



## The Impact of 'IT' Outsourcing on the Restaurant Industry

Frank KwadwoTakyi<sup>1</sup>, Lomatey Isaac Toku<sup>2</sup>

*Koforidua Technical University P.O Box Kf 981, Koforidua- Ghana.*

*Email: anyemitoku@hotmail.com , fkt@yaahoo.com*

### Abstract

This research examines the impact of IT outsourcing on Restaurants' Operations within the United Kingdom (UK). The study employs the theory of Transaction Cost Economics (TCE) and Resource-Based View (RBV) to conceptualise a theoretical framework. Data for the study was collected from 100 respondents consisting of supply chain managers, IT managers and senior management team members from three Restaurant Operations in the UK. The respondents were purposively sampled in order to ensure that only staffs with the relevant knowledge were contacted. A case study research design was adopted. Data was then analysed using both qualitative and quantitative techniques. The study established that increase in operational efficiency and cost reduction are recorded as benefits in IT outsourcing; companies have not experienced any serious post-contractual problems because they take the necessary safeguards to ensure that success is achieved in contracts; decision making is also the prerogative of top management and companies still talk about 'giving out non-core functions in order to concentrate on core competencies' without giving the necessary attention to other costs associated with the process. It was therefore recommended that due diligence and critical thinking have to be done by all stakeholders to be able to avert and manage any challenge that may occur in the process of outsourcing in restaurants' operations.

**Key words:** Outsourcing; Contract; Restaurant; IT; Theory.

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### 1.0 Introduction

It is believed that the trend of IT outsourcing for the past two decades has been prompted by improvements in technologies, advance management tools, and increasing flexibility in requirements from buyers of many organisations (Kagalwala and Tisnovsky, 2006). This, however, does not imply that IT outsourcing is a new phenomenon in the business environment, rather, it is the scale and occurrence of outsourcing that have greatly increased over the last decade. The growth and expansion of an organisation is normally associated with an increase in the volume of organisational data, effective management of which becomes problematic with the passage of time. While it was true that

companies could no longer manage their data/information manually some years back, it is correct today that companies on their own can no longer manage their data as effectively and efficiently as expected. It is therefore not surprising that majority of companies have resorted to giving out the management of their data to third party service providers with the aim of achieving efficient, cost-effective and expert solution and the need to meet the demands of system implementation, maintenance, security and operations. Thus, in an attempt to ameliorate the effect of the critical operations problems and difficulties being faced by companies, some of them are now considering putting their responsibility to IT service providers. It has been revealed by some financial experts that IT outsourcing has become a practice in which a company uses an outside service provider to arrive at better business decision (Ray and Ramaswamy, 2007). The transaction cost economics (TCE) theory makes it possible to explain whether some specific activities of a firm are to be carried out in-house or outside by resorting to the market (Oxford University Computing Services, 2008). The resource-based view theory (RBV) on the other hand is of the view that a company can achieve competitive advantage by concentrating on its core-competences (Wernerfelt, 1984 and Barney, 1991). Literature on outsourcing in general has turned to be dominated by attention being focused on the protection of 'core competencies' of organisations at the expense of other equally important areas (Mclvor, 2005). This study seeks to unravel the reasons behind the rapid adoption of outsourcing policy and its attendant problems in general in the restaurant industry in the UK in connection to the theories mentioned earlier.

### *1.1 Outsourcing.*

Fan (2000) posits that outsourcing is a contractual agreement between the user and one or more providers to provide services or processes that the user is currently providing. Dawne (2003) points to some of the reasons firms enter into outsourcing agreement. These include increasing customer satisfaction of its products and services and increase the shareholders' value, obtain expertise, skills and technologies not otherwise available, acquire innovative ideas, improve credibility and image by associating with superior providers. Firms may also outsource because of revenue driven reasons with the aim to gain market access and opportunities through the provider network, which will help in accelerating expansion by tapping into the provider's developed capacity. Thus, outsourcing is a means to secure best available expertise for products and services available in the market. This helps in the improvement of management control on the business if outsourcing contract is reached by means of a well-structured agreement (University of Johannesburg, 2006). There are financial benefits that could be realised from outsourcing IT decisions. For example; outsourcing can bring IT costs under control through efficiency which can be delivered by the service providers. Thus, the use of quality service provider reduces firms risking in the wrong technology or significantly limit the required capital investments, making financial resources available for more strategic activities (The Canadian Institute of Chartered Accountant, 2003). Cost savings is the major driver for IT outsourcing, though the importance of superior technical skills to improve quality is rising rapidly among firms (Ray and Ramaswamy, 2007). Boldea (2006) also examines the factors likely to cause restaurant firm to embark upon outsourcing its IT system. One of the major factors is the treatment of its accounting system. The way in which IT costs are treated for accounting purposes can affect the outsourcing decision. Moreover, the management perception of IT may be another factor that can make the organisation to seek for IT service provider. For example; Laube and Robert, (2002) argues that few restaurants could operate profitably without the managers having access to accurate and timely financial information. Although the accounting is

not core function of the restaurants, however with the advances in the technology, restaurant companies of all sizes are turning their accounting processes over to IT service providers that have superior software, computer technology and manpower to do the better job at a lower cost. Ray and Ramaswamy (2007) and the Canadian Institute of Chartered Accountants, (2003) identify problems with outsourcing as security vulnerabilities, poor contract management, loss of competence, loss of IT network, gaps between the standard of service a restaurant company expects from its service provider and the services actually delivered and loss of data integrity. Thus, the need of management competencies for effective governance, monitoring and problem resolutions are lacked.

### *1.2 Transaction cost economics ( TCE ) theory.*

Williamson uses the transaction cost economics (TCE) to explain why firms exist (Oxford University Computing Services, 2008). The theory suggests that it is possible to define whether some specific activities of a firm are to be carried out in-house or outside by resorting to the market. The TCE theory in general assumes that markets are competitive ex ante (with many buyers and sellers). Opportunism emerges ex post due to certain characteristics of the supply relationship which give one or both parties some monopoly power when certain contingencies arise. The theory also assumes that there is a strong incentive to structure contracts to minimise reliance on the legal system and therefore to structure vertical arrangements to achieve a "private ordering" that does not rely on legal enforcement (Williamson, 1985 and Scott, 1996). The theory contains a number of variables that can be used to examine the IT outsourcing arrangement. These variables determine whether transaction will be lowest in the open market. In addition, it is easy to consider these variables with respect to decision of firms to integrate vertically (Oxford University Computing Service, 2008). Brewer (2006) argues that the primary concern of TCE is to minimise cost and the TCE Theory is developed to examine the particular structure of a firm and the firm's aim. Brewer (2006) concurs to this and argues that the primary behavioural assumptions related to transaction cost economics are found in the human behavioural aspects of contracting. This involves drafting of the outsourcing contract which may not address all the firms need. Thus, firms involved in contract may act opportunistically, which may lead firms not receiving services as desired. Transaction cost economics constructs the asset specificity and market uncertainty. Kvaloy (2005) describes asset specificity to usually vertical integration, which breeds opportunistic behaviour. The asset specificity asserts that transactions between firms involve assets, which may be tangible or intangible and these assets can be valuable and much more valuable when specific transaction is involved. TCE points out that this transaction tends to be vertically integrated (Oxford University Computing Service, 2008). The asset specificity aims to explain the boundary of firms, strategy, vertical, horizontal and decision making. In the TCE, the greater the value of asset the more likely the transaction will be managed (Dawne, 2003). Baethelmy and Quelin, (2002) consider asset specificity to be most important in outsourcing, when firms entrust their assets to an outside service provider and this makes business relationship to be developed and this asset must be protected against potential vendor opportunism. Asset specificity becomes problematic where there is opportunism (Lonsdale, 2001). Market uncertainty increases as the length of the contract increases. Thus, if there is greater uncertainty in transaction, the contract is likely not to be completed. Transaction cost economics holds that if there is presence of greater uncertainty, there is likelihood that the contract will be internally mediated (Brewer, 2006). It should be noted that market uncertainty is characterized by information asymmetry when some parties to business transactions may have an information advantage over others. In the case of outsourcing contract, it is believed that service providers

have skilled and more information than firms, which leads to adverse selection. Thus, to avoid the occurrence of adverse selection that may lead to moral hazard, most firms delegate outsourcing contracts to specialised contracting agents (Money Instructor, 2005).

### *1.3. Resource based view theory ( RBT ).*

The resource-based view theory (RBT) stipulates that a company can achieve competitive advantage by concentrating on its core-competence (Wernerfelt, 1984 and Barney, 1999). The capacity of a company to obtain a profit margin higher than its cost of capital depends on two principal factors: the attraction of the industry in which it operates and the establishment of a competitive advantage over its rivals (Porter and Millar, 1985). But the resource-based thinkers believe that the 'capacity' of the firm to achieve these higher profit margins (rents) is greatly dependent on the core competence the company possesses. In 'The Core Competence of the Corporation' Prahalad and Hamel (1990) describe core competence as something that a firm can do well that meets three conditions: 1) it provides consumer benefits; 2) it is not easy for competitors to imitate; and 3) it can be leveraged widely to many products and markets. Core competence in this context can be explain as a key ability or strength that an organization has acquired that differentiates it from others, gives it competitive advantage, and contributes to its long-term success or the cluster of extraordinary abilities or related excellences that a firm acquires from its founders, after consistent striving over years, and which cannot be easily imitated (Lysons and Farrington, 2006). Resource-Based View argues that a firm has the ability to achieve and sustain competitive advantage if it possess resources that are valuable, rare, imperfectly imitable and non-substitutable (Barney 1991). Quinn and Himmer (1994) also argues that an organization must not outsource its core competencies, and systems must be created to protect them. The inference one can make from all these explanations and definitions of core competence emanating from the RBV approach to outsourcing is that the company must distinguish between its core and non-core functions i.e. differentiating strategic functions from commodity functions (Lacity and Willcocks, 1995). However, evidence abounds that it is not easy to do this distinction. What comes to mind immediately when one thinks of the distinction between core and non-core functions is IBM's mistake of what really constituted its core and non-core when it outsourced its 'strategically critical' components such as microprocessor and operating systems to Intel and Microsoft ( Balakrishnan et al 2007).

## **2.0. Methodology.**

A case study design was adopted for this study. The researchers adopted a case study approach for this research because they wanted to study contemporary phenomenon in its real-life context (Yin 2003). The target population for this research are supply chain managers, IT managers and senior management of the restaurant companies in the UK. The unit of measure for this research were three restaurant businesses in the UK. These companies were selected based on the spread of their outlets and have operated for at least twenty years. Purposive sampling method was employed so as to get people with the relevant background knowledge to talk to. To strengthen and give more credibility to the study three research instruments were used for data collection. These were internet survey; personal survey through questionnaires and interviews. Data was then analysed using both qualitative and quantitative techniques because of its enormous advantages (Cohen and Crabtree 2008; Hoff and Witt 2000). A total of 320 e-mail questionnaires were sent for the survey for a period of five weeks. But out of this number, 265 got to the recipients because 55 bounced. Thus,

from a total of 265 questionnaires sent, 60 were received which were properly answered. To ensure that the data are valid, all data gathered are checked for accuracy (Trochim and Donnelly, 2007). Interviews were also used to allow for short comings of the statistical approach to be reduced or eliminated in the research process as the limitations of one method is strengthened by the other. The data gathered from the series of interviews from 40 respondents from top management provided more information on the validity or otherwise of the TCE and RBV theories and IT outsourcing. In addition, the questions posed to the interviewees provide the validity of uncertainty in the contract agreements. In other words, the interviews provided more understanding on TCE theory in relation to outsourcing contract management.

### 3. 0. Results and discussion.

Table 1

The detail summary of findings from the questionnaire

SR	Summary of question	% SA	% A	% SwA	% NA	% SNA	Comment
1	IT outsourcing increases competitive advantage	80.8%	11.5%	3.8%	3.8%	0.0%	Most respondents strongly agree that IT outsourcing increases competitive advantage
2	IT outsourcing reduces cost	76.9%	15.4%	7.7%	0.0%	0.0%	Most respondents strongly agree IT outsourcing reduces costs
3	IT outsourcing improves efficiency	80.8%	11.5%	0.0%	7.7%	0.0%	IT outsourcing is strongly agreed to improve firms' efficiency
4	Outsourcing increases profitability	73.1%	15.4%	7.7%	3.8%	0.0%	IT outsourcing mostly increases profits
5	IT outsourcing involves risks	69.2%	19.2%	3.8%	3.8%	3.8%	Most respondents strongly agree that high risks are involved in IT outsourcing
6	Outsourcing stifles employees' morale	65.4%	19.2%	7.7%	3.8%	0.0%	IT outsourcing is strongly associated with staff moral efficiency reduction
7	Outsourcing involves risks	62%	15%	7.6%	3.8%	11.5%	Outsourcing in general involves considerable risk
8	Outsourcing involves long-term contract	38.5%	38.5%	19.2%	0.0%	3.8%	Equal proportion of respondents strongly agree and agree IT outsourcing involves LT contracts (77% of total respondents)

9	Vendors amend contract price post-contractually	69.2%	19.2%	7.7%	3.8%	0.0%	Majority of respondents strongly agree that service providers inflate contracts after agreement
10	Involvement of procurement in outsourcing decision is crucial	19.2%	15.4%	38.5%	3.8%	19.2%	Although the view is not common, more respondents are not specific whether procurement manager should participate in IT outsourcing decision
11	Outsourcing decisions should be taken at executive levels	76.9%	15.4%	3.8%	3.8%	0.0%	Majority of respondents strongly agree that only high level management should make outsourcing decision
12	IT functions ought to be outsourced	38.5%	23.1%	23.1%	11.5%	3.8%	More respondents strongly agree that it is crucial to outsource IT functions, although they are far from the majority of respondents
13	Change of asset location in outsourcing is risky	80.8%	7.7%	3.8%	7.7%	0.0%	Most respondents strongly agree that assets transferred to service providers involves high risks
14	Vendors meet expected standard in outsourcing	30.8%	15.4%	23.1%	15.4%	15.4%	NB: As these 2 questions aim at collecting the same information, the discordance between the answers renders the results non-exploitable
15	Vendors fail to meet expected standard in outsourcing	38.5%	15.4%	30.8%	7.7%	7.7%	

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To begin with, 80% of the respondents from the survey agreed that firms outsource to: increase competitive advantage, reduce cost, and to improve efficiency. Again, most of the respondents from the survey also agreed that IT outsourcing in particular and outsourcing in general involve considerable amount of risk. This is indicated by 70% and 62% of those strongly agree when the questions: IT outsourcing involves risk and outsourcing involves considerable risk respectively were asked. All three companies interviewed agreed that the main reasons for giving their IT functions to an outsider were: to reduce cost; increase efficiency; and to have ample time to concentrate on their core functions. Also they all indicated increase in operational efficiency and cost reduction as a benefit. The interviewee from company Z asserted that "the maintenance and management of the company's computer systems and networks are now being undertaken at a reduced cost and efficiently as compared to when they were performed internally. In the case of company X, it claims that "now it obtains deliveries in real time with drastic stock reduction. The logistics solution provided by the vendor has greatly improved its procurement and logistics operations. Company Y said "it enjoys quick response from its suppliers, efficient payroll system, effective communication due to the intranet facility provided by the IT service provider, etc. Also the time taken to respond to customers' needs/orders has also reduced with the IT service provider taking charge of the call centre. Concerning problems being faced, the opinions of the three companies are same. They have not encountered any serious problem yet. The interviewee from company X said "they only have minor relationship management problem with the supplier and that this arises when the later calls for upwards price adjustment. However, this has not posed any serious problem since most of the time their (vendors) demands are met. Companies Y and Z did not have much to complain about even though they believe there is more room for improvement in the area of cost savings.

On asset specificity and hold ups, all the companies agreed that certain assets, at times including some staff, are transferred to the vendor's location. For example; about 90% of company X's IT employees were sent to the vendor's location after the outsourcing contract was entered into. The vendor also comes to give regular training and/or upgrading to the staff that are retained in the company. This takes the form of video and CD-ROM. However, they all disagreed that vendors use and/or could use this to take them into hostage. It is also clear that all the three companies have not experienced any serious post-contractual problems such inflation of prices and/or amending of contract after it is signed. Companies X and Y attributed this to "*insignificant nature of the demands/adjustments normally requested by the vendors*" while company Z attributed this to "*effective pre-contractual assessment and arrangement/negotiation*"

With regards to uncertainty, the interviews conducted with these three companies revealed that all the companies were aware that there is some level of risks in the outsourcing contracts, especially when contracts involve several millions of dollars. To avoid the contract collapse before the term of the contract, the three companies confirmed that they take the necessary safeguards to ensure that the company achieve success in the outsourcing contract. For instance; the interviewee from Company X asserted that "Management takes several measures before signing contract agreement with vendors. Firstly, we assure that the vendor is credible, has long years of experience in the areas of outsourced, we do this by investigating on the past performance of the vendor in question. The interviewee from Company Z posits that "Management goes to the extent of using private consultant to investigate the past records of the vendor the company is

contemplating to enter into the agreement with to make sure that the vendor has already completed several related outsourcing contract without problems”.

It also emerged from the interviews conducted with the sample restaurants that outsourcing decision making is the prerogative of top management. On the question of the level of participants’ involvement in outsourcing decision making, it came to light that in all the three companies only the directors and people of executive position in the company participate and that the involvement of other managers depends on the quantum of money and contractual size. For instance, the interviewee from company Y said “the procurement manager’s involvement in such decisions is restricted to a ceiling of £100,000 worth of contract”. The interviewee from company Z was of the view that “outsourcing is pure contract and therefore should involve people who have knowledge on the legal issues and procurement may lack contract law”.

The transaction cost economics theory (TCE), of Williamson (1985) appears to not be valid in the variable of asset specificity as it was revealed from the findings of the interviews conducted with the sample restaurants. The interviews revealed that none of the companies has experienced hold-up post-contractually. It is basically due to the fact that the IT outsourcing contracts they sign involve basic standard (non-specific) functions such as finance and management administration, provision of intranet facilities, accounts and payroll and training, etc. such functions can be fairly reversed in-house and/or switch from the existing vendor to another provider if things go wrong. For instance; it was not possible for Company Y to be held-up by its vendor (as asserted by the IT manager) because the service it requires from the provider is fairly simple and standard i.e. payroll solution delivered by Moorepay. The theory assumes that outsourcing of IT functions suffers post-contractually where there is unbalanced of specific asset investment and uncertainty. This was heavily supported from the survey findings in which most respondents agreed that IT outsourcing involves considerable risk (Ray and Ramaswamy 2007). The apparent contradiction in the findings from the survey and the interviews concerning post-contractual problems could be attributed to the fact that most of the IT functions outsourced in the sample companies are standard functions and do not require much specific investments. Beside this, the contract durations were relatively short term and for that matter involve less uncertainty. It is therefore not surprising that these companies do not experience the problems contained in the theory. The implication here is that, the problems of hold-up can be reduced when firms sign short-term less complex contracts which involve standard functions. Thus the statistical findings revealed that IT outsourcing involves risks in the restaurants industry whilst the qualitative results disagreed. Although the resource-based view has several disadvantages theoretically due to the clear omission of certain vital elements of conducting business, surprisingly enough, the findings indicate that in reality managers in the restaurants industry are ‘hooked’ to this approach or thinking. It was found from the interviews that companies still talk about ‘giving out non-core functions in order to concentrate on core competencies’ unfortunately, this they do without giving the necessary attention to other costs associated with the process. For instance, from the interviews, it came out that some companies employ the services of consultants to check the records of the intended vendor to be used which supports (Money Instructor, 2005) view, however they do not always consider the percentage of this consultancy fees, coordination cost with an outsider supplier to the total outsourcing contract and other costs incurred ex post. This also supports the claims made by (The Canadian Institute of Chartered Accountants, 2003).

#### 4. 0. Conclusions.

This study has shown that outsourcing contract supports the variables of asset specificity and uncertainty. The sample companies interviewed indicated that ex ante contractual precautions can avert ex post contractual problems such as hold-up and opportunism. This is true in situations where there is balance of specific asset investment and less uncertainty due to short-term nature of the contract. In such situation, it is possible to sign complete contract since there would not be much complexities involved. The IT outsourcing contracts entered into by the companies sampled involved non-specific deals/simple buyer requirements. On the issue of problem of IT outsourcing, it was revealed that the post-contractual problems of hold-up and opportunism normally encountered in the manufacturing sector are not much prevalent in the restaurant industry. This is attributed to the fact that, in the restaurant industry most of the contracts involve non-specific functions, relatively short-term and less complex. It was also certain that certain level of management is predominantly influenced by the RBV thinking. This was confirmed by the answers obtained from the survey and the interviews. This means that countless number of companies would continue to "suffer in disguise" until they realise the danger of conducting business without the due attention to other costs of transactions which occur both pre-contractual and post-contractual. It is important that due diligence and critical thinking are done by both top management and all stakeholders to able to avert and manage any challenge that may occur in the process of IT outsourcing in the restaurant industry in the UK.

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