is not without potential pitfalls; for instance, some firms are less than confident when it comes to giving e-outsource access of their sensitive data. Also, some question like, how much responsibility an e-outsourcer will accept when its service isn't sufficient and whether it can integrate its offering with a business existing infrastructure and legacy applications or not. Other negative consequences include operating risks, diminishing service level, loss of internal skills, loss of flexibility, cultural and social problems, technical constraints and contract irreversibility. To some extent the outsourcing contract could prove to be too rigid to accommodate changes. Management changes at the outsourcing company could lead to friction and at times the outsourcing company going out of business. Organizations in Kenya are no exceptions to these pitfalls and therefore have been forced to restructure their process and system so as to remain competitive and profitable.

There is nothing inherently wrong with outsourcing per se. It can be, and is, used effectively. What is important is to view outsourcing in strategic and offensive terms instead of merely as a defensive technique for trying to fix problems. Outsourcing cannot fix a strategically sick business, although it may provide a rational mechanism for a phased withdrawal from a business once a strategic exit decision has been made. Furthermore, it provides a logical alternative to conserve resources for a business that is relatively healthy, but unrelated or distant from the core technologies of the firm. Outsourcing can also be an important component of strategy in a healthy business involving the firms' core competences if proper safeguard are observed. Outsourcing is an important part of overall strategy to treat sourcing decisions strategically, it is necessary to ensure a true strategic review of any outsourcing decision.

Treating outsourcing decisions strategically most fundamentally implies an in-depth understanding of the core competences on which the firm intends to build its future competitive advantage. Outsourcing should generally focus on areas far removed from core competences. As outsourcing decisions become closer to the core competences, the strategic risk increases. The impact of outsourcing decisions on continued skill and competence accumulation must be assessed. This impact must then be weighed against the potential financial savings from outsourcing.

1.1.1 The concept of strategic alignment outsourcing

Strategy is concerned with the long term direction and scope of an organization. It is crucially concerned with how the organization positions itself with regards to the environment and in particular to its competitors. It is concerned with establishing competitive advantage, ideally sustainable overtime, not by technical maneuvering, but by taking an overall long-term perspective (Faulkner and Johnson, 1992). Strategic alignment and benefit management are implicated to have a positive effect on the success of IT outsourcing. Strategic alignment is supposed to bring mutual understanding between the IT function and the business. Henderson and Venkatraman (1993) describe strategic alignment as a process of continuous adoption of change. On the other hand, benefit management is 'the process of organizing and managing such that potential benefits arising from the use of IT are actually realized' (Ward & Peppard, 2002). Benefits management provides a mindset in which it is clear that it is impossible to simply purchase the path to success.

IT is evolving from its traditional administrative role to a more strategic role in the organization. IT is important for delivering the organization's strategy; this can be done through strategic alignment: applying Information Technology (IT) in an appropriate and timely way, in harmony with business strategies, goals and needs, (Luftman, .J, 2000). The problems and benefits have to be faced now from the strategic viewpoints, emphasizing risks and advantages, which can arise from the practice of outsourcing, and highlighting the importance of contract management (Clover, 2000; Graham, 1993; Lonsdale, 1999; Udo, 2000; Zhu et al., 2001).

There is also need for an integrated model to manage the implementation of an outsourcing process from the 'outsourcing' point of view, aimed at organizing all the elements that could have impact on strategic decisions, economic factors, organization and Human resources a model that should be easily adapted to specific application fields, starting from a benchmarking procedure to evaluate the best practice (Yasin, 2002). Management needs to understand the architectural choices in IT as well as the way by which IT managers understand where and how IT can make a difference in the business (Joost & Ton, 2007); this known as functional integration. To effectively manage the organization strategic fit, functional integration and cross-domain alignments are essential (Henderson & Venkatraman, (1993). Although strategic alignment is usually the terrain of intra-organizational management, IT outsourcing alters this (Joost & Ton, 2007). Joost and Ton argues that, it intrinsically introduces third-party managers and employees of a service provider, making relations inter-organizational. The distance and larger number of people involved require better and more structured management.

According to Joost and Ton (2007), the IT strategy of the service recipient should fit with the modes of operation (Information Technology) of the service provider. The service recipient is forced to consider the external implications for its IT strategy in IT outsourcing, especially regarding what a service provider will be able to deliver. The service provider on its part requires in-depth knowledge of the business of the service recipient and of the Information System architecture of the service recipient in order to ensure a proper functional integration. The strategic outsourcing literature points out that the outsourcing of goods and services should be integral to an organization's overall strategy formulation process (Domberger, 1996; and Hilmer and Quinn, 1994; Di Romualdo and Gurbaxani, 1998; Quinn, 1999; Venkatraman, 1997). The organization needs to determine the scope of its internal activities by reference to its objectives, in contrast to resorting to outsourcing when there is a pressing need to apply cost disciplines or find ways around difficult industrial relation disputes. As IT outsourcing becomes a more pervasive organizational phenomenon, the multitude of driving and constraining forces should be understood in a larger organizational context.

More specifically, it could be asked: Why do some organizations spend a greater portion of that IT budget on IT outsourcing while others rely mostly on their internal development or insourcing? This study makes several contributions to the growing literature of IT outsourcing, the body of which has been of enduring concern to many IS researcher and practitioner and a new insight is provided with respect to the determinants of IT outsourcing. Extracting from multiple stream of research, it present an integrated framework by which the sourcing conundrum can be explained in light of larger organizational context that goes beyond the organization's financial situation.

1.2 Problem Statement

The main purpose of this study was to shed some light on the factors affecting organizations in the decision to outsource or not, in conjunction with the broader organizational factors that may influence a firm's propensity to outsource IT services. These factors are examined in three dimension; individual characteristics, environment and the organization itself. This perspective is required to derive both the internal and external factors affecting IT outsourcing in organizations in a more comprehensive manner.

Despite the ongoing debate over its business benefits and risks, IT outsourcing has become a widespread organizational practice, and has witnessed brisk growth in the recent years (Ang and Straub, 1998). It first became highly visible, received a lot of attention, and turned into an established concept after Kodak's decision to outsource their IT functions in 1989. IT gets increasingly sophisticated and organizations need to rely on outside expertise that is more capable in keeping up with the leading edge technologies. This movement comes with inherent risks that the firm might, experience, together with the agent, providing the services. As organizations searched for ways to grow and maintain their competitive edge, outsourcing emerged as a dominant organizational strategy for achieving those goals. In outsourcing, firms' orientation toward internal action gives way to greater dependence on external service providers (Kanter 1989, Quinn 1992). Unlike the old model of organization characterized by hierarchical ownership and avoidance of external dependence, new models of organizations are characterized by networks of lateral and vertical interlinkages across firms (Nohria and

Eccles 1992). Outsourcing thus epitomizes a more open and networked form of organizing organizational resources. One central value chain activity that companies have outsourced is the information services function (Quinn 1992). In Kenya, there is significant rise in outsourcing of IT services in organizations. Chanzu (2002) asserts that all the manufacturing industries in Nairobi that were surveyed outsourced various activities. This was most prevalent in department like human resources, finance and Information Technology (I.T). Surprisingly, in a survey done by the Central Bank of Kenya, a number of financial institutions have no risk management framework, (Central Bank of Kenya, 2005). One interesting and disturbing finding is the large number of financial institutions (nearly 50%) involved in outsourcing of certain I.T functions, in an environment without a regulatory framework. Currently, there exists no regulatory guideline on I.T outsourcing. This calls for urgent measures to institute a regulatory framework in place in the form of an outsourcing guideline to the organizations.

Over the past several years, the literature on outsourcing has tapped into a variety of issues, including the performance impact of IT outsourcing (Loh and Venkatraman, 1992), transactional risks inherent to outsourcing arrangement (Lacity and Willcocks, 1998), the relationship between clients and vendors (Kern and Willcocks, 1997), and the determinant of IT outsourcing (Smith et al., 1998). However, little is known about the larger organizational factors that influence a firm's propensity to outsource IT resources for their given IT budget. Therefore this study aims at filling this gap so that these driving and constraining factors are identified in an organizational context. As IT outsourcing in Kenya gain more popularity, it is important to know why other firms outsource IT more aggressively than others and the organizational characteristics that influence the organizational decision to outsource or not. Outsourcing IT is about value addition and client benefit from added support service availed by the technical team, while the agent benefit from providing the services and the charging cost that comes along with the services. With a clear understanding of all these aspects of IT outsourcing, both parties are able to exploit the opportunity, increasing the rate or extent at which IT outsourcing will be adopted.

1.3 General objective

The purpose of this study is to examine the organizational characteristics affecting the success of IT outsourcing services in the Nairobi, Kenya.

1.3.1 Specific Objectives

The specific objective of this study is;

i. To examine the effect of IT outsourcing on the overall organization's budget.

ii. To identify effect of IT outsourcing on organizational profitability.

iii. To establish organizational strategies affecting IT outsourcing decisions.

iv. To examine Agency constraints associated with IT outsourcing practices.

1.4 Significance of the Study

This study will be of critical importance in providing a clearer and a deeper understanding on how organizations could take advantage of the organizational characteristics to successfully outsource IT services and allow focus on cost-cutting measures in the organization. It will enable the agents to assess their competitive advantages and business opportunity to explore and also help the government make favorable IT policy decision, which would further deepen the adoption of IT outsourcing in the market, especially the future market. Finally, the findings of the study will be a source of secondary data for future researcher in the area of outsourcing of IT functions.

1.5 Scope

The research study was focused on surveying organizations in Nairobi only; as this is where most of the IT services is outsourced by majority of organizations, and where most of the organizations' headquarters are located. The scope of this study attempts to address issues involved with organizational characteristics affecting the propensity to outsource IT services. It addresses organizational characteristics such as individuals attributes; organizational structure, strategies, culture and technology. It addresses issues such as cost reduction, increased productivity, increased customer satisfaction, access to better services, availability of financial resources and expertise, governmental influence,

company focus. The study provides exploratory findings in the Kenyan context, and presents opportunities for further research.

1.6 Limitations

The use of questionnaire to gather relevant information on the perceived benefits and risks on outsourcing must be noted. The richness and depth of this research can be enhanced by use of interviews and observations. In addition, a pragmatic review and analysis could have benefited more by use of internal organizations' documents like board minutes, policies and procedures which could have provided more insight into the operations and strategic thinking of the management.

The study is limited to the extent that it focuses on only organizations that outsource IT services and on a specific location, which is Nairobi, Kenya. This can be overcome by future study on sample number of different organization in different geographical location in Kenya and also organizations that do not outsource to answer the question 'why they prefer in-house to outsourcing'. This will generate more accurate results.

Confidentiality of information may limit the information availed by the responded in aim to protect the firm's corporate image. Competitors are always on the lookout and because of this, the bank has to be secretive therefore limiting the kind and amount of information they avail to researchers. The researcher will officially hand in a written letter to indicate the purpose of the research and guarantee to use the information only for educational purposes. Interviews will be conducted in cases where confidentiality is threatened to enhance the level of trust between the researcher and the respondent.

1.7 Definition of terms

Profitability

Organizations outsource certain activities to concentrate on the core function of the organizations' business. Quinn et al (1990) emphasized the benefits of outsourcing in providing increased focus upon a set of core activities and reduction in the functional scope of the organization, enabling the development of a more focused organization

capable of increased responsiveness to market change. This is attributed to profitability of an organization.

Firm Uncertainty

Firm uncertainty, measured by the degree of volatility in individual stock returns, indicates the degree of risk induced by a firm's inability in maintaining future cash flows. Generally, there are two types of firm risk; systematic and unsystematic. Systematic risk is concerned with general economic conditions such as interest rates and inflation, whereas unsystematic risk is derived from firm-specific internal operations such as managerial policies and investment decisions (Lev, 1975).

Agency Risk

Agency theory literature suggests that a conflicting interest exist between shareholders and management with respect to the amount of free cash flow (FCF) discretionarily available to managers (Jensen, 1986). FCF has been wildly used in finance and strategy to substantiate the agency cost between shareholders and management. The free cash flow asserts that to increase the bargaining power against shareholders, managers tend to allocate more resources under their control, and limit dividend payments to shareholders (Wonseok, 2005). Therefore, if managers withhold a substantial amount of free cash without distributing it to investors via dividends or by investing it in other value-creating project, the agency costs increases severely.

Cost Reduction

One of the key motivations for outsourcing IT activities is to save on cost reduction associated with outsourcing. Literature suggest that the key strategic factors that influence decision to outsource are centered on cost reduction [Akomode, (1998); Willcocks, Fitzgerald and Fenny, (1995)]. In this regards, cost reduction involves best use of organization's resources in creating, refining and pursuing organizational objectives.

IT intensity

Some organizations aggressively pursue an IT strategy and spend more on IT than others. IT intensity is the optimal level of IT investment that yields maximum economic returns (Wonseok, 2005), it is a proportion of IT budget allocated to IT outsourcing. A firm's IT intensity may influence the degree to which it outsources IT. Intuitively, firms that spend relatively more on IT accumulate a greater amount of IT capital and labor, which, in turn, promotes an internal development. More importantly, firms with high IT intensity may more readily recognize the strategic value of IT, leverage it to gain and sustain competitive advantage (Barney, 1991). IT intensity indicates a percentage of IT spending standardized by firm revenue.

Firm Size

Size of an organization portends a number of attributes such as business complexities and geographical dispersion. The firm size is measured as total assets of an organization (Dulacha and Peter, 2008). It is a significant determinant of outsourcings decisions. Large companies may be better placed to mange risks associated with information technological advances (Palvia and Chervany, 1995) compared to small companies.

CHAPTER TWO

LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1Introduction

While there a number of empirical research studies on outsourcing practices [Lob and Venkatraman (1992); Teng, Cheon and Grover (1995)], there is no published research in Kenya taking into consideration organizational effects on IT outsourcing. This section documents findings of relevant research papers, summaries the theoretical framework, and specifies the research questions. It conceptualizes the overall aim of the study, clearly showing the variables under consideration in a conceptual framework.

2.2Determinant of It Outsourcing Decision

Grover et al (1996) defined the success of IT outsourcing as an overall organizational advantage gained from an outsourcing strategy. The continuous need to improve efficiency and effectiveness in organizations is one of the main driving forces for the development of IT outsourcing services. Although many outsourcing transactions have fallen short of set goals, IT outsourcing services as a whole have developed into a major and continuously growing IT services business. Tomi and Mari (2006) argue that over the years, these services have matured and the breadth and depth of IT outsourcing transactions have increased. Today, an organization may selectively outsource specific IT services, the organizations entire IT infrastructure, and/or even network management to project work, website development and data warehousing. One may also benefit from the latest technology and software upgrades without having to invest in expensive systems or keep up with industry trends.

Researchers have examined the determinant of IT outsourcing decision from different theoretical and empirical orientation. Loh and Venkatraman (1992) find that an outsourcing decision is positively dependent on both business and IT cost structure, but positively associated with a firm's IT performance. However, none of the other variables inherent to their model; such as business performance, financial leverage, business size and industry, such were found to have a significant association with outsourcing expenditure. Nam, Rajagopalan, Rao and Chaudhury (1996) shows that asset specificity,

tacit IT knowledge and decision analysis effort have a significant strategic impact on a firm's differentiation effort, but these variables do not appear to affect cost reduction effort. They also identify four types of outsourcing relationships (i.e. reliance, alliance, support and alignment) based on two criteria, namely, strategic impact of IS application and the extent of substitution by vendors. This classification scheme was used to predict the possibility that a client will continue a relationship with the same vendor. Their results indicate that an outsourcing relationship is likely to be sustained when either the strategic impact of outsourced resources or extent of substitution by vendors is high. Interestingly, however the relationship is likely to be terminated when both criteria are simultaneously high.

Ang and Straub (1998) examine the economic determinant of IT outsourcing. They find that production cost advantage, transaction cost and firm size are significantly associated with the degree of IS outsourcing, which was perceptually measured by a survey instrument. Contrary to their expectation, the degree of financial slack resource was not found to have a significant bearing on an outsourcing decision. Smith, Mitra and Narasimhan (1998) explore the specific financial characteristics of the firms that enter in large-scale IT outsourcing arrangements. They test empirically the general motives of IT outsourcing as identified in the literature, including cost reduction, cash generation, profitability, organization focus on core competencies and access to technical expertise. Among these potential motivators, only cost reduction and cash generation were found to be main divers in the IT outsourcing phenomenon.

The focus in outsourcing has widened from technical to service management and relationship management issues. Grover et al (1996) summarized the main differences in outsourcing between the 1970s and 1990s. He argues that in the 1990s larger companies became outsourcers and the sizes of outsourced services were bigger and their depth deeper. Organization began to gradually outsource their entire functions. The service providers accepted management responsibility and risks and the nature of the relationship between the service provider and the outsourcer had changed towards a partnership. Since the 1990s organizations have started to use simple outsourcing service providers

instead of a single/main vendor, they change vendors more easily and often and reserve more right to discontinue contracts. The markets of some outsourcing services have become much matured and the overall professionalism of outsourcers and vendors has increased.

2.3 Why Outsourcing IT services

At war with the bottom line and seeking higher Return of Investment (ROI) yet recognizing the need to hit the ground running when business turn new corners in the market place, shrewd executives turn to outsourcing as the most effective, time-tested strategy for achieving their objectives (Gottorna, 1978). Peters and Waterman (1982) argues that excellent companies remained close to the knitting, focusing on their core businesses and outsourcing what was regarded non-core. While the concept of outsourcing is not new, it has been an important precursor to some of the new structures that have been developed.

In the article by Grover et al (1996), success was measured by the strategic, economic and technological benefits obtained through outsourcing. Strategic benefits were defined as the ability of a firm to focus on its core business and outsource routine IT activities, so that the organization can focus on strategic uses of IT, and enhance IT competence and expertise through contractual arrangements with an outsourcer. Economic benefits were defined as the ability of a firm to utilize the expertise and economics of scale in human and technological resources of the service provider, and to manage its cost structure through unambiguous contractual arrangements. Technological benefits were defined as the ability of a firm to gain access to leading-edge IT and to avoid the risk of technological obsolescence. The benefits of IT outsourcing have to match the organization and the service-specific objectives of outsourcing transactions, if the achievement of objectives fails, also outsourcing fails. Misra (2004) suggests that success means that both the outsourcer and vendor achieve their objectives.

2.3.1 Strategic Benefits

Quinn and Hilmer (1994) suggest that unless IT is a core-competence offering long-term competitive advantage, it could be outsourced. Yet, the outsourced IT must be flexible to support the strategy of the organization, for example, allow rapid market entry of new innovations and support changes in business processes. Tomi and Mari (2006), define the strategic benefit factor of IT outsourcing as "An organizations ability to continuously leverage and manage IT resources (internal and external), and to fit resources to achievement of competitive advantage".

Management has a central role in fitting human and technological resources into the activities of an organization with the objective of achieving the best possible outcome (Porter, 1996). The outsourcers' biggest disappointment would probably be in the perceived disability of outsourcing vendors to propose new "innovations" and/or to present better ways to work, as compared to the outsourcer's current practices, (Tomi and Mari, 2006). Reduction of IT personnel would be a good reason to outsource. This relates to other strategic objectives such as focusing on core-business, or improving the control of resource usage. From strategic and senior executive perspectives, higher valuation of a company can be one of the reasons to outsource IT, (Tomi and Mari, 2006).

2.3.2 Technological Benefits

Grover et al (1996) measure technological benefit by improved access to new technology and reduced risks of technological obsolescence. Yet, an organization may not want to use new technology, but could be satisfied with current and/or prudently tested technology, and define the required technical skills accordingly. Tomi and Mari (2006) define the technological benefit factor of IT outsourcing as "An organization's ability to access required key Information Technology components and skills".

The training, development, maintenance and follow-up of an individual's IT skills with the objective of establishing a harmonic and flexible bet of necessary skills requires a lot of coordination and organizing activities from an organization. "To establish a standardized IT environment" emerged clearly as a technical reason for outsourcing (Tomi and Mari, 2006). By outsourcing organizations need to standardized their

technology and/or applications, cut down vendor specific and/or bespoke IT (Software Development) processes.

2.3.3 Economic Benefits

Grover et al (1996) consider the utilization of expertise an economic' benefit item, the other economic item is cost structure control. The economic value added (EVA) is commonly used as the measure of value created by an organization. EVA is defined as the after-tax cash flow generated by a business minus the cost of the capital deployed to generate that cash flow, (Keen and Knapp, 1995). EVA can be improved with increased profitability, lower costs, or more effective use of capital. As companies are evaluated (by capital markets) on the basis of these three EVA factors, the outsourcing of IT should also increase EVA. Economic benefits of IT outsourcing can be reaped by decreasing IT costs, by releasing fixed capital from IT, and/or by increasing profitability through IT ousourcing, (Tomi and Mari, 2006).

Tomi and Mari (2006) define Economic Benefit factor of IT sourcing as "An organization's ability to increase its value by increased profits, decreased costs, and/or accelerated capital flow". By IT outsourcing, organizations seem to seek solutions to imminent concrete needs. This means that various short-term economic impacts of IT outsourcing are more important than far reaching objectives (although there is strong evidence that significant changes in it take several quarters, years or budgeting cycles to materialize).

2.3.4 Social benefits

Lee et al (2003) regard social benefits as an important factor of IT outsourcing success. Their study applies the social perspective to explain interrelationships between IT outsourcing service providers and outsourcers. The relationship between these parties has been considered a prerequisite for outsourcing success, [Grover et al., (1996); Lee and Kim, (1999)], similarly to other factors, such as organizational capability and knowledge sharing, (Lee J.N, 2001). According to Scott (1998), social structures in organizations refer to relationships among the participants of an organization. These relationships are affected by technology, participants, goals and environment. Social benefits cumulate

from all background factors, bonds and influences, which as a whole; contribute to the attitudes and development of employees in the environment of which they are a part. If the working environment encourages employees and increase their satisfaction, social benefits cumulate to net benefits, that is, to strategic and economic benefits. This chain of events has been labeled as the IT success model by Delone and Mclean (2002). The chain starts, from system, information, and service quality, which in turn influence user satisfaction.

Tomi and Mari (2006) define social benefit factor if IT outsourcing as "an organizations' ability to create a working environment which leads to improved motivation and user satisfaction'. User satisfaction is not only dependent on working IT environment and/or the quality of service. IT services must be available when people work, or more generally, as much as possible, not only during office hours. They argue that the ability to secure access to a wider range of services, for example, 24 hours and 7 days a week, is reason for outsourcing.

2.4 Factors influencing the decision to outsource

2.4.1 Need for Specialized Expertise

As one highly respected senior executive stated: "You outsource when someone else can perform the activity better than you." Another said that companies should ask, "What is it we will never be experts at or shouldn't spend time doing?" These attitudes are consistent with the results of a recent survey that identified vendor expertise, along with time savings, as the most frequently cited rationales for outsourcing IT activities." The demand for specialized expertise is not surprising, given the growing rate of Information Technology. As companies require more specialized IT expertise, their best alternative is to hire external IT vendors to perform activities that were formerly performed in-house. Some executives argued that in tight markets for IT services, such as for web design, software development, they cannot permanently employ the best specialists. Specialists such as web designers' experts can earn more by operating their own firms. Agents and consultants can also provide special knowledge of regulatory compliance criteria and regulators gained from experience and personal friendships formed during prior employment with governmental agencies.

Outside vendors can be more objective than internal staff members in conducting training program evaluations; furthermore, when the IT function lacks credibility with the company's senior management, evaluations or research performed by outside vendors perceived to have expertise and objectivity are given more credibility.

2.4.2 Focus, Leverage and Diversification

A number of authors (including Quinn et al., 1990) emphasized the benefits of outsourcing in providing increased focus upon a set of core activities and reduction in the functional scope of the organisation, enabling the development of a more focused organisation capable of increased responsiveness to market change. The complementary use of outside resources can also provide opportunities for enhanced leverage of the organisation's core resources. The use of IT outsourcing may also facilitate the development of economies of scale through product diversification (Reve, 1990). This may be achieved indirectly, through reduced functional complexity and greater focus upon core activities facilitating the development of product/market complexity. More obviously, organisation in the course of diversification may choose to buy-in activities, expertise and components that they lack or would find inappropriate to develop.

2.4.3 Time Pressures

IT outsourcing enables executives to cope with time sensitive issues and competing demands. The training and development function provides another example of how time pressures often do not allow internal development of trainers or program design. Vendors can supply generic services, such as diversity software development, that can be customized and delivered quickly.

2.3.4 Cost Reduction

Cost reduction has been the predominant motive for outsourcing (Ford et al., 1993). The expectation that outsourcing will cut costs is consistent with the strategic management view of competitive resource allocation. This perspective holds that all activities unrelated to strategic core competencies should be outsourced since economies of scale allow specialized vendors to provide services at lower costs.

A recent study of information technology found that efficient vendor management practices drive costs down more than economies of scale. As noted earlier, several IT professionals from large companies reported that, because of the magnitude of their internal operations due to the rapid change of technology, specialized vendors were unable to achieve greater economies of scale and cost savings. It is observed that outsourcing produces no cost savings when only two or three vendors dominate a specialized market. As noted, cost savings are often an important rationale for outsourcing, but don't let cost be the absolute driver.

2.4.5 Vendor Efficiencies and Service

For some activities, the decision to outsource is straightforward. For example, many large financial services companies, who have little or no idea on web designing, would opt to outsource it since they may only require the services at a particular time, for instance only when they are making changes or updating their website. For specialized vendors, these activities are their core business and constitute their strategic focus. As a result, they produce high service and customer satisfaction.

Exceptional service is another reason organizations outsource services. A certain manager once said that "We are willing to pay more for a vendor service because we are buying specialized expertise and exceptional service." On the other hand, several executives claimed that better service could not be obtained with most outsourced services. They argued that the pursuit of cost savings often resulted in the loss of service quality. For example, one interviewee reported unsatisfactory experience in two attempts to outsource unemployment claims because "the vendors had an exploit-the-employees philosophy."

2.4.6 Firms' Capacity

In organization, activities are occasionally outsourced because of such extraordinary circumstances as an activity level that is too overwhelming for in-house personnel to perform. Extreme demands for services take place during natural disasters or strikes. Planning for an anticipated pilots' strike in 1997, American Airlines made arrangements with an outside vendor to handle COBRA processing for some 80,000 employees.

Outsourcing is also used when companies are operating at full capacity and do not have additional staff to handle increased activity. Because such levels of business will eventually decline, companies may prefer to outsource some activities rather than hire more staff. This approach is similar to using overtime to handle peak.

2.4.7 Reduction of Liability or Risk

Outsourcing IT service activity can reduce liability and risk, which is critical for smaller companies that do not have the resources to employ IT specialists who are fully informed on all the IT functions. For example, substantial expertise is required to insure that all the organizational functions are carried out as normal, irrespective of what is sourced outside. IT services like Software development, can be hired only when needed, this can be when the organization is upgrading its software to suit the rapid change of technology, or when there is a software failure like, virus infection.

2.5 Challenges/Risks faced in IT Outsourcing

Prior research has identified several factors, which impact the success of IT outsourcing, such as the roles and responsibilities of parties, the characteristics of outsourcing contracts, or measures and procedures applied to govern IT outsourcing services. Outsourcing decisions and contractual arrangements of the type required by an IT outsourcing deal, do indeed entail some challenges. This is not to say that outsourcing is bad in itself. It only means that, as in other risky business ventures such as new product development, capital investments and projects, risk assessment and risk management are important contributors to the success of an IT outsourcing venture, (Rao and Nam, 1996).

Several authors both from academia and from practice have identified undesirable consequences that might result from such a venture. The first group of undesirable consequences pertains to hidden costs, which are sometimes said to be the IT outsourcing problem, (Lacity et al., 1995). Translation costs include setup costs, redeployment costs, relocation costs, and parallel-running costs and so on. Management costs refer of the human resources that have to be put into managing an outsourcing contract, (Earl, 1996). According to Earl, companies often underestimate these two types of costs which can

increase quite rapidly. Nelson et al (1996) identify another type of costs that could be added to the transition and management cost related to searching and evaluating the appropriate vendor, benchmarking the services offered, specifying the legal terms of contracts, negotiating contracts, and resolving dispute. Hirscheim (1993) and Lacity et al (1995) identify another types of hidden costs that is those costs that the client assumed were included in the contract, but which, in fact, were not. These include maintenance on personal computers, sales tax on equipment purchases, rewiring for office moves e.t.c, which can add up to several hundreds of thousands , even millions of dollars.

Contractual difficulties constitute another category of negative outcomes of outsourcing that are faced by majority of organizations in Kenya. Conceptual amendments are often ecessary, either because the clients' needs are changing or because most contracts are indeed incomplete, [Milgrom and Robert, (1992); Williamson, (1986)]. As a result, several firms have seen their outsourcers charge them high fees for such new services or changes in the services rendered, [Earl, (1996); Lacity et al, (1993)]. Sometime, requests for changes give rise to disputes, and even litigation. An unsatisfied client may wish to repatriate the service yet, they may encounter several difficulties in attempting to do so. Often, the required assets will have been transferred to the outsourcer, along with the personnel who possessed the expertise to conduct the outsourced activity. Not only can reparation be very costly (Aubert et al., 1997), in some occasions it will be impossible (O'Leary, 1990). The client might then consider the alternative of transferring the services to another outsourcer. Yet, if the number of suppliers is small, this might be an impossible alternative, hence, the lock in problem (Klein et al., 1978); Williamson (1985)]. Benoit et al., (1998) point out other cost like service quality and service costs which arc major issues in IT outsourcing. Examples of degrading service levels resulting from outsourcing include poor response time, poor turn around time, late updates of software, applications that do not meet the requirements, and so on. Often, parallel to service degradation service costs arise. For instance, one of the firms studied by Lacity and Hirschheim (1993) indicated that their outsourcing costs were almost three times the cost internal services.

The area of organizational competences appears to be quite vulnerable in the outsourcing context, (Benoit et al., 1998). Outsourcing deals almost always include IT personnel. Benoit et al., (1998) argue that, the very fact that no, or little, IT expertise remains in the firm is seen as dangerous, since the firm will have lost its ability to use IT efficiently and effectively, and will remain dependent on an external supplier. The ability to align IT with the firm's strategy might also be hampered, thus affecting the firm's ability to maintain competitive advantage, and to use IT in an innovative fashion [Earl, (1996); Doni, (1989)].

IT outsourcing raises a number of critical risk-related issues and conflicting objectives between the customers and IT providers. Increased flexibility is a key objective when an organization outsources its IT functions (Kaminsky and Simchi-Levi, 2003). This implies the adaption of IT functions to suit the organization needs and requirement. IT providers typically focus on cost reduction. They are reluctant to adapt systems and attempt to implement systems with as little changes as possible. IT providers may be slow in their responses to IT problems. Outsourcing also brings uncertainty. It may be based on 'untested agreement', requires changes in the organization's culture and new relationship with outside providers. It is difficult to know prior whether the IT functions will be run more efficiently as when the organization was managed in-house (Frost, 2000).

2.6 Reference Theories

2.6.1 Agency theory

This theory describes the relation between the principle (the client) and an agent (the outsourcer). A basic assumption of this theory is that opportunism is an inherent characteristic of such a relationship. Opportunism leads the principal or the agent to seek their interest "with guide" to deviate from the behavior prescribed by the contract whenever they benefit by doing so "cheat", "shirk" or "lie", (Benoit et al, 1998). This is not to say that principals and agents will always adopt an opportunistic behavior, moral codes, social norms, the risk of prosecution and the possible detrimental effects on reputation tend to limit the extent of opportunism. This theory is particularly relevant to the risk/challenges identified in the previous section. This is due to this aspect of opportunism which is an important risk factor in outsourcing contract.

According to Benoit et al (1998), there are three main manifestations of opportunism: Moral hazard, adverse selection and imperfect commitment. Moral hazard results from the fact that it is impossible for a principal to observe the behavior of the agent without incurring probative costs. Since the client cannot directly observe the level of effort deployed by its supplier, it cannot easily tell whether a problem is due to negligence on the part of its supplier or to an unforeseeable event. Adverse selection will develop when the principal cannot observe the characteristics of the Agent. The client must validate the suppliers' claims, which often is a difficult task. Finally, imperfect commitment is the imperfect capacity of both the client and the supplier to commit themselves, for instance, clients and outsourcers may be tempted to renege on their promises and commitments.

Other characteristics of the agent constitute sources of risk. The lack of experience and expertise of the agent with the outsourced activity is one of them, (Earl, 1996). It may happen that a supplier eager to obtain a contract exaggerates the expertise it possesses with certain activities. Benoit et al, (1998) suggests another risk factor which is the lack of experience or expertise of the agent with the management of outsourcing relationships, which could lead to disputes and to escalating costs. The extent of competition among agents, which is often related to the number of available vendors, is also a risk factor. A small number of vendors may bring about the lock-in problem, since it will be difficult for the client to find alternative sources of services, (Nam et al, 1996).

Agency theory can be applied to IT outsourcing. Within this context, the service recipient acts as the principal and the agent is represented by the service provider. Given the existence of asymmetric information and different risk perceptions, it is important to allocate clear decision rights, formulate clear agreements on responsibilities and align goals, (Logan, 2000). Strategic alignment can help bridge the intrinsic gap in interests between service providers and recipients. While benefit management could shed light on in cases of shirking or consumption on the job, since it focuses on evaluations, of which it is stated in an early phase that these will be held. Secondly, strategic alignment and benefits management try to provide a clear allocation of responsibilities and tasks.

2.6.2 Transaction cost theory

Essentially, IT outsourcing is a make or buy decision. Therefore transaction costs occur. From a transaction cost perspective, IT outsourcing creates a market-contracting, Inter-organizational relationship between an external service provider and a service recipient. This requires the service recipient to incur substantial cot costs for monitoring, negotiating and supervising of the contractual parties. Transaction cost increase through complexity, assets specificity and service provider presence (Williamson, 1975).

Transaction cost theory (TCT) (Coase, 1937; Williamson, 1991) assumes people have limited knowledge of future events and act opportunistically. The transaction cost to avoid in contracting with another firm are those related to what Williamson calls opportunism. Williamson developed a reduced form model that highlights the relative cost of outsourcing versus in-house production of services. For example, the reduced form model uses three economic incentive factors as determinants as to why an organization would choose to outsource for IT services compared to providing those same services via internal procurement with a set of employees who would be responsible for maintaining IT services. Hence, the organizations faces a make (provide internally via employees) or buy (from an IT firm) decision for IT services. The three economic incentive factors TCT uses are uncertainty, frequency and asset specificity which are the three primary determinants that explain the make or buy decision for IT.

Frequency refers to how often a transaction will take place to provide services. For an organization, it might represent the number of times IT services would be purchased from an IT based firm for organizations' operations. According TCT, the higher the frequency, the more likely an organization would consider hiring employees to provide IT services in-house. Hence, frequency would usually have a negative effect on outsourcing for IT services assuming the cost of outsourcing exceeds that of in-house production.

Uncertainty can refer to demand, technological or environmental dimensions that affect outsourcing. For example, a manager of an organization would consider the performance record of an IT firm before deciding to outsource for IT services to avoid poor quality service and cost overruns. High performance uncertainty raises the cost of doing business

and an organization may be better off hiring its own employees and providing IT services in-house. Hence, high performance uncertainty tends to increase the likelihood that an organization would choose to provide services in-house because the cost of outsourcing exceeds in-house production.

Finally, TCT uses alternative types of what Williamson calls asset specificity to understand the relative cost of using outsourcing compared to in-house production. The two primary types of asset specificity variables used in TCT studies relate to investments made in human and physical assets. High asset specificity means the organization makes a sizeable investment in an IT system specifically designed for its business operations; hence, switching costs for the organization to switch to another IT system would be high. The IT firm, knowing such an IT system has been developed for the unique organization's operations, could hold-up the businesses for more value at contract renegotiation. Given switching costs are high; the IT firm would have some opportunity to capture more of a margin. Knowing this type of opportunism by the IT firm exists, the organizations could opt to go with a less specialized IT system to avoid the costs of hold-up. Hence, TCT suggests if the organizations invests in a highly-specific IT system, more control over that system would be preferred to less and this usually means hiring employees and developing an IT system in-house. Providing in-house IT services would then avoid the added cost of hold-up associated with outsourcing to the IT services firm. One type of direct cost of hold-up could be a higher upgrade price (than otherwise was agreed to) for the software that organizes the IT infrastructure. An indirect cost of hold-up could be the opportunity costs associated with not having the updated IT system, including hiring and managing day-to-day operations.

2.6.3 Social Exchange Theory

This theory uses the concept of trust to explain interactions between participants. The notion is that partners in an exchange relationship share certain risks and rewards which are reflected in the agreement. Such a relation is called a partnership, (Rothery and Robertson, 1995).

Some buyer organizations might falsely believe that they share risks and rewards with the service provider organization. When there is no structural implicit risk and reward mechanism, calling a relationship a partnership alone will not improve outcomes, (Lacity and Willcocks, 2003). They add that alliances between strong and weak organizations do not work. Rothery and Robertson (1995) indicate that a contract with ambiguously defined clauses is sometimes referred to by the participating organizations as a strategic alliance. However, there are no shared risks, no shared rewards and no synergies. Obviously, these so-called strategic alliances do not work, because they create a clash of interests (Joost and Ton, 2007). They add that, explicit clauses in the contract and specific controls are necessary to reduce conflicts.

A vague contract is sometimes called a strategic alliance, even if essential components are missing (Lacity and Willcocks, 2003). Benefits management can be an aid for service recipients to stay focused on benefits achievement and not only on implementing the IT outsourcing process. Strategic alignment could help IT and the business understand each other better, reducing the need or temptation of designing vague contracts, (Joost and Ton, 2007).

2.6.4 Resource-based view theory

In the last few years, the resource-based theory (RBT) has gained much influence in Strategy. This approach results from several research streams, notably economic theory and strategic management. Its roots go up to the 1950's, with the work of Penrose (1959). More recently, Rumelt (1984), Wernerfelt (1984), Dierickx et al. (1989) and Barney (1986, 1991, 1999) have strongly contributed to its development. The weakness in classical theories is addressed by the resource-based theory. The majority of the studies using classical economic theories do not manage to establish significant links between the characteristics of an industry and the profitability of the individual businesses which make it up (Rumelt, 1991; Rumelt et al., 1991; Hansen and Wernerfelt, 1989). According to Rumelt (1991), the variations of performance between individual firms inside the same industry are much more important than the variations of performance between different industries. This observation underscores the possibility that the main source of competing advantage comes primarily from within the company in the form of resources and

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distinctive competencies that are not easily imitable for the competition. RBT aims to conceptualize this idea.

Resource-based thinking considers that a company's resources include all assets, organizational characteristics, processes, aptitudes, information and knowledge controlled by that company and its employees (Barney, 1991). Barney (1999) argues that if the resources and competencies that a company possesses are heterogeneously distributed in an industry, and if these competencies are difficult to emulate or substitute, then that company can implement competitive strategies that its competitors will be unable either to conceive or to implement, since they do not have access to an equivalent set of resources. Resources can be difficult to emulate or substitute because of their intrinsic properties, either because their use implies complex interactions between members of the personnel or between members of work groups (social complexity), or because the actions necessary to acquire them are not perfectly identified and depend on tacit knowledge (causal ambiguity). They can also result from specific historical conditions (historical context) or from a long and difficult to replicate learning process (path dependency). All these elements restrict the mobility of the resources. (Barney 1986, 1991; Dierickx et al., 1989).

In the context of IS development, these resources can take the form of technical skills such as expertise in analysis and design, and the ability to integrate emerging echnologies with the firm's strategic objectives. They can also take the form of managerial skills such as the ability to establish close links with the user community, the ability to effectively develop appropriate IT applications, and the ability to anticipate the future IT needs in terms of IS development. Together, these competencies contribute to a competitive advantage by increasing the firm's operational efficiency and flexibility, either by automating certain key activities or by supporting congruence and complementarily between these activities (Mata et al., 1995; Bharadwaj, 2000). Aside from being valuable for a company, these competencies are difficult to acquire or imitate, since they often depend on interpersonal relationships, tacit knowledge, and are developed over long periods of time through trial and error.

The strategic value of resources can be viewed as the degree to which these resources have an impact on the growth and the prosperity of the company. It is the extent to which key activities create added value for the customers. Actually, their contribution to a sustained competitive advantage is made possible either by neutralizing threats or by allowing the organization to exploit opportunities that arise. The actual value of IT resources can be assessed only through the activities that they contribute to support and, by extension, through the products and services that result from these activities. To use a comparison, the talents of an artist can only be appreciated through his or her production (i.e. what the patrons are ready to pay for his or her work).

Likewise, in the context of an IS project, the anticipated value of the system can serve as substitute measurement for the strategic value of the resources that help create it. This use of a proxy is analogous to the use of the small number of suppliers to estimate vertical integration or the degree of asset specificity in Economics (Caves and Bradburd, 1988). It is also comparable to the concept of user satisfaction to approximate the degree of effective utilization of a system in the IT field (Bailey and Pearson, 1983).

2.7 IT Outsourcing Arrangements

IT outsourcing is about contracting technology services to third-party but involves much more than that contractual definition of the arrangement. Structuring the alliance, managing the relationship and planning for the business must complement the contractual arrangements. It is not until all of these elements are gained that IT outsourcing is likely to succeed, (Fitzgerald and Willcocks, 1994).

A few suggestions to bear in mind; Measure and Review: since the primary reasons for outsourcing include getting a job done well and within budget, it is vital to evaluate results and costs on a regular basis. You have to constantly watch, revisit and renew what you are doing. One step at a time, based on the organizations' need and culture; enthusiastic for outsourcing usually on the consulting side , may sometimes be too enthusiastic and take the outsource –everything-you-can approach. Every organization however, presents unique needs and should base outsourcing decisions on its own culture and on knowledge of its employees and mission. An 'outsource everything' approach probably will in reality fit very few organizations.

Once the decision to outsource a particular service or function is made, there should be an organized process to evaluate and choose the best service provider for your needs. When dealing with a service provider it is often difficult to predict with certainty what may occur at contract renewal, what may be charged for adjustments or add-ons during the contact periods or the effect service quality reductions may have where outcomes are not thoroughly specified. Indeed, a company often does not have expertise to judge the need for other services, as it does not have this expertise internally (Rothery and Robertson 1995).

According to Harkins et al (1996) and Rothery & Robertson (1995), when considering outsourcing, it is important to create an internal evaluation team. This team should lead the evaluation and selection process. In this case the IT professional will have to include the HR department when it comes to financial matters. Accordingly, a team offers a greater potential for making a decision that is informed from all angles. In choosing the team, think about including existing in-house providers in selecting the new external providers. They know the job better than anyone else.

Hankins et al (1996) also discusses the importance of conducting a thorough investigation of each vendor before reaching any conclusion. Do not move too fast; take your time; this is a high stakes venture. The vendor will be key to its success. At the point of developing the Request for Proposal (RFP), keep in mind your objectives and make sure they are reflected. The RFP is the document used to communicate and state the level quality of service desired; establish a formal and measurable evaluation procedure that meets your objective; schedule meeting with the vendors during which you should permit vendors about the proposal details. It is important that this face to face interaction be fully utilized; find a partner with whom you share values and principles. Strategic objectives should be explained clearly to the prospective service provider in order to build up a healthy outsourcing relationship [Corbeit, (1994); Peish, (1995); Perry et al., (1997); Harkins et al., (1996)]; check reputation, references certification for an industry – accepted standard mode (e.g. ISO 9000) and create healthy competition among multiple vendors.

Before outsourcing a business function therefore, management should develop a strategy detailing the organizations outsourcing intentions, the strategic rationale for outsourcing and key issues to be addressed. These may include: objectives for outsourcing; relationship of outsourcing to the overall corporate strategy; strategic forces driving the organization into an outsourcing relationship; processes to be outsource; links between the outsourced processes and the organizations core competencies; scope of coverage or extent of outsourcing ; critical factors under considerations; expected duration of the relationship and expected benefits and its limitation.

IT outsourcing is precarious: 'Many such deals are large and strategic enough to qualify as "bet the company" arrangements involving a complex mix of people, processes and assets (Craig and Willmolt, 2005). Therefore, it is clear that the organizations concerned with IT outsourcing have high expectation about its outcomes. However, many organizations still manage IT outsourcing in the same way they make commodity purchases (Craig and Willmolt, 2005). The need for a focus on the realization of business benefits is demonstrated by Jenster and Pedersen (2000): 'Many companies have been dissatisfied and their notions have ranged from being mildly annoyed "to" extremely unhappy. The need to outsource IT services is clear and this is a growth industry for consultant and vendors.

From the literature review the following research questions are derived;

2.8 Research questions

Cost Reduction

Cost reduction has been the predominant motive for outsourcing (Ford et al., 1993). In this regard, Kakumanu and Portanova (2006) note; "the main driver in outsourcing is often cost reduction". IT outsourcing is increasingly being used as a means of reducing organisational cost, by outsourcing services that are not core to the business function. Thus, consistent with prior finding the following question is derived:

1. **Is cost reduction the main predominant motive for outsourcing in organisations?**

Profitability

Organizations outsource IT activities to concentrate on the core function of the business; this will enhance an organization's competitiveness in the market and improve its earnings, which is what all organizations are aiming at. The following research question is therefore derived:

2. **Is organizations' profitability positively associated with the I.T Outsourcing decisions?**

Agency performance

According to Benoit et al (1998), there are three main manifestations of opportunism: Moral hazard, adverse selection and imperfect commitment. Moral hazard results from the fact that it is impossible for a principal to observe the behaviour of the agent without incurring probative costs. Adverse selection will develop when the principal cannot observe the characteristics of the Agent. Finally, imperfect commitment is the imperfect capacity of both the client and the supplier to commit themselves. This eventually determines overall performance of the agents, thus the research seeks to find out:

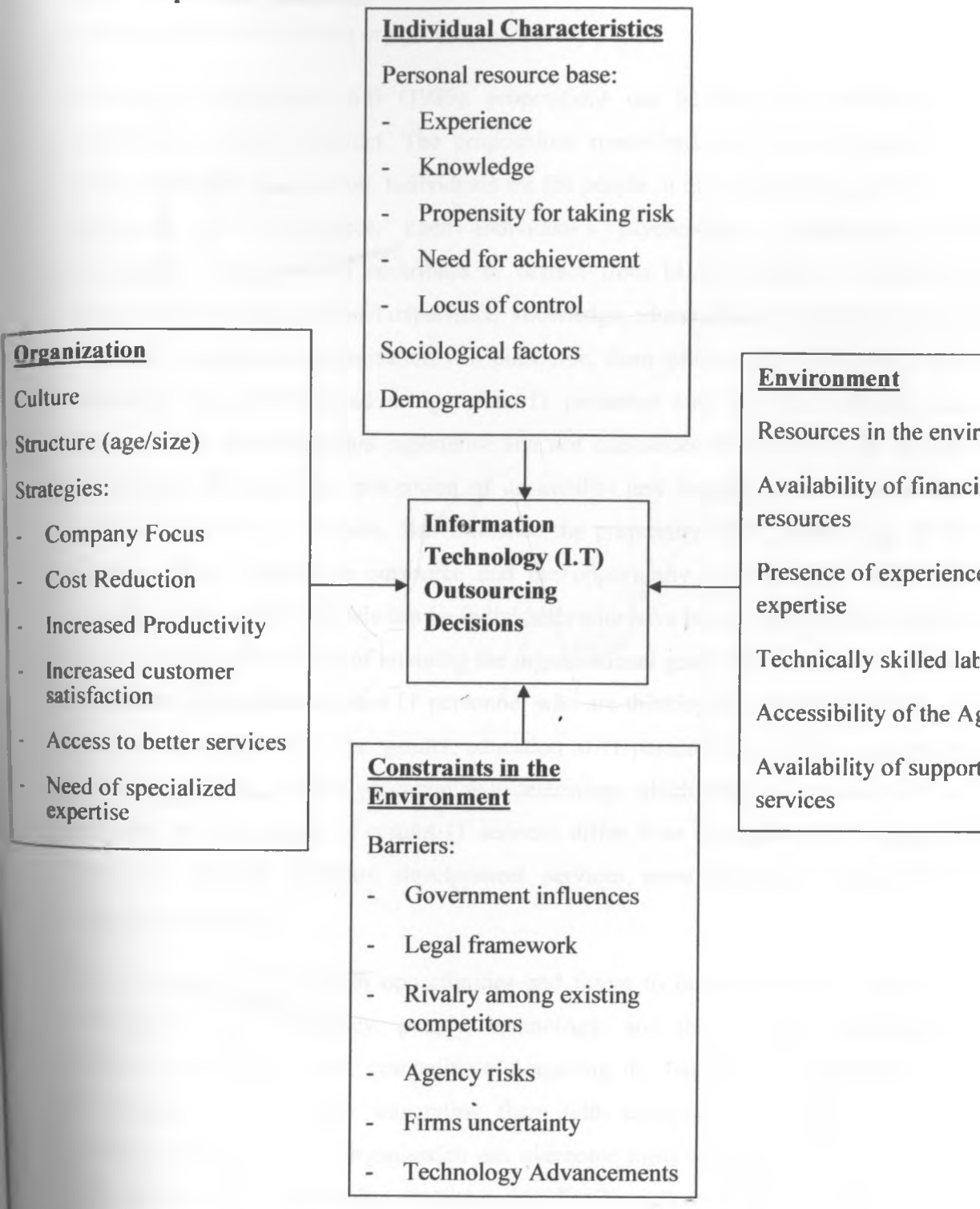
3. **Is there a negative relationship between the agency performance and the decision to outsource IT services?**

IT Intensity

A firm's IT intensity may influence the degree to which it outsources IT. A Intuitively, firms that spend relatively more on IT accumulate a greater amount of IT capital and labor- which, in turn, promotes an internal development. More importantly, firms with high IT intensity may more readily recognize the strategic value of IT, leveraging it to gain and sustain competitive advantages. According to the Resource-Based View (Craine, R., 1989), IT provides firms with competitive advantages only when it is unique and non-imitable.

4. **Is there a negative relationship between organisations' I.T intensity and the propensity to outsourcing IT services?**

2.9 Conceptual Framework



To conceptualize, the researcher concentrated on the factors affecting the success of outsourcing IT services in an organizational context:

According to Bacharach, S.B (1989), propositions can be seen as a statement of relationship between construct. The propositions researched here are: individual, the environment and Organisation. Individuals are the people in the organisation involved in outsourcing of IT services. Each individual's psychological, sociological and demographic characteristics contribute or detract from his/her ability to effectively outsource the services. Personal experience, knowledge, education and training contribute to what IT services the organisation will outsource, from whom and for how long. For instance, if an agent takes advantage of an IT personnel and offer poor services, the personnel will learn from this experience and not outsources at all from these agents. Sociological attributes like perception of desirability and feasibility, role models and mentors, network and contacts, also influence the propensity of IT outsourcing. If IT personnel have a desire to outsource and the opportunity presents itself, s/he will defiantly go for it. Role models can be individuals who have been outsourcing for a time and are doing well in terms of attaining the organisational goals and profitability. These role models will influence other IT personnel who are thinking of outsourcing to do so. Demographic factors like Age, gender, education of IT personnel also play a major role in IT outsourcing. Level of education will determines which types of services will be outsource, the importance of certain IT services differ from one individual to another. Some will consider software development services more important compared to networking services.

The environment posses both opportunities and threat to outsourcing of IT services; opportunities such as money, people, technology; and threats such governmental influences, legal framework, competition. Acquiring the required resources from the environment and effectively integrating them with existing ones could pose as a challenge to organisations. Organisation can overcome these constrains, or protect from their worst effect by developing strategies that distribute these resources evenly across the organisational functions. Since the environment is characterized by change,

uncertainty and complexity, organisation must continually monitor these events and trends to ensure they are in alignment with their organisational goals.

Organisation has a form and structure. It has a strategy that enables it to penetrate or create a market and protect its position. It also has a culture, that is, "how things are done in the organisation" and posses resources, that is, time, money, people and technology. The structure in terms of age and size, affects the type of services outsource and the extent of outsourcing them. According to the literature, organisation that has existed for a longer period are bound to outsource different and more services compared to new or upcoming organisations. The size of a firm has been considered a potential determinant moderating IT buy-or-make decision (Ang and Straub, 1998). Developing IT internally requires resources and expertise that are not readily available in small firm. Generally compared to their larger counterparts, small firms have a lower IT adoption rate, accumulate limited IT knowledge and expertise, under-utilizes their IT applications and lack infrastructural integration (Cohen and Levin, 1989). Financial limitations also result in a shortage of management staff, which restricts a small firm's ability to develop innovative and sophisticated IT application (Markland, 1974). In contrast, larger firms are typically less limited by the availability of financial resources and have more expertise in developing and managing IT than small firms do (Delone, 1981). In addition, tangible and intangible assets are relatively more ubiquitous in large firms, making it easier for them to develop applications that are tailored to their specific needs (Ang and Straub, 1998).

Variables 'may be viewed as an operational configuration derived from a construct' (Bacharach, S.B, 1989). When each variable is a valid description of the construct, it is possible for all variables together to measure a construct. The researcher conceptualized in the study that the success of IT outsourcing could only succeed if it was geared towards attempts to understand organizational factors affecting IT outsourcing. Once they understand these factors they would be able to compete favorably in the market as the world has become one big market, and we are all customers of and suppliers to it.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter highlights the overall research methodology that was adopted for the study. It represents and explains the research design, study population, study design and methods of data collection and data analysis.

3.2 Research Design

The research design used was Survey. The use of this type of research design was because surveys are useful in describing the characteristics of a large population. No other method of observation can provide this general capability. Consequently, very large samples are feasible, making the results statistically significant even when analyzing multiple variables. The study was carried out in the Nairobi, Kenya. The selection of the area was appropriate since the largest numbers of organizations involved in IT outsourcing are mainly established in the part of Nairobi, where recognition of ICT is high and its application is constantly increasing at a high rate compared to other areas outside Nairobi and it is a headquarters for most organizational bodies in the country.

3.3 Study Population

The sample size consisted of organisation divided into various sectors; Finance, Manufacturing/Production, Educational, Communication, Hospitality, Health and NGOs, and a proportionate sample of 50 organizations was drawn as it was considered appropriate for the reason of making it easy and increasing the accuracy of the findings and also for it to ensure high percentage involvement by the subject. The estimated number of population depended on the identified total number of major organizations that outsource IT services in the Nairobi Area.

3.4 Sampling design

Sampling refers to the process of selecting number of individuals for a study in such a way that the individuals selected represents the large group from which they were selected. The study used stratified sampling design.

3.5 Unit of observation and Analysis

The unit of observation were the IT managers and unit of analysis the organisations.

3.6 Type and source of data

The study used Primary data collected by using questioners administered to organisations in Nairobi.

3.7 Data Collection Methods

The instrument of data collection integrated both questionnaire and interviews, which were carried out online, via telephone and by the researcher herself, to ensure the efficiency and effectiveness of the data collected. The researcher started with the formulation of questionnaire to the selected subjects. A pilot test then earned on these subjects and then the questionnaire was revised accordingly taking into account the outcome of the pretest.

Data was collected using structured and unstructured questions in a questionnaire form. The questionnaire had both open-ended and close-ended questions, which required the subjects to tick the relevant boxes or write a few points/comments. The attitude/opinion of the respondents was captured on a positive-to-negative 5 point Likert scale. Interviews were conducted in between the data collection process to capture any information that might have been left out while administering the questionnaire and to establish the confidence and trust of these subjects of study.

3.8 Data Analysis and Presentation

The researcher used Statistical Package for the Social Sciences (SPSS) program, used to analyze data and MS Excel used to present the data after the analysis. This includes frequency distribution, measure of central tendency, percentages, tables, histogram, bars, and pie charts.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter provides statistical presentation and analysis of the data collected. The data had been presented in Table and Figures with summaries being given for each Table and Figure. The objective of this chapter was to explain the data rather than draw conclusions and interpretations. From the study population target of 50 firms, a total of 38 questionnaires were returned for a response rate of 76%.

4.2 Industry type

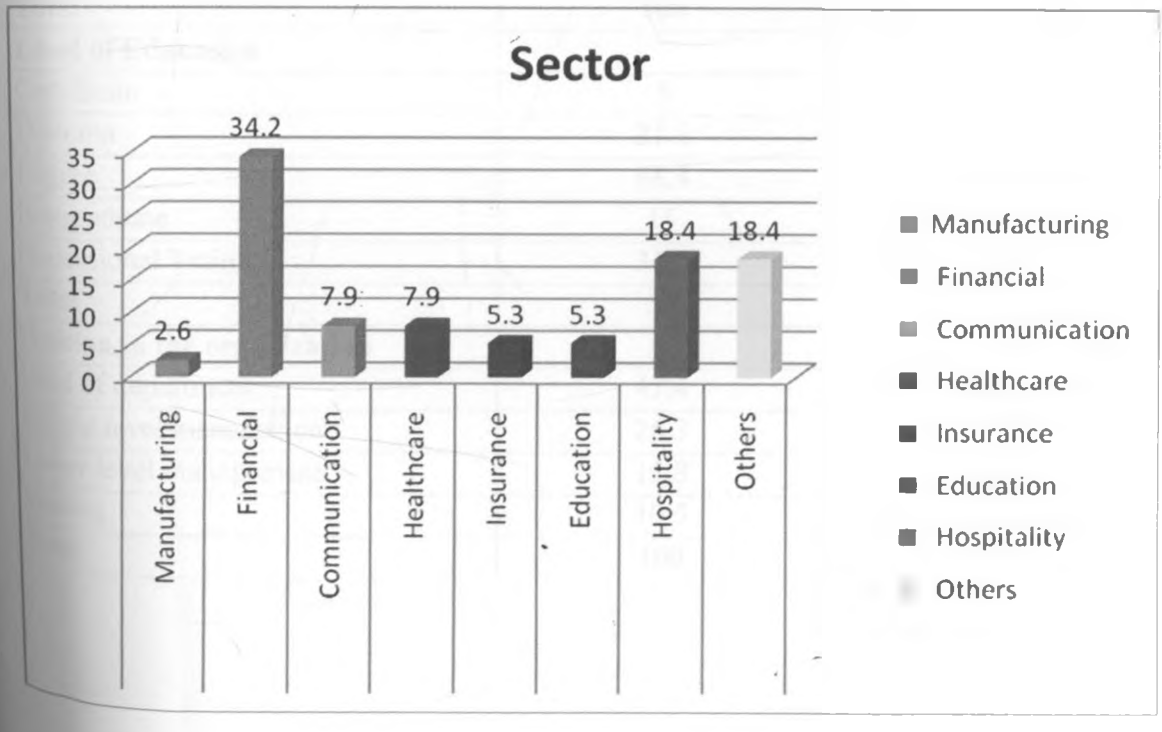
These firms were randomly selected among several industrial sectors. The following industries were represented: finance sector 34.2%, hospitality 18.4%, healthcare 7.9%, communication 7.9%, insurance 5.3%, education 5.3%, manufacturing 2.6%, the other 18.4% represented organisations that did not fall in any particular sector listed. These organisations included sectors like clearing and forwarding, oil & gas industries, research institute and technology. These results are as depict in table 4.2 below.

Table 4.2: Outsourcing rate in different sectors

Sector	Frequency	Percentage (%)
Financial	13	34.2
Hospitality	7	18.4
Healthcare	3	7.9
Communication	3	7.9
Insurance	2	5.3
Education	2	5.3
Manufacturing	1	2.6
Others	7	18.4
Total	**38**	**100**

The type of industry will influence the decision to outsource IT services. For instance, its known that there are industries that have been traditionally less active in adopting and using IT (e.g., manufacturing and healthcare) from those industries that have been characterized as more IT intensive (e.g., financial, insurance, service, retail, etc) (Brynjolfsson, E. and Hitt, L., 1996). Industries less active in IT are predicted to be more dependent on IT outsourcing than those which are active because the former is less likely to have the IT capabilities and experience necessary to develop their own IT systems, but these analysis prove different. In these findings, the less active in adopting and using IT still outsource at a lower rate and the more IT intensive like the financial sector still outsource at a high rate constituting 34.2%. This study proves that despite the level of IT capabilities by active sectors, they still outsource IT at a high rate compared to the later which adopting IT outsourcing at a lower rate and this may be explained by the outsourcing risk (vendor opportunism, contractual difficulties, confidentiality and privacy) identified with outsourcing. This is clearly depicted in the graph 4.2 below:

Figure 4.2: Outsourcing rate in different sectors



4.3 Demographic characteristics of the respondents

A demographic factor is the other organizational characteristics that the study analyzed to see its effect on the organizations decisions to outsource. Table 4.3 below, presents these demographic factors.

Table 4.3: Respondents' background information

Background	Proportion of the respondents (%)
Gender	
Male	84.2
Female	15.8
Total	**100**
Age (Years)	
21-30	73.7
31-40	26.3
41-50	0
51-60	0
Above 60	0
Total	**100**
Level of Education	
Certificate	5
Diploma	21.1
Degree	68.4
Postgraduate	15
Professional Training	31.6
Total	**38**
Position in the organization	
Head of department	47.4
Middle level management	26.3
Lower level management	15.8
Missing	10.5
Total	**100**

These findings indicates that respondents are well eduacted with 68.4% holding at least a first degree and all the respondents occupying management positions. This suggests that all the respondents were well versed with the policies and operations in the organisations and involve in IT outsourcing descions. Thus, the survey response can be relied upon to the extent that all respondents are IT managers with majority 47.4% in senor mangemnt positions. Only 15.8% were female, an indication of low female representation in the banking organisation. This was explained by concentartion of male figure in technical field compared to women. The respondents constituted young, energetic and innovative managers with majority at 73.7% and 26.3% constituting managers between age 31-40years. This may be explained by the nature of work which is tasking and the rapidly changing technology that managers need to keep up with to maintain the competitive edge. The study found out that these young manager were also participating in maintaining these IT service recevied from the agents, they were required to move from one branch to another, handling of heavy hardware, which explained the age bracket.

4.4 Type of services outsourced

Organisations were asked to identify the type of IT services that they outsourced or were attempting to outsource and those that they would not consider to outsource. This was captured using three constructs, dependent upon whether the organisation; already outsource the function, is under consideration and decided against. (Note that the frequency of each IT services is represented by the total response rate which costituted 38 respondents).

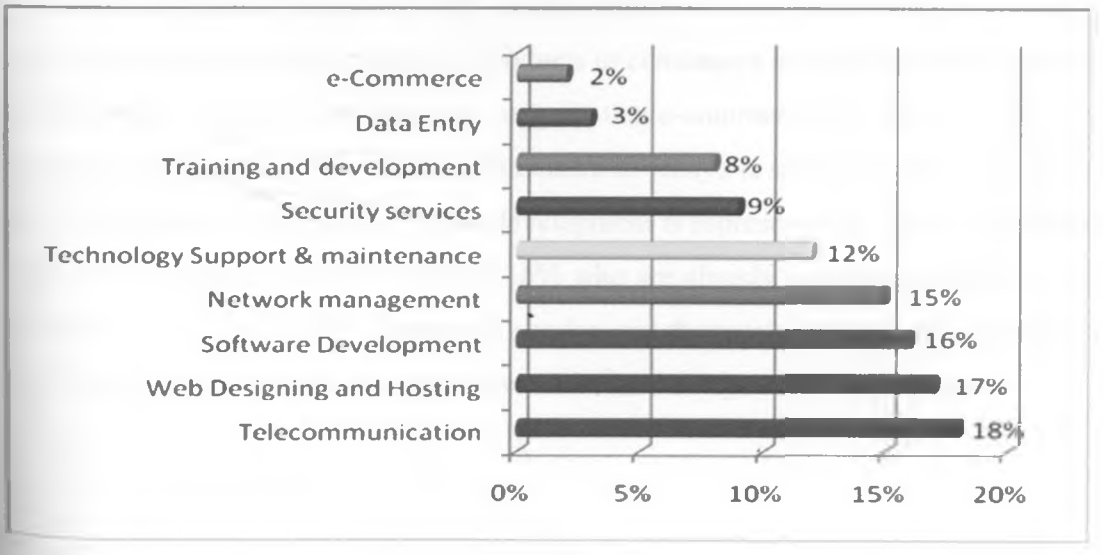
Table 4.4 (a) shows the first construct, which is on IT services already outsourced.

Table 4.4 (a): IT services already outsourced

IT Services	Frequency	Percentages (%)
Telecommunication	21	18
Web Designing and Hosting	20	17
Software Development	19	16
Network management	17	15
Technology Support & maintenance	14	12
Security services	11	9
Training and development	9	8
Data Entry	3	3
e-Commerce	2	2

The top services or functions identified were telecommunication function which was the most outsourced with 21 (18%) this may be explained by the need to incorporate fast and easy communication and the emergence of private companies offering the service at affordable prices. This was closely followed by web designing and hosting 20 (17%), software development 19 (16%), network managemnt 17 (15%) as shown in figure 4.4 (a), below.

Figure 4.4 (a): IT services already outsourced



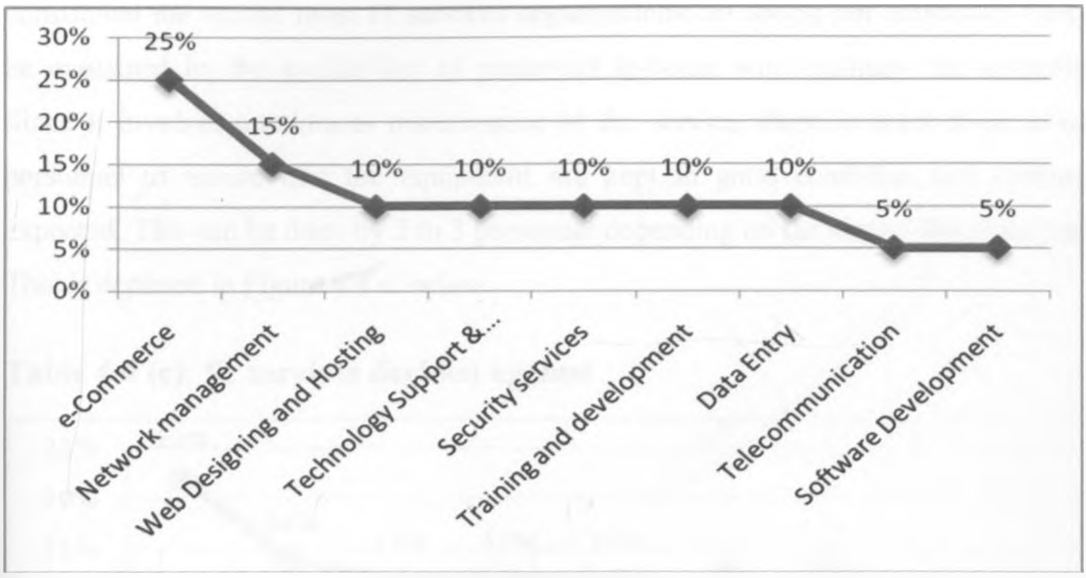
E-commerce is the least outsourced function with 2 (2%) of the respondents indicating that their organizations are outsourcing e-commerce at very low rate. This is probably explained by the nature of the service which deals with online selling and buying of goods and services. This is applied mainly to the service sectors that require selling their products and services via the internet, allowing customers to access their products remotely.

Table 4.4 (b); IT services under consideration

IT Services	Frequency	Percentage (%)
e-Commerce	5	25
Network management	3	15
Web Designing and Hosting	2	10
Technology Support & maintenance	2	10
Security services	2	10
Training and development	2	10
Data Entry	2	10
Telecommunication	1	5
Software Development	1	5

An interesting finding was the 5 (25%) respondents who were considering outsourcing e-commerce to facilitate easy access of products to consumers in the near future. (See table 4.4 (b), above) Although the literature suggests that e-commerce is being outsourced by a number of organizations, the findings indicate that Kenya is still yet to take advantage of this. Telecommunication and software development is represented by 5% of the response rate. This is explained by the 18% and 16% who are already outsourcing these services, indicating that it is a highly outsourced service and those who haven't outsourced it yet are considering to it. Figure 4.4 (b) below, shows the comparison more clearly.

Table 4.4 (b); IT services under consideration



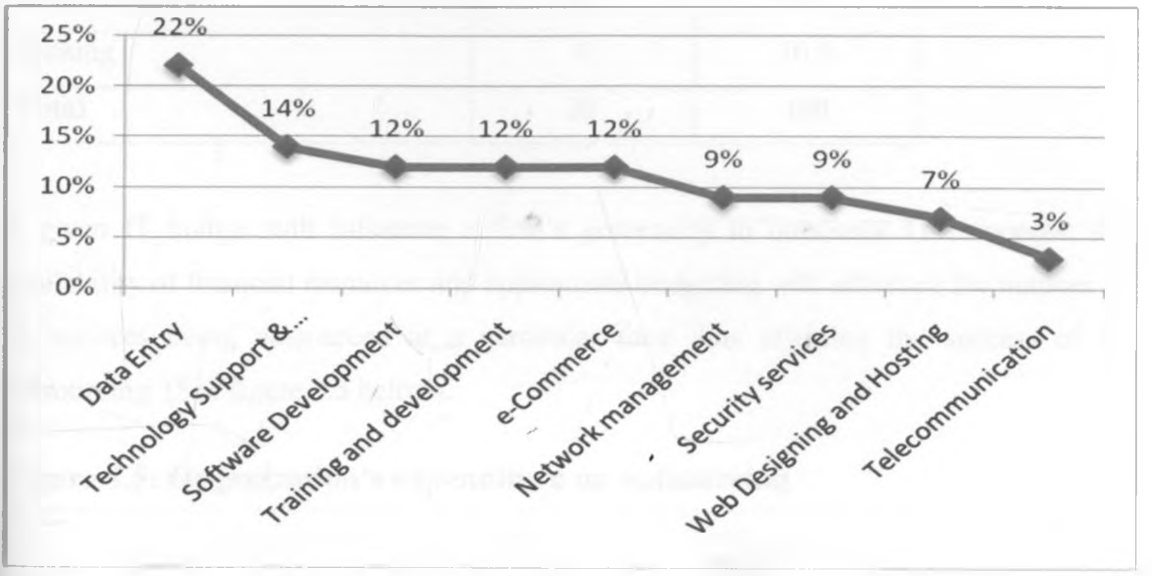
Data entry constituted 22% of response rate that were against outsourcing the services. This may be explained by the seriousness the organizations attach to the principle of confidentiality of information, few would entrust the organization's information to the third party. (See figure 4.4 (c) below)

Table 4.4 (c); IT services decided against

IT Services	Frequency	Percentage (%)
Data Entry	13	22
Technology Support & maintenance	8	14
Software Development	7	12
Training and development	7	12
e-Commerce	7	12
Network management	5	9
Security services	5	9
Web Designing and Hosting	4	7
Telecommunication	2	3

Technology Support and Maintenance represented 14% of the response rate. This constituted the second most IT services organizations are opting not outsource. This can be explained by the availability of personnel in-house who maintain the equipments. Since it involves continuous maintenance of the service, there is need of an in-house personnel to ensure that the equipment are kept in good condition and running as expected. This can be done by 2 to 3 personnel depending on the size of the organization. This is depicted in Figure 4.4 c, below.

Table 4.4 (c); IT services decided against



4.5 Research question one: Is there a negative relationship between organizations' I.T intensity and the propensity to outsourcing IT services?

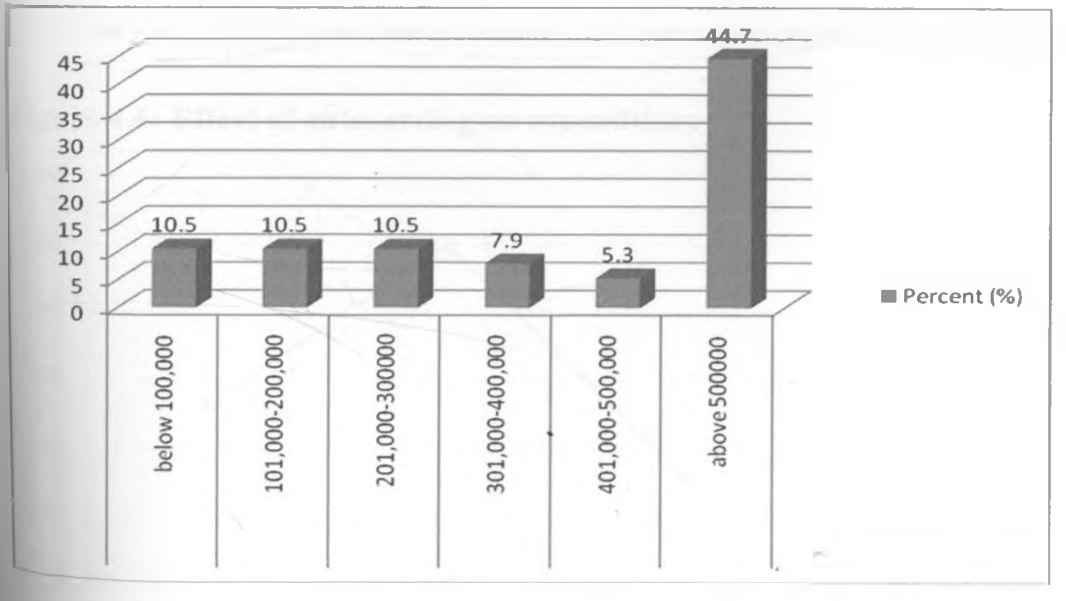
The table 4.5 shows the organizational spending on outsourcing. It clearly shows that the highest percentage spend over Kshs. 500, 000 which constitute 44.7% of the respondents. This shows that majority of organization have dedicated quite a large percentage of their budget to outsourcing IT services. IT intensity has been measured by a proportion of IT budget being spent by an organization, therefore the table 4.5 shows that the IT intensity is high, considering spending approximately over half a million per month.

Table 4.5: Organization's expenditure on outsourcing

Expenditure in Kshs.	Frequency	Percentage (%)
below 100,000	4	10.5
101,000-200,000	4	10.5
201,000-300,000	4	10.5
301,000-400,000	3	7.9
401,000-500,000	2	5.3
above 500,000	17	44.7
Missing	4	10.5
Total	**38**	**100**

A given IT budget will influence a firm's propensity to outsource IT resources; the availability of financial resources and appropriate budgeting will influence the number of IT services being outsourced at a particular time thus affecting the success of IT outsourcing. (See figure 4.5 below).

Figure 4.5: Organization's expenditure on outsourcing



4.6 Research question two: Is cost reduction the main predominant motive for outsourcing in organizations?

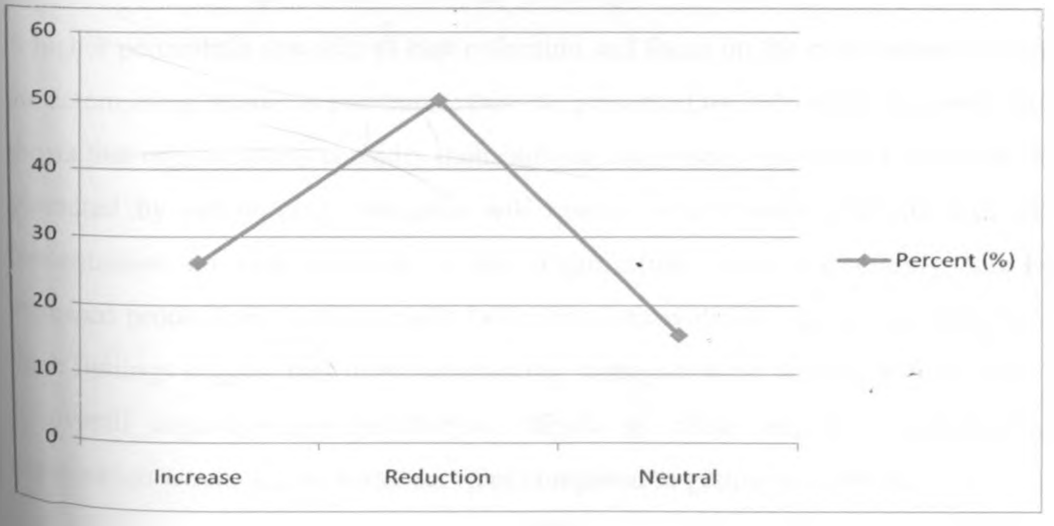
With the average spending ranging over Ksh.500, 000, the question that comes to mind is the effect of this expenditure on the organization's budget. See table 4.6 below

Table 4.6: Effect of outsourcing on expenditure

Effect on expenditure	Frequency	Percent (%)
Reduction	19	50
Increase	10	26.3
Neutral	6	15.8
Missing	3	7.9
Total	**38**	**100**

Half the responses agreed there was a reduction on the overall organizational expenditure with 19 (50%) response rates; although quite a good number felt that it had an increase on their expenditure with a response rate of 26.3%. A small percentage (15.8%) was neutral, that is, the expenditure did not have a drastic effect on the organization's budget. The expectation that outsourcing will cut costs is consistent with the strategic management view of competitive resource allocation. Figure 4.6 below shows outsourcing can be used to cut cost by the 50% responded agreeing a reduction on the organization's budget.

Figure 4.6: Effect of outsourcing on expenditure



Cost reduction is one of the reasons organizations opt to outsource IT resources that acquire them in-house. These findings agree with the fact that IT outsourcing can be used as a strategy to cut cost on organizational expenditure, although 26.3% of the respondents tend to disagree with these findings, indicating that there are other underlying benefits that would prompt an organization to outsource despite an increase in the expenditure. The increase on expenditure was explained by a need for a fresh start up for new organization before stabilization, support for the organizations application and IT upgrading which require payment of a particular wage each year. An organization would not pursue an opportunity if the benefits do not outweigh the risk and cost involved. These findings shows that they are spending less on outsourcing and this will prompt the decision to outsource more services or increase the level of outsourcing.

4.7 Research question three: Is organizations' profitability positively associated with the I.T Outsourcing decisions?

IT outsourcing is affected by the strategies used to determine the decision to outsource or not, these strategies may either increase or reduce level of outsourcing efficiency, which in turns affects the profitability of an organization. Table 4.7 below shows various strategies considered by organizations in making IT outsourcing decisions. (Note that the frequency shows the number of respondents out of 38 who answered to having considered the various organisational strategies in aim to successfully outsource IT services).

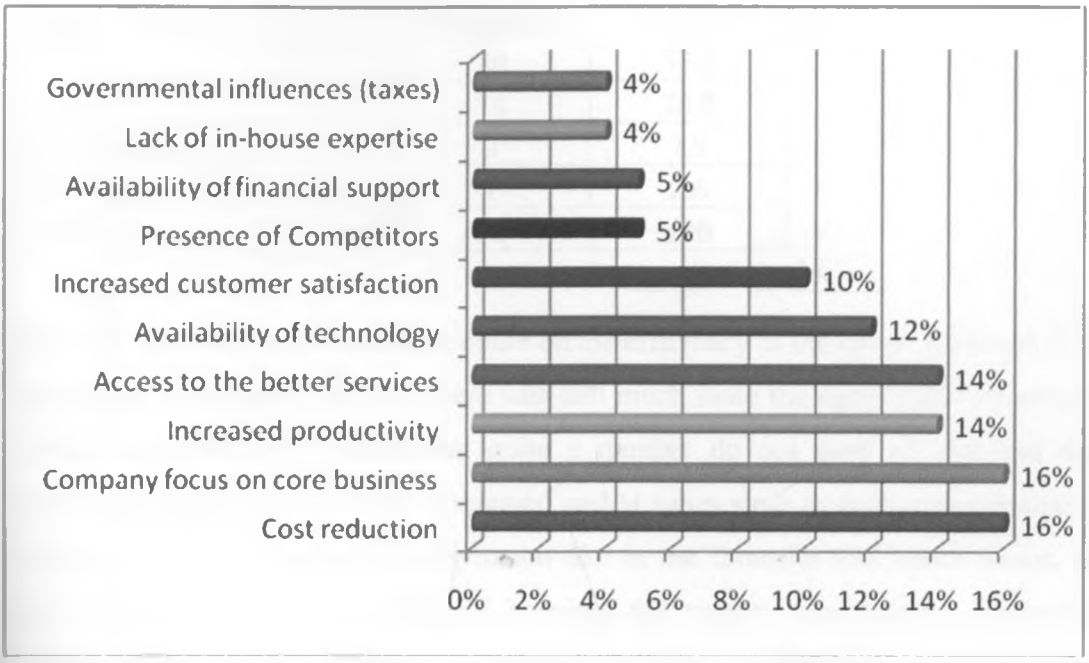
A higher percentage considered cost reduction and focus on the core business function as the determining factors to outsource; this is represented by 16% of the response rate. This shows that organizations consider their outsourcing process successful when the benefits generated by outsourcing strategies will results in cost reduction and will facilitate concentration on core function in the organization. This was closely followed by increased productivity and access to better services with 14% each. One way to explain these findings suggest that these outsourcing strategies were making a huge contribution to overall organizational profitability which in effect improves performance and organization would access better services compared to getting it in-house.

Table 4.7: Outsourcing strategies

Strategies	Frequency	Percentage (%)
Cost reduction	23	16
Company focus on core business	23	16
Increased productivity	20	14
Access to the better services	19	14
Availability of technology	16	12
Increased customer satisfaction	14	10
Presence of Competitors	7	5
Availability of financial support	7	5
Lack of in-house expertise	6	4
Governmental influences (taxes)	6	4

Lack of in-house expertise and Governmental influences (taxes) were the least applied strategies with a response rate of 4%. An interesting finding was the least number 4% of respondents taking advantage of the governmental influence on outsourcing taking into account the recent keen interstet shown by the govermnet to faciliatate smooth development of Buiness Process Outsourcing (BPO). These findings shows the government has a long way to go towards achieving its overall goal of facilitating easy and efficient outsourcing. Organisations were not driven by lack of in-house expertise to outsource but availbility of a better offer by thr agents.Competitors are no longer a great threat to outsourcers, this is shown by the 5% respoinse rate. Towards acheiving a successful outsourcing practice, organisation concentrate more on strategies that will improve and facilitate easy outsourcing process and less concentration on the competitors. Figure 4.7 below, graphically represents the rate at which organisational strategies are employed by these organisations.

Figure 4.7: Outsourcing strategies



4.8 Research question four: Is there a negative relationship between the agency performance and the decision to outsource IT services?

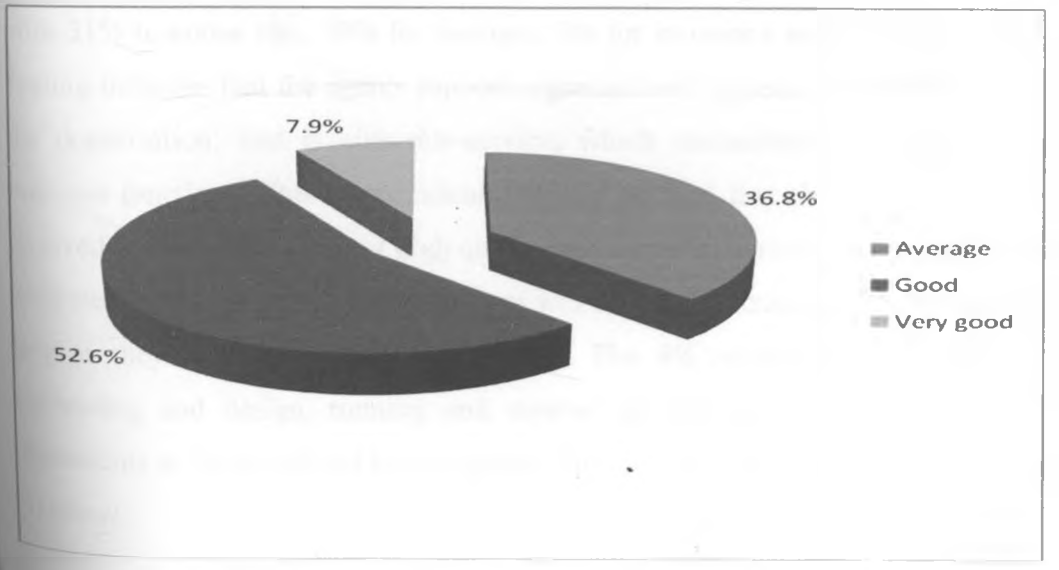
The agents' posses' particular risk associated with IT outsourcing which may hinder the success of IT outsourcing process. To examine the agency performance effect on IT outsourcing, respondents were asked to identify opinions concerning the degree of effectiveness of the current agents they are outsourcing from. Table 4.8 (a) below indicate agents rating using a likert scale of 5 points; Very good, Good, Average, Poor, Very poor. Majority of respondents represented by 20 (52.6%) rated their agents as being Good, 14 (36.8%) Average and 3 (7.9%) Very good. None of the respondents rated their agents as being Poor or Very Poor which was a good sign on the part of the agency performance.

Table 4.8(a): Organization's ratings on agents

Agents Rating	Frequency	Percentage (%)
Good	20	52.6
Average	14	36.8
Very good	3	7.9
Missing	1	2.6
Totals	**38**	**100**

The 7.9% response rate raised some doubt on the efficiency of the agent. Although 52.6% agreed they were good some felt there was still much more the agent could improve on. Certain organizations observed that quite a number do not meet all the laid down contractual agreement, are slow to respond and at times slow to deliver the products or services on time. On sensitive information like in the financial and health sector, trust issue were raised, in fact in Nairobi hospital, the system administrator advised that hospital should develop an adequate in-house facility to maintain the patients privacy. See figure 4.8 (a) below.

Figure 4.8 (a): Organization's ratings on agents



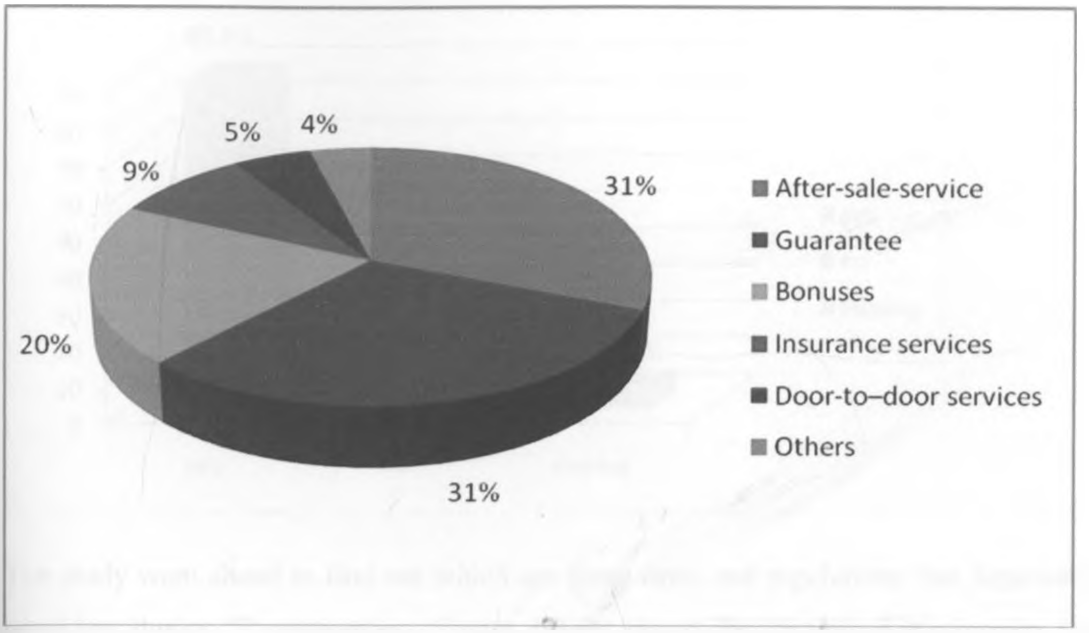
In an aim to retain their customers and attract new ones, the agents strive to offer some incentives within the legal provision. These incentives would attract the outsourcing company and prompt them to outsource from a particular agent in the process facilitating an effective IT outsourcing transaction. The incentives offered to these organizations are shown in table 4.8 (b) below.

Table 4.8 (b): Incentives offered by agents

Incentives	Frequency	Percentage (%)
After-sale-service	12	31
Guarantee on any product purchased	12	31
Bonuses	8	20
Insurance services	3	9
Door-to –door services	2	5
Others	1	4
Total	**38**	**100**

Respondents were asked to identify of the above named incentives, which they received from the agents. After-sale-services and Guarantee were the most received incentives with 31% response rate, 20% for bonuses, 9% for insurance and 5% door-to-door. This finding indicates that the agents support organizations' systems even after installation in the organization; that is after-sale-service, which necessitates concentration on core business functions. The organizations are also assured that the products and services received by these agents are of high quality and they will perform as expected, producing accurate results. As a result, organizations will continually outsource from these agents as long as they meet part of their agreement. The 4% represented incentives like free webhosting and design, training and support on call which were identified by the respondents as being offered by the agents. This comparison is best shown on Figure 4.8 (b) below.

Figure 4.8 (b): Incentives offered by agents



4.9 Rules/regulation governing IT outsourcing in organizations

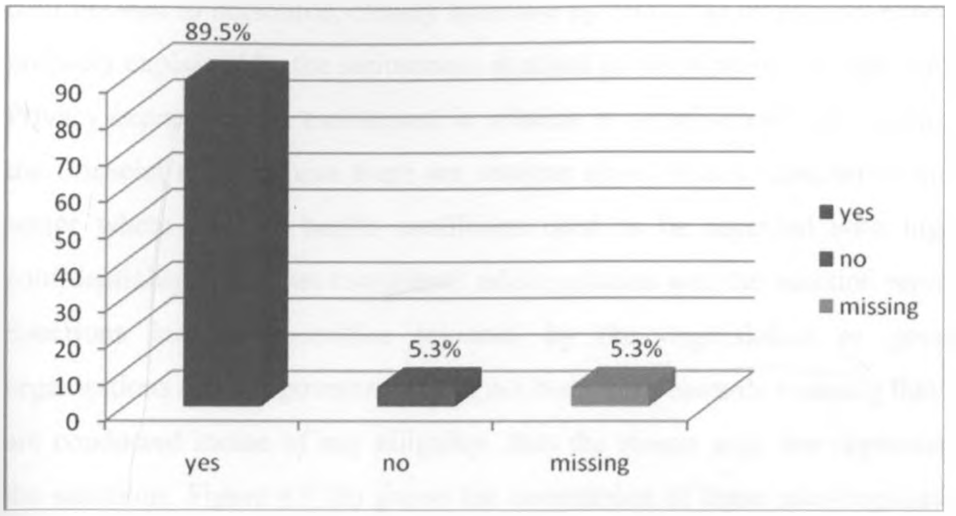
The table 4.9 (a) below represents the number of respondents who consider rules/regulations while outsourcing their IT services.

Table 4.9(a): Rules/Regulation

Consider any rules/regulation	Frequency	Percentage (%)
Yes	34	89.5
No	2	5.3
Missing	2	5.3
Totals	**38**	**100**

IT outsourcing rules/regulations will determine the level of outsourcing of organizations and how efficient the process will be. This rules/regulation facilitates ease of IT outsourcing avoiding disagreement with the agents. Despite all these 5.3% still do not consider any rules/regulations. This can be explained by lack of knowledge by these organizations on the presence of these rules/regulations and the benefits that results from considering these rules/regulations. See figure 4.9 (a) below

Figure 4.9 (a): Rules/Regulation



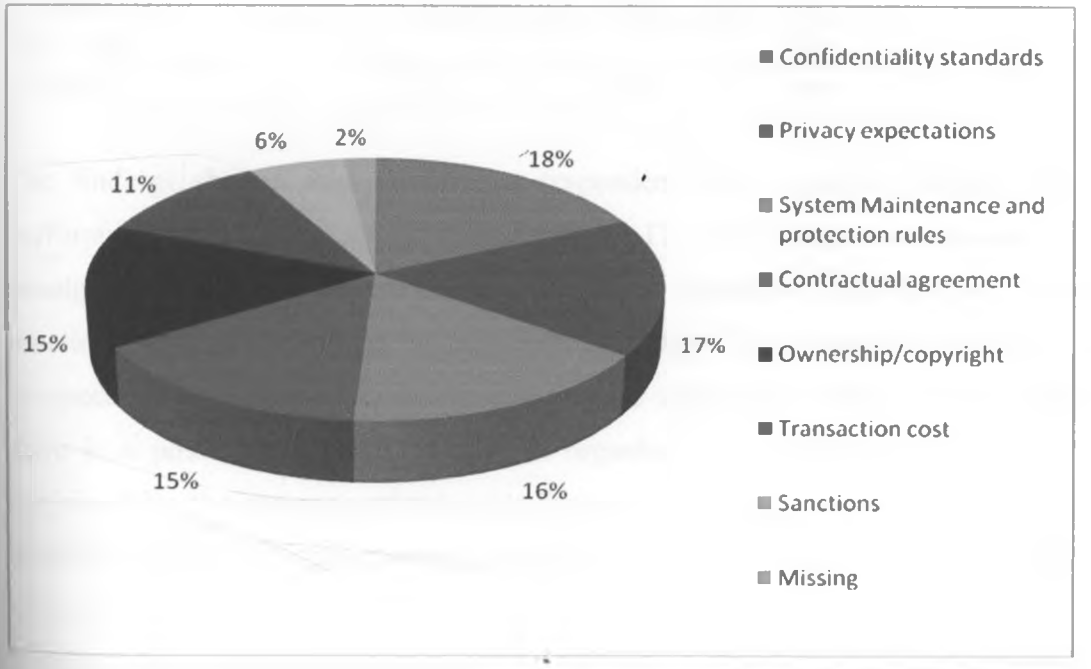
The study went ahead to find out which are these rules and regulations that organsations considers during IT outsourcing. Figure 4.9 (b) shows the results of this inquiry (Note that the frequency shows the number of respondents out of 35 who answered to having considered the listed rules and regulations).

Table 4.9 (b): Rate of rules/regulations considerations

Rules/Regulation	**Frequency**	**Percentage (%)**
Confidentiality standards	29	18
Privacy expectations	26	17
System Maintenance and protection rules	26	16
Contractual agreement	23	15
Ownership/copyright	23	15
Transaction cost	18	11
Sanctions	10	6
Missing	3	2
Total		**100**

A majority 29 (18%) of these respondents indicated Confidentiality of standards affected their decsion to outsource, closely followed by 26 (17%) on privacy expecations. This is probably explained by the seriousness attached to the principle of high confidentiality and Privacy expected to be maintained in relation to organisation's infromation. An area like the financial sector where there are conerns about money laundering and in healthcare sector where patients health conditions need to be regarded with high privacy and confidentiality. The least considered rule/regulation was the sanction represented by 2%. Sanctions included penalties imposed by the organsiation or governments. The organisations and the government has not been keen towards ensuring that these penalties are conducted incase of any elligality, thus the reason why few organisations considers the sanctions. Figure 4.9 (b) shows the comparsion of these rules/regulations with much clarity.

Figure 4.9 (b): Rate of rules/regulations considerations



4.10 Impact of IT outsourcing on overall organizational performance

IT outsourcing has had an impact on the overall organizational performance. Table 4.10 below shows the impact on organizations performance. An outsourcing process requires organizations to consider certain rules and regulations. Respondents were asked if they considered any rules/ regulations, 89.5% of the response rate considered particular rules and regulation while 5.3% did not, this is shown on table 4.9 (a). This can be explained by a requirement by the government that each outsourcing organization to consider particular rules for a successful outsourcing. These finding was a clear indication of a need for organizations to take full advantage of the IT outsourcing activity.

Table 4.10: Outsourcing impact on organizations performance

Impact of IT outsourcing	Frequency	Percentage (%)
Positively	37	97.4
Negatively	0	0
Missing	1	2.6
Total	**38**	**100**

The findings showed that 37 (97.4%) respondents had a positive impact on their performance due to outsourcing. This shows that IT outsourcing has been successful in penetrating through organizations as it positively transform organization's business functions. Therefore according to these figures on table 4.10, it would be right to say that, irrespective of the risks and challenges that these organization faces as they outsource, there is a positive effect on the general organizational performance. This could be explained by the presence of adequate internet, efficient manpower utilization, and availability of up-to-date technology, acquiring product/services on credit, continuous service support and improved communication flow, identified by respondent. The positive impact can also be explained by efficiently employing organizational strategies during IT outsourcing process.

4.11 Recommend outsourcing alliances to other organizations

Finally the study sought to find out if these IT outsourcing organizations would recommend outsourcing alliances to other organization. This is depicted in table 4.11 below.

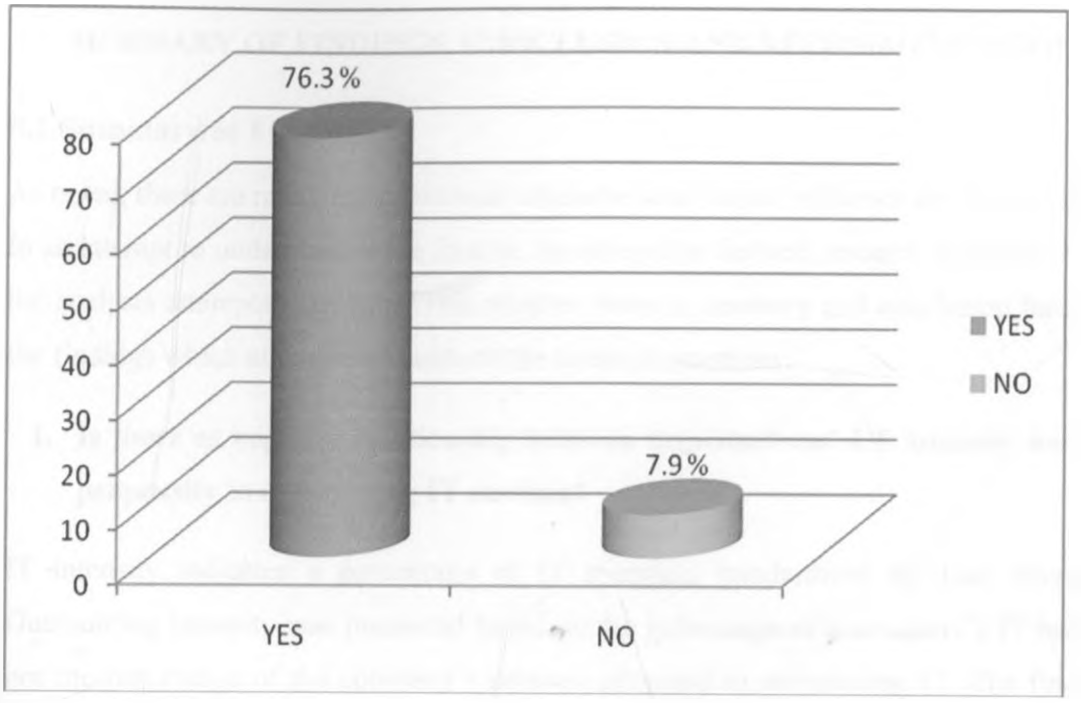
Table 4.11: Recommend outsourcing alliances to others

Would you recommend IT outsourcing	Frequency	Percentage (%)
Yes	29	76.3
No	3	7.9
Missing	6	15.8
Totals	**38**	**100**

A great percent (76.3%) of the respondents agreed to recommend IT outsourcing to other organizations while 7.9% thought that it wouldn't be such a good idea. Those in agreement supported their decisions on improved partnership, increase in sales and revenue that would be evident in IT outsourcing. Other respondents suggested they would recommend IT outsourcing if it's not within their core business, the services being outsourced are not too sensitive and confidential and finances are available.

A certain manager stated that: "since we are moving to the digital era it would be a requirement to keep up with these changes, thus IT outsourcing will at one time be a compulsory activity for each organization to undertake. The 7.9% respondents represented those who were not for complete IT outsourcing stating that for organizations dealing with sensitive matters, outsourcing would not be a smart move since they need to safeguard their information from outsiders. Some showed the intention to acquire IT services in-house by employing enough manpower and fear of unfair competition rising up as more organizations adopt outsourcing. (See Figure 4.11 below)

Figure 4.11: Recommend outsourcing alliances to others



CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

5.1 Summary of Findings

As noted, there are many organizational characteristics which influence the success of IT. In an attempt to understand these factors, the researcher derived research questions which the analysis attempts to answer. This chapter draws a summary and conclusion based on the findings which attempted to answer the research questions.

1. **Is there as negative relationship between organizations' I.T intensity and the propensity to outsourcing IT services?**

IT intensity indicates a percentage of IT spending standardized by firm revenues. Outsourcing intensity was measured based on the percentage of a company's IT budget, not the percentage of the company's revenue allocated to outsourcing IT. The findings clearly show that 44.7% of the respondents spend over Ksh. 500, 000 monthly on their organizational budget, though IT intensity does not seem to significantly affect the propensity to outsource IT. Based on the resource-based view, the findings predicted that firms with high IT intensity view IT as a strategic initiative; that is to cut cost, rather than a commodity that is easily duplicable. Thus, this research question is not supported by our data.

2. **Is cost reduction the main predominant motive for outsourcing in organizations?**

The benefits of IT outsourcing can be related to both increased financial benefits and improved non-financial benefits (Gilley and Rasheed, 2000). Increased financial benefits of IT outsourcing include reduction of operational costs, reduction of capital invested, improvement of measurability of costs, and transformation of fixed costs into variable costs, whereas increased non-financial benefits include focus on core competencies, improvement of quality, acquisition of external competencies, and control over internal departments (Quelin and Duhamel, 2003). One of the intriguing results obtained from this

study is that, a higher percentage considered cost reduction and focus on the core business function as the determining factors to outsource; this is represented by 16% of the response rate. The focus on core business function represents the non-financial benefits enjoyed by the organizations. A 50% response indicated that there was a reduction on the organization's budget agreeing with the fact that IT outsourcing can be used as a strategy to cut cost on organizational expenditure. This cost reduction is explained by the availability of competitive tenders, reduced workforce thus less number of IT personnel to pay wages, problems are being realized on real time basis, and total assignment of infrastructure responsibility to the agents taking the expense away. These findings indicate that cost reduction is still the predominant motive for outsourcing IT services.

3. **Is organizations' profitability positively associated with the I.T Outsourcing decisions?**

Organizational profitability can be explained on how well an organization carries out its business functions and the level of productivity which affects organizations' profitability. The study found out that organizations do not only outsource to cut cost but also to be able to concentrate on the main business function, this is represented by a 16% response rate. This enables an organisation to increase their production rate thus increasing the organisations' profitability. Therefore it is right to say that once an organisation is able to concentrate on its core function it will eventually improve the organisational overall profitability. Therefore the findings supports that profitability is positively associated with the decisions to outsource IT services.

4. **Is there a negative relationship between the agency performance and the decision to outsource IT services?**

Agency performance is measured by how effective they deliver their products and services to their clients; in this case the organizations outsourcing the IT functions. When outsourcing IT resources, a smaller amount of resources -both human and capital- is likely to be under the manager's control, and a form of power transfer will occur. In

addition, various types of transactional risks inherent to IT outsourcing may further reduce the manager's control and power, and limit his or her "sphere of influence" within the organization. This fear expressed by the outsourcers affects the decision of an organization to outsource, eventually determining agent's performance. The findings shows that 52.6% rated their agents being Good, with none rating their services as being poor which was a good feedback on agency performance towards successful IT outsourcing. The agents also offered some incentives which organizations benefited from and encourage the rate of outsourcing among the outsourcers. Respondents indicated continuous outsourcing of these services as long as the agents provide these incentives adequately. Consequently, findings indicate agency performance is strongly and positively associated to IT outsourcing. Thus this research question is not supported by the study.

5.2 Conclusion

This paper has provided a methodology for analyzing the IT outsource decision by studying the effects of organizations' characteristics on IT outsourcing decisions. Each of the salient business motivations for firms to opt for outsourced or insourced IT has been well documented in the literature. A number of organizational strategies were also identified as key contributors to outsourcing success, they include; cost reduction, the ability to focus on core competence, access to better services, etc. these strategies are thought to improve quality, deliver, and performance. The study attempted to provide new insights into the organizational characteristics that may influence IT outsourcing decisions, namely, individual characteristics, environment constraints and the organization itself. Individual characteristics the study sought to analyze are the age, gender, level of education and position in the organization. The findings showed that demographic factors did not play a major role in IT outsourcing decision, but much concentration was on the strategies (cost reduction, focus on core business, access to better services etc) employed by organizations in decision to outsource.

Majority of the respondents agreed these strategies influenced the success of outsourcing, for instance by outsourcing IT function organization are able to concentration on core business easing the process of outsourcing. The findings show that there is some level of agency conflict between managers (agents) and shareholders (principals) explained by the need of improvement in their service rendering. A manager strong incentive to distribute more resources under his control through in-house development in order to increase his power within the company and outsourcing IT services to external vendors is likely to require some degree of "power transfer", which diminishes his organizational control. Despite the risk and challenges faced by the respondents, they still want to outsource more and increase the level of outsourcing. As IT outsourcing has become a ubiquitous organizational phenomenon, a variety of driving and inhibiting forces should be understood in a larger organizational context. Such a broader approach may provide firms with vantage points from which to identify the new opportunities and challenges IT outsourcing creates, looking beyond the traditional framework concerned with the direct causes of IT outsourcing. Such a broader approach may provide firms with vantage points from which to identify the new opportunities and challenges IT outsourcing creates, looking beyond the traditional framework concerned with the direct causes of IT outsourcing.

5.3 Recommendations

i. An important extension of this study is to replicate this research to other areas outside Nairobi; other parts of Kenya and more important conduct comparative country studies.

ii. Given the changes that are taking place globally and enactment of rules and laws, on corporate governance, it would be necessary to carry our research on the role of the agents in IT outsourcing decision making process.

iii. Organizations should maintain a database of all its agents and IT services they offer to make tracking of these IT services much easier. There always should exist a service level agreement between the agent and the outsourcing company.

iv. Government to create a conducive IT infrastructure by reducing taxes on IT products, improve security in the country as this determines foreign and local investor confidence in carrying out outsourcing in the country. There should be a reduced legal setup processor to provide enabling environment for IT outsourcing, for example; free trade zones and BPO initiatives. ICT policy papers should be developed and a clear regulatory framework that should be incorporated by all organizations outsourcing. The government should encourage sanctions by imposing penalties, providing protection and copyrights of products. More resources should be created for the youths with innovative skills to facilitate effective outsourcing.

v. Agents should improve their response time and value added services. Monopolization of IT services should be encouraged to better provide these services effectively and make it easy for organizations to identify them with specific services. For instance access Kenya is well known for providing internet services. For success of outsourcing contractual issues should be looked into since some of the Service Level Contract (SLC) is not binding enough to protect the outsourcers from these contractual challenges.

vi. The findings are useful to further refine the already existing corporate guidelines with respect to the role of the organizations considering outsourcing of IT services from a third party.

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APPENDIX: QUESTIONNAIRE

I am a masters' program student at University of Nairobi; undertaking a research project on effects of organizational characteristics on Information Technology (IT) outsourcing decisions. Your organization has been selected to form part of this study. The information provided will be used exclusively for academic purposes and will be held in strict confidence. Thank you.

Kindly answer the following questions by **ticking in** the appropriate box or filling the spaces provided.

SECTION A: PERSONAL INFORMATION

1. Position held in the organization

   (*optional*).....

2. How long have you worked in this position (*above*)?

   ☐ Below 1yrs ☐ 6-10yrs ☐ 16-20yrs

   ☐ 1-5 yrs ☐ 11- 15yrs ☐ Above 20yrs

3. Age

   ☐ 21-30yrs ☐ 41-50yrs ☐ Above 60yrs

   ☐ 31-40yrs ☐ 51-60yrs

4. Gender

   ☐ Male ☐ Female

5. Educational level

   ☐ Certificate ☐ Degree ☐ Professional Training.....

   ☐ Diploma ☐ Postgraduate .....

SECTION B: ORGANISATIONAL DETAILS

6. Organization's Name (*optional*).....

7. Among the listed establishments, where do you classify yourself as an Organization/Company?

☐ Manufacturing/Production Sector ☐ Healthcare sector

☐ Financial Sector ☐ Insurance Sector

☐ Communication Sector ☐ Educational Sector

☐ NGOs ☐ Hospitality sector

☐ Others.....

8. How long has the organization been in existence (*months/years*)? .....

9. How many people are employed in the organization? .....

10. a) Does your organization outsource IT services?

☐ Yes ☐ No

b) If yes, what **duration in years** has the organization outsourced these IT services?

☐ Years

11. Of the outsourced IT services, tick where applicable.

IT Services	**Already outsourced**	**Under Consideration**	**Decided against**
Network management/ Infrastructure ("Networks")			
Software Development/Programming			
Web Designing and Hosting			
Technology Support and maintenance services			
Telecommunication (landlines, satellites phones, Voice Over internet Protocol(VoIP)/ISP)			
Data Entry			
Electronic Commerce ("e-Commerce")			
Training and development			
Security services			

Any other, comment

.....
.....
.....

12. How much does the organization spend in outsourcing these I.T services (***monthly***)?

☐ Below Ksh: 100,000 ☐ Ksh: 201,000–300,000 ☐ Ksh: 401,000-500,000

☐ Ksh: 101,000–200,000 ☐ Ksh: 301,000 – 400,000 ☐ Above Ksh. 500,000

b) What effect has outsourcing of IT service had on overall organization expenditures?

☐ **Increase** ☐ **Reduction** ☐ **Neutral**

Explain.....
.....
.....

13. Which of the following strategies affects your propensity to outsource IT services?

To what extent do they influence your decision to outsourcing IT services?

	Factors Influencing IT outsourcing	**To a great Extent →**		**To some Extent →**		**Not at all →**	
		5	**4**	**3**	**2**	**1**	**0**
1.	Cost reduction						
2.	Increased productivity						
4.	Lack of in-house expertise						
5.	Increased customer satisfaction						
6.	Company focus on core business						
7.	Access to the better services						
8.	Availability of technology						
9.	Presence of Competitors						
10.	Governmental influences (taxes)						
11.	Availability of financial support						

☐ Others.....

14. a) Do you consider any rules/regulations when outsourcing?

☐ Yes ☐ No

b) If **yes**, which of the following rules/regulations affect your decisions in outsourcing these IT services?

☐ Confidentiality standards
☐ Privacy expectations
☐ Ownership/copyrights/licensing of product
☐ Transaction cost
☐ Sanctions (penalties imposed by self/government)
☐ System Maintenance and protection rules
☐ Contractual agreement (new product acquisition policy)
☐ Others.....

.....

c) If **No,** why, and what criteria do you use in case of any legal formalities?

.....
.....
.....

SECTION C: AGENT'S DETAILS

15. To whom do you outsource IT services

☐ Particular agent ☐ Different/several agents

Why?

.....
.....
.....

16. Are these agents accessible?

☐ Yes ☐ No

Comments

.....
.....
.....

17. To what extend do you consider the following factors when selecting these agents?

- ☐ Experiences of the agent/s
- ☐ Geographical location of the agent/s
- ☐ Types of services provided (core/non-core)
- ☐ Promptness of services
- ☐ Cost
- ☐ Confidentiality and sensitivity of information
- ☐ Others .....

18. a) How do you rate the current agent/s from whom you are outsourcing the services

☐ Very good ☐ Good ☐ Average ☐ Poor ☐ Very poor

b) Comment

.....

.....

19. a) Which incentives within the legal provision do you get by outsourcing these services (from the agent/s)?

- ☐ After-sale-service
- ☐ Insurance services
- ☐ Bonuses (e.g. free maintenance services for a 1year contract)
- ☐ Guarantee on any product purchased
- ☐ Door-to –door services
- ☐ Others .....

b) How effective are these initiatives?

.....

.....

.....
.....
.....

17. To what extend do you consider the following factors when selecting these agents?

- ☐ Experiences of the agent/s
- ☐ Geographical location of the agent/s
- ☐ Types of services provided (core/non-core)
- ☐ Promptness of services
- ☐ Cost
- ☐ Confidentiality and sensitivity of information
- ☐ Others .....

18. a) How do you rate the current agent/s from whom you are outsourcing the services

☐ Very good ☐ Good ☐ Average ☐ Poor ☐ Very poor

b) Comment

.....

.....

19. a) Which incentives within the legal provision do you get by outsourcing these services (from the agent/s)?

- ☐ After-sale-service
- ☐ Insurance services
- ☐ Bonuses (e.g. free maintenance services for a 1year contract)
- ☐ Guarantee on any product purchased
- ☐ Door-to –door services
- ☐ Others .....

b) How effective are these initiatives?

.....

.....

20. How has IT outsourcing impacted on your organization?

☐ Positively ☐ Negatively

a) Has had a Positive effect. **Comment**

.....

.....

b) Has had a negative effect. **Comment**

.....

.....

21. Do you intend to outsource more I.T services activities in the near future?

☐ Yes ☐ No

Comment:

.....

.....

.....

22. Would you recommend I.T outsourcing alliances to other businesses or organizations?

☐ Yes ☐ No

Justify!

.....

.....

.....

23. Comment on any improvements or recommendation that you think the agent or the government could adopt to enable the success of IT outsourcing in Kenya.

.....

.....

.....

NB: Brochures or other materials relevant to this study would be welcome.

Thank you for taking time to fill in this questionnaire.

ESTHER N. KAMENWA

0721 616 990