

Chapter 10

Outsourcing of IT Resources: Basic Principles

ABSTRACT

This chapter describes the principles of IT resources and IT outsourcing. It first reviews the fundamentals of strategic resources including IT resources, then it explains the basic principles of IT outsourcing including the attendant opportunities and risks.

INTRODUCTION

As introduced in chapters 1, 2, 3 and chapter 6, performance differences across firms can be attributed to heterogeneity in the firms' resources and capabilities. The essence of the resource-based theory of the firm lies in its emphasis on the internal resources available to the firm, rather than on the external opportunities and threats dictated by industry conditions. A firm's resources are said to be a source of competitive advantage to the degree that they are scarce, specialized, appropriable, valuable, rare, and difficult to imitate or substitute—i.e. the VRIN principles mentioned briefly in chapter 2 and elaborated further in this chapter.

A fundamental idea in resource-based theory is that a firm must continually enhance its resources and capabilities to take advantage of changing conditions. Optimal growth involves a balance between the exploitation of existing resource positions and the development of new resource positions. Thus, a firm would be expected to

develop new resources after its existing resource base has been fully utilized. Building new resource positions is important if the firm is to achieve sustained growth. When unused productive resources are coupled with changing managerial knowledge, unique opportunities for growth are created (Pettus, 2001).

From the resource-based view, firms need to use a combination of internal firm-specific and external publicly available resources to create differentiating capabilities to offer products and services to the marketplace. This view is reinforced with the advent of open innovation (Chesbrough, 2003), where the firm's capabilities to conduct strategic sourcing and to constantly reconfigure its available (internal and external) resources in entrepreneurial ways to create new products and services have become the source of competitive advantage. However, what skills do firms need to excel in strategic sourcing? How do firms conduct strategic sourcing?

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CAPABILITIES AND KNOWLEDGE AS STRATEGIC RESOURCES

The resource-based theory prescribes that firm resources are the main driver of firm performance. The resources to conceive choose, and implement strategies are likely to be heterogeneously distributed across firms, which in turn are posited to account for the differences in firm performance. This theory posits that firm resources are rent yielding, when they are Valuable, Rare, Inimitable, and Non-substitutable (VRIN). Moreover, resources tend to survive competitive imitation because of isolating mechanisms such as causal ambiguity, time-compression diseconomies, embeddedness, and path dependencies (Ravichandran & Lertwongsatien, 2005).

Firms develop firm-specific resources and then renew these to respond to shifts in the business environment. As discussed in Chapters 2 and 3, firms develop dynamic capabilities to adapt to changing environments. According to Pettus (2001), the term dynamic refers to the capacity to renew resource positions to achieve congruence with changing environmental conditions. A capability refers to the key role of strategic management in appropriately adapting, integrating, and reconfiguring internal and external organizational skills, resources, and functional capabilities to match the requirements of a changing environment.

If firms are to develop dynamic capabilities, learning is crucial. Change is costly; therefore, the ability of firms to make necessary adjustments depends upon their ability to scan the environment to evaluate markets and competitors and to quickly accomplish reconfiguration and transformation ahead of competition. However, history matters. Thus, opportunities for growth will involve

dynamic capabilities closely related to existing capabilities. As such, opportunities will be most effective when they are close to previous resource use (Pettus, 2001). Firm renews or reconfigures its resources or operational capabilities, through its higher-level dynamic capabilities, in order to exploit the new opportunities (Helfat & Peteraf, 2003; Teece, 2007).

According to Johnson and Scholes (2002), successful strategies are dependent on the organization having the strategic capability to perform at the level that is required for success. So the first reason why an understanding of strategic capability is important is concerned with whether an organization's strategies continue to fit the environment in which the organization is operating and the opportunities and threats that exist. Many of the issues of strategy development are concerned with changing a strategic capability better to fit a changing environment. Understanding strategic capability is also important from another perspective. The organization's capability may be the leading edge of strategic developments, in the sense that new opportunities may be created by stretching and exploiting the organization's capability either in ways which competitors find difficult to match or in genuinely new directions, or both. This requires organizations to be innovative in the way they develop and exploit their capability.

In this perspective, strategic capability is about providing products or services to customers that are valued—or might be valued in the future. An understanding of what customers' value is the starting point. The discussion then moves to whether an organization has the resources to provide products and services that meet these customer requirements.

A resource is meant to be anything that could be thought of as a human or non-human strength of a given firm. More formally, a firm's resources at a given time can be defined as those (tangible and intangible) assets that are tied to the firm over a substantial period of time. Examples of

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