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Outsourcing

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Planning for Strategic Partnerships
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Contributing Editors
Joan Weisman, President, The Sheridan Press
Kevin E. Pirkey, Formerly Sales Manager, The Sheridan Press

Authors
Linda Beebe
Barbara Meyers

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Outsourcing--Planning for Strategic Partnerships

Outsourcing . . .makes sense in an economy that no longer tolerates institutional bulk and demands agility and speed.
– Elliot & Torkko, 1996, p. 47

INTRODUTION

Outsourcing, used previously to merely vend a variety of functions, has taken on a new imperative as a strategic management tool in recent years. Elliott and Torkko (1996, p. 47) define outsourcing as “a conscious business decision to move internal work to an external supplier.” In the past, outsourcing was viewed primarily as a cost-cutting measure. Now, however, managers are recognizing that smart outsourcing can result in an expansion of an organization’s ability to serve customers’ needs.

Traditionally, the business literature has discussed outsourcing as a questions of commodities versus core function. A core function is “one of a limited number of functions that provides strategic advantage to the company. A core function is one that evolves slowly through collective learning and information sharing, cannot be quickly enhanced through additional large investments, and cannot be easily imitated or transferred to others.” (Saunders, Gebelt, and Hu, 1997, p. 64) For publishing, certainly knowledge development is a core function. Commodities, on the other hand, are purchasable items - functions necessary to the business but not unique to it. For example, every organization needs payroll services.

The current business literature suggests another model for analysis, one that looks at results in addition to function. Thus, managers strategically evaluate functions on the basis of whether internal staff or external suppliers can perform them most effectively. The result may be selective outsourcing.

Outsourcing is not a simple matter, it is a complex procedure that requires new sets of behavior on the part of managers, who must examine all aspects of their business critically. They need to develop a coherent outsourcing strategy that focuses on the needs of their unique customer base in terms of product, price, and means of distribution. Publishers must clearly state specific objectives in terms of the relationship that they will create with one or several suppliers of services.

These relationships may be very different from those they have had in the past. First, publishers may need to find new suppliers and new ways to secure the delivery of services. If they do, managers must become comfortable in the new relationships. And, perhaps most important, managers may be dealing with a supplier who is carrying out a function formerly performed within their operations (Fischli, 1996). Consequently, they may fear a loss of control, even though successful outsourcing results in increased controls over quality and performance.

Publishers have long used outsourcing in such areas as copyediting and writing on a freelance or contractual basis. The scope of publishers' outsourcing activities expanded further when the computer was integrated into the publishing process from composition to distribution. This trend has accelerated with the advent of new technologies. The need for technical expertise in the areas of electronic product development has caused publishers to engage a variety of firms from other industries to provide new ways of creating and disseminating published materials. The supply and demand of specialized skills, such as those required by the new technologies, is an important factor influencing the decision to outsource (Slaughter & Ang, 1996).

It is essential not to confuse outsourcing with an opportunity to terminate current staff. Greco (1997, p. 51) noted that outsourcing "may mean eliminating or reassigning employees, [but] outsourcing is no longer a euphemism for downsizing." By identifying core competencies, managers may find the need to increase staff investments in those areas. The primary purpose of outsourcing is not to rid an operation of undesirable elements, but to achieve optimum results. Managers who outsource a department's activities will still require in-house technical expertise for oversight and management of supplier's activities.

When considering outsourcing publishers should restrain their normal tendency to take a tactical approach (that is, getting something done in the near term) and develop a more strategic view. By doing so publishers will improve their business focus, gain the potential to share risks, free staff and other resources to maintain their core functions, gain access to greater technical expertise and capabilities, and increase their ability to create cutting-edge solutions.

This paper is intended to provide a brief overview of outsourcing and how it has evolved over the past few years. Rather than detailing the options a publisher may face, the intent is to furnish information on evaluating and justifying outsourcing as a sound business strategy.

EVOLUTION OF OUTSOURCING

Since the Industrial Revolution, companies have grappled with how they can exploit their competitive advantage to increase their markets and their profits. The model for most of the 20th century was a large integrated company that can "own, manage, and directly control" its assets (Corbett, 1996, p.14). In the 1950s and 1960s, the rallying cry was diversification to broaden corporate bases and take advantage of economies of scale. By diversifying, companies expected to protect profits, even though expansion required multiple layers of management.

Subsequently, organizations attempting to compete globally in the 1970s and 1980s were handicapped by a lack of agility that resulted from bloated management structures. To increase their flexibility and creativity, many large companies developed a new strategy of focusing on their core business, which required identifying critical processes and deciding which could be outsourced (Fischli, 1996).

Initial Stages of Evolution

Outsourcing was not formally identified as a business strategy until 1989 (Mullin, 1996). However, most organizations were not totally self-sufficient; they outsourced those functions for which they had no competency internally. Publishers, for example, have often purchased composition, printing, and fulfillment services. The use of external suppliers for these essential but ancillary services might be termed the baseline stage in the evolution of outsourcing.

Outsourcing support services is the next stage. In the 1990s, as organizations began to focus more on cost-saving measures, they started to outsource those functions necessary to run a company but not related specifically to the core business. Managers contracted with emerging service companies to deliver accounting, human resources, data processing, internal mail distribution, security, plant maintenance, and the like as a matter of "good housekeeping" (Alexander & Young, 1996).

Outsourcing components to effect cost savings in key functions is yet another stage as managers seek to improve their finances. In publishing, a notable example is copy editing.

Outsourcing Stages
- Ancillary functions to delivering product or service
- "Back office" support functions
- Key cost-saving measures
- Selective strategic partnerships to improve competitive advantage

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Strategic Partnerships

The current stage in the evolution of outsourcing is the development of strategic partnerships. All the outsourcing examples noted above were designed to improve efficiency; none involve the customers. Until recently it had been axiomatic that no organization would outsource core competencies, those functions that give the company a strategic advantage or make it unique. Often a core competency is also defined as any function that gets close to customers. In the 1990s, outsourcing some core functions may be good strategy, not anathema. For example, some organizations outsource customer service, precisely because it is so important (Greco, 1997).

Eastman Kodak's decision to outsource the information technology systems that undergird its business was considered revolutionary in 1989 (Gurbaxani, 1996), but it was actually the result of rethinking what their business was about. They were quickly followed by dozens of major corporations whose managers had determined it was not necessary to own the technology to get access to information they needed.

The focus today is less on ownership and more on developing strategic partnerships to bring about enhanced results. Consequently, organizations are likely to select outsourcing more on the basis of who can deliver more effective results for a specific function than on whether the function is core or commodity.

WHY CONSIDER OUTSOURCING?

The main business purpose for outsourcing is to enhance the value of an organization's offerings to its customers. Earl (1996) calls this "smart" outsourcing, which indicates a careful selection of functions to be outsourced based on strategic decisions. Strategic or smart outsourcing of functions necessary to maintain an organization's market advantage allows the organization to get closer to its customers. Improving an organization's market advantage should be the primary motivation for any decision to outsource.

The experience of analyzing the potential for outsourcing gives a publisher four very positive outcomes. First, it helps the manager evaluate opportunities. As part of a strategic plan, a cost-benefit analysis delineates those functions that can be performed as efficiently, if not more so, by outside suppliers. Developing a cost quality matrix helps managers visualize which functions are high or low in their priorities for "smart outsourcing." Second, it gives a manager a greater awareness of supplier competencies in the field. Strategic outsourcing involves creating and sustaining partnerships with world-class companies; therefore, selecting the right supplier for the right function is essential.

Third, as publisher and suppliers share responsibility for the transition of processes along with human and technical resources, professionals from all areas of publishing management learn to identify key people issues. And fourth, to develop and maintain any successful business relationship, managers must become proficient in monitoring such activities as service levels, customer satisfaction, costs, and attainment of agreed-upon goals (Elliot & Torkko, 1996).

Merely going through the exercise of determining whether to outsource will provide valuable insights into a publisher's operational efficiencies. It may also trigger a significant shift in internal attitudes and perceptions about existing staff and how best to optimize their performance, whether the decision is made to outsource or not.

Prevailing wisdom says the worst reason for outsourcing is to rid an organization of a staffing problem, rather than resolving it. Expecting a supplier to take on a function that has been performed poorly internally is merely setting the stage for failure if the inherent problem is not identified and addressed.

Positive Effects
- Evaluate opportunities.
- Discover supplier competencies.
- Identify key people issues.
- Become skilled at monitoring services, customer response, and costs and goals.

TACTICAL & STRATEGICAL RATIONALES

Competitive advantages from information no longer accrue naturally to institutions that have internal technological 'resources.' Rather, the benefits accrue to institutions with the flexibility to tap the source of the best technology at an acceptable price.
-Huber, 1993, p.12

Sometimes companies are simply looking for a quick fix or a way to deal with an intolerable internal problem. Looking for an easy way out is likely to lead to failure in outsourcing. There are, however, sound tactical and strategical rationales for outsourcing.

Tactical Rationales

Traditionally, companies have outsourced for tactical reasons - reduce costs, free up cash, obtain resources not available internally, and improve their performance. Outsourcing some functions can shift costs from fixed to variable, thus enhancing a company's ability to manage costs more effectively. If a company is moving into a new arena, outsourcing enables it to add new functions with minimal impact on internal resources.

It is difficult to quarrel with cost savings, and the companies that approach outsourcing with careful planning save money. Surveying 30 companies, the Outsourcing Institute found they averaged a 9 percent cost savings and a 15 percent increase in capacity by outsourcing. In a survey of 19 companies that outsourced their information technology, Saunders, Gebelt, & Hu (1997) found that the average savings was 15.4 percent, with a range from 0 to 40 percent.

Tactics
- Reduce costs.
- Infuse cash.
- Get new services.
- Change fixed costs to variable ones.
- Improve performance.
- Add functions.
- Cure a problem.

Strategical Rationales

Organizations today also approach outsourcing as a business strategy. Nowhere is this more evident than in high-tech companies, such as Sun and Microsoft. Drtina (1994) described these firms as "intellectual holding companies" because they focus so strongly on their core technologies while they purchase other services from companies that excel at delivering them. Thus, their entire operations function at a high level, yet they do not have to maintain everything. They get world-class capabilities without the risks involved in developing all of them.

Companies that have undergone reengineering often find that outsourcing reinforces the benefits they gained from the process. Other strategical reasons include long-term flexibility, good access to best practices, and acquisition of new skills (Elliott & Torkko, 1996). If a company selects suppliers who have outstanding technical capabilities, it can leverage the skills and knowledge in both companies to enhance their competitive advantage and achieve technical supremacy.

Increasingly, managers talk about *sourcing* rather than outsourcing. Timothy Taylor, director of corporate purchasing for AT&T Capital, noted that people need to think, not about outsourcing, but about suppliers (Mullin, 1996). Some suppliers may be internal, and some may be external - they all require the same high level of planning and management.

Strategies
Improve focus.
Obtain world-class capabilities.
Step up reengineering benefits.
Manage risks.
Redirect resources.
Acquire skills.
Achieve flexibility.

PUBLISHING FUNCTIONS

For publishers, there may be less question about what is core and what is commodity. The authors believe that the only true core competency for a publisher is knowledge development. Historically, publishers have performed internally a large number of additional steps in the publishing process. On the other hand, some publishers have outsourced critical components of the publishing process, such as editing, composition, marketing, and dissemination, which can be considered commodity functions.

The publisher's job is to manage the overall process, not necessarily to perform all the tasks involved. Instead, publishers must first create a conducive environment in which knowledge development takes place. In addition, they must oversee an operational structure to ensure that the product of knowledge development can reach the ultimate customer.

Thus, most steps in the publishing process are potential candidates for outsourcing. Determining which functions are better done internally and which externally requires a company-specific analysis. No matter which or how many of the functions are outsourced, the degree of success will be dependent on competent, visionary management. Outsourcing does not mean abdicating responsibility or control, rather it refines the application of those business practices.

Publishing Examples

Many functions in the publishing process are candidates for outsourcing (see the chart on the following page). Three brief examples might illustrate how hypothetical company, Zeus Publications, considers its outsourcing options.

Allocation of Resources

Zeus staff have decided that they should be preparing their books for electronic delivery and archiving. They investigate their options (SGML, PDF, HTML, XML) with experts in the field and select SGML as their format of choice. After considering the possibility of doing the SGML coding internally, they decide against it for several reasons. Zeus receives disks from most of their authors, but not all. Determining the staff level they would require is difficult, as the number of books is not large and there are peaks and valleys in the manuscript flow. None of their current staff has the expertise, and all staff are fully occupied with current job responsibilities. The staff decide that the only logical approach is to locate a supplier who will key and code manuscripts from both hard copy and disk.

Quality Control

Disaster strikes. Zeus staff did not tag and bag their last journal issue according to periodicals postal regulations. Correcting the mishap was so costly that it led them to consider having a supplier (mailhouse or printer) maintain their subscriber list. Maintaining currency of mailing lists and compliance with postal regulations is a classic control issue in the dissemination of journals. Publishers often think that they must maintain the lists themselves in order to control quality, whereas the Zeus staff learned "leave it to the experts."

Acquisition of New Skills

Zeus staff, like all others in publishing, are getting pressure from authors and readers to “go electronic.” But how do they get there? They realize they do not know what would make the most viable product, nor do they know how to go about getting the information they need. After discussion with potential suppliers, they learn about the variety of research techniques available. They then contract with a market research professional to engage in focus sessions to learn their customers’ preferences and experiences with electronic information.

ANALYSIS OF OUTSOURCING POTENTIAL

The outsourcing issue should be part of a larger question regarding how the function being evaluated. . . fits into the organization and what types of services it offers.
-Jones, 1997, p. 66

The decision-making process related to outsourcing starts with a determination of what you will “make” versus what and when you will “buy.” To get to that decision, managers must analyze all the parts of the publishing process and decide which functions staff will perform and which functions are necessary but can be better and more cost-effectively accomplished by creating a partnership with one or several suppliers. Efficiencies are realized when the right supplier is selected for the right function. That supplier will be one whose staff are competent and efficient at certain functions because that’s all they do all day, every day.

One method for analysis might be to create clusters of functions for potential outsourcing. The first cluster would include activities that are core to the business of publishing. In essence, these are publishing’s “traditional franchise” (Huber, 1993). These functions would not be touched but would remain in-house. After that, all other functions should be assessed on their own merits as to whether internal or external sourcing will garner the best performance.

Managers should recognize that outsourcing is not an “all-or-nothing” approach. As they assess each function, they need to look at the benefits that should accrue from internal or external sourcing. By focusing on these benefits as the primary objective for outsourcing, managers should be able to realize better use of technology, strategic enhancements, financial gain, and improved management and budgeting.

Next, a comprehensive analysis of costs by function will be critical in framing a request for bids and contract requirements. Kee and Matherly (1996) declared that “the actual cost of the service should be calculated by adding the cost of the service’s [function’s] operations to the costs of resources used by other departments that support that service - costs that are difficult to determine because of their indirect relationship to the service being evaluated.” Simply put, it is essential to consider *all* direct and indirect costs when assessing the make-or-buy decision for any function.

In addition to these concrete assessments of functional areas and their costs, qualitative factors, such as employee morale, loss of control over a function, and integration of internal operations with those of chosen suppliers should be considered.

After all the internal analyses and assessments have been made, the work of identifying and creating relationships with potential supplier partners begins. Successful organizations rigorously evaluate suppliers, tailor the terms of the outsourcing agreement, and carefully manage the functions undertaken by the supplier. One of the major objectives should be to maximize flexibility in the control of the outsourced function to allow an organization to follow different options. These options present themselves as staff learn more about how a function can be performed more efficiently and effectively or as environmental factors change (Lacity, Willcocks, & Feeny, 1995).

The application of selective or smart sourcing should meet customers' needs while minimizing the risks associated with total outsourcing approaches. Current business thinking is to contract for more flexible, modular outsourcing that provides managers with a greater number of options. This practice places greater demands on managers as they need to carefully select the functions to be outsourced to achieve a successful outsourcing environment. To be competitive in the marketplace, an organization must be able to manage change.

Ask the Right Questions

- What are our core competencies in the publishing process?
- What support functions found in any business do we require?
- What necessary functions (core and support) could potentially be done more efficiently and more cost-effectively by a supplier?
- What are our overall objectives for outsourcing?
- What barriers exist to outsourcing?
- What is the potential functional impact of outsourcing?
- What can be improved internally before outsourcing is considered?
- What are our requirements for each of the functions to be outsourced?
- Who are the major suppliers (world-class companies) in each of these functional areas?

PREPARING FOR SUCCESS

Once the decision is made to outsource any component, a company must make sure its house is in order before the operations are transferred to the new supplier. There may be significant internal clean-up work to be done, for example, if the function to be outsourced has operated inefficiently. If it is not possible to correct problems, then it is essential to be clear about what they are and what changes are expected from outsourcing.

Even if the internal operations are not in bad shape, there are numerous staffing and cost issues to be considered in addition to relationship building. Successful partnerships with suppliers must be build on strong frameworks.

Staffing Issues

One of the key elements of a good outsourcing plan is communication with staff. In their zeal to keep staff informed, companies contemplating a potential outsourcing agreement sometimes share information too soon. Judicious sharing of findings, such as feasibility studies and vendor screening, at a point when there is solid information to give, can help minimize staff anxieties and smooth the process. Before decisions are announced, the company should have a detailed plan for handling employee issues fairly and directly.

In-House Staff

Managers sometimes assume that they can eliminate all staffing for a function if it is outsourced, when in fact very skilled staffing is required for a successful partnership. Critical skills include those in contract management and conflict resolution, as well as the requisite technical skills. To take full advantage of the supplier's technology, the company must employ a liaison who has the expertise necessary to evaluate performance, negotiate with suppliers, and make decisions.

The staff liaison’s attitude may be nearly as important as their problem-solving skills. Successful outsourcing partnerships occur when suppliers are managed as partners, not as vendors. Consultants can supplement staff and can be particularly helpful in guiding staff through the implementation of a contract with a supplier. However, they generally cannot substitute for a skilled in-house liaison.

Key Elements for Success
- Staffing
- Costs
- Roles & Expectations
- Written Contract
- Performance Criteria

Outsourcing an Entire Function

When an entire function is outsourced, companies must consider additional issues. For example, will the new partner hire the staff who have carried out the function internally? Companies generally want to protect staff who have been loyal and productive workers. Further, the company will need their help in a successful transition to outsourcing, especially for technical operations that are not well documented. And a supplier is likely to need additional experienced and competent staff.

When suppliers hire existing staff, companies see the pay-off for careful planning and fair treatment of staff early in the process. Those former staff who were treated fairly are much more apt to perform well in the transition and the ongoing implementation.

If the staff who have performed the function internally are not competent, the company should deal with them before outsourcing. Companies that outsource to rid themselves of personnel problems have found themselves dealing with the same personnel with the same performance problems now reporting to, and presumably loyal to, another company.

Costs

Identifying the total costs before an agreement is signed is essential. What are the set-up costs? Have the cost implications of any required conversions been explored? What management costs will be incurred - internally and with the supplier? Managers should not assume a cost is included if it is not specified.

There may be potential hidden costs related to staffing if an entire function is being outsourced. For example, the company may pay for career transitions such as severance and outplacement or for additional training if existing staff are moving to the supplier.

Roles and Expectations

Clear expectations of roles, responsibilities, and expectations pave the way for a successful partnership. The supplier needs to know the company’s goals in outsourcing. If the outsourcing is expected to solve an internal problem, the supplier should be told. Specific designations of who will do what at what time are important details. The information channels should be established from the beginning.

Knowing precisely what the supplier’s capabilities are is key to successful outsourcing. Can they deliver exactly the services the company expects? Will the reports provide the information needed? Will schedules mesh with company timing? Is the company expecting the exact service it had with an internal operation or a very different one? Sometimes companies and suppliers both make assumptions that cause difficulties in the partnership.

Evaluation Factors

- Agreed-on services
- Delivery times
- Average response time for corrective action
- Communications
- Flexibility
- Problem-solving
- Feedback
- Meeting commitments

Performance Evaluations

The time to establish evaluation measures and procedures is before the agreement is signed. To assure that performance will be measured against original expectations, it is important to develop mutually-agreed upon measures early on and put them in writing.

The internal staff plan for carrying out regular monitoring and measurements should also be established early. All business functions require oversight and regular reviews, but systematic oversight is often neglected in outsourcing. When total functions are outsourced, many of the people involved in the negotiations may not be present for the evaluation stage. It is not enough to have written evaluation plans and schedules, they must be incorporated into the company's operating plans. Otherwise, they may languish in a file drawer.

The most successful partnerships establish best practice goals from the beginning and then benchmark against them on a regular basis. Companies should expect excellence on both side of the compact.

For large operations, Elliott and Torkko (1996) recommended a joint oversight committee that includes representatives from the company and the supplier. Any outsourcing partnership will benefit from regular meetings between the key players for both parties. These meetings should feature a specific agenda that includes emerging issues and follow-up action plans.

Companies must also evaluate their own performance for clarity of communication and on-time deliveries. All suppliers will have difficulty meeting deadlines if they do not receive the materials they need from the company in a timely manner.

A Good Contract

- Terms of the agreement (the trend is to shorter-length contracts)
- Detailed description of supplier's obligations and services to be provided
- Publisher's responsibilities and obligations
- Performance measures and expected service levels
- Rates, fees, and any incentives or penalties
- Ownership rights if the agreement is terminated, including intellectual property rights
- Warranties
- Disclaimers
- Annual reviews
- Option to renegotiate
- Means for conflict resolution

The Agreement

Too frequently, companies, even those that have done their homework in the analysis and bid processes, rush into contracts. Taking the time to negotiate a good contract that is fair and reasonable for both parties is a must. Neither party wins if the contract is not profitable for both, and the company that demands the most upfront savings may pay dearly in the long run.

Experienced outsourcing consultants caution that a contract must reflect the company's business plan and must accommodate changes in the business plan (Mullin, 1996). While the parties are building in flexibility, they must also develop very specific measurements and definitions.

For very large contracts, experts often recommend hiring an external expert to write and negotiate the contract. Contracts should fit the work and the organizations involved, and standard supplier contracts often are not sufficiently detailed. Although contract negotiations can be time-consuming, the time will be well spent if the contract is sound. Experts agree that well-drawn, specific contracts lead to successful partnerships (Saunders, Gebelt, & Hu, 1996).

STRATEGIC PARTNERSHIPS

Many managers have resisted outsourcing because they equate internal control with assurances of high performance; however, there is ample evidence that internal operations do not always guarantee success. As Alexander and Young (1996, p. 117) noted, "Retaining direct control in-house may offer managers psychological comfort, but it may not guarantee performance."

Determining what to outsource may no longer be a question of whether a function is core or commodity. Instead, the question may be how the company can get the best and most efficient solution for a necessary function. Focusing on the required result can help managers develop a framework for analyzing what should be outsourced and what can be accomplished more efficiently in-house.

Developing successful partnerships with external suppliers requires careful planning. The following are key steps in the process:

- Evaluate core and commodity functions.
- Determine requirements and analyze internal capacity.
- Investigate potential partners.
- Select the right partner or partners.
- Negotiate a win-win agreement.
- Make the transition.

When companies outsource key functions, they must be certain to maintain strength in the functions they keep internally. Outsourcing is a powerful tool, but if a company becomes merely a collection of outsourced activities, it will lose its unique value.

Chesbrough and Teece noted that virtual companies - those that develop partnerships with external suppliers - can "harness the power of market forces" to produce, market, disseminate, and support their products "in ways that fully integrated companies can't duplicate." (1996, p. 65) With technology changing so rapidly, companies need innovation, flexibility, and sound business strategies to maintain a competitive advantage. Selective, strategic partnerships with world-class suppliers can strengthen that advantage.

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ABOUT THE AUTHORS

Linda Beebe is President, Parachute Publishing Services, which provides project and program management and support for all publication phases from content development through promotion, distribution, and evaluation.

Barbara Meyers is President, Meyers Consulting Services (MCS), which provides expertise in management, marketing, research, and planning to professional societies, scholarly publishers, and commercial firms.