IT Outsourcing Risk Management at British Petroleum

Benoit A. Aubert ¹ and ²
benoit.aubert@hec.ca
Michel Patry ¹ and ²
michel.patry@hec.ca
Suzanne Rivard ¹ and ²
suzanne.rivard@hec.ca
Heather Smith ³
smithhas@silver.queensu.ca

¹ HEC Montréal
3000 Chemin de la Côte-Ste-Catherine
Montréal, Canada H3T 2A7
² CIRANO
2020 University, 25th floor,
Montréal, Canada H3A 2A5
³ School of Business
Queens’s University,
Kingston, Canada K7L 3N6

Abstract

This paper reports the results of a study of three successive IT outsourcing contracts at British Petroleum (BP). We offer an operational definition of IT outsourcing risk and use it to assess the risk exposure associated with each contract. We then examine how the management at BP dealt with outsourcing risk. Our results show that careful and deliberate risk management can substantially attenuate the level of risk exposure, and that IT outsourcing risks can be managed.

1. Introduction

“Risk is a choice rather than a fate”
Peter Bernstein [9, p.8]

Bernstein’s history of man’s effort to understand risk begins with the following question: “What is it that distinguishes the thousands of years of history from what we think of as modern times?” to which the following answer is provided: “The revolutionary idea that defines the boundary between modern times and the past is the mastery of risk: the notion that the future is more than a whim of the gods, and that men and women are not passive before nature” [9, p.1]. The question and its answer could be transposed to the context of the management of Information Technology (IT) outsourcing. While a decade ago, firms considering to outsource their IT activities were often portrayed as facing numerous and important risks against which little could be done [14], there are now examples that show that these risks can be managed [4].

Using a risk management framework advanced by Aubert et al. [4], this paper reports the results of a study of three successive IT outsourcing contracts at British Petroleum (BP). The paper illustrates how risk management and learning can eventually transform risk into a “choice” rather than a “fate”.

2. IT outsourcing risk and risk management

March and Shapira define risk from two broad perspectives: the economic perspective and the managerial perspective [20]. The economic perspective defines risk as the variance of the probability distribution of possible gains and losses associated with a particular alternative [5]. The managerial perspective considers the notion of risk differently [20]. Managers do not equate the risk of an alternative with the variance of the probability distribution of possible outcomes, and they do not treat uncertainty about positive outcomes as an important aspect of risk. Rather, to them, the potential positive outcomes constitute the attractiveness of an alternative, while risk is associated with its negative outcomes. That is, risk is perceived as a “danger or hazard”. March and Shapira also emphasize the fact that, to managers, the magnitude of the loss due to a negative outcome is salient.

In order to take into account these two aspects of the managerial perspective, the risk management model advanced by Aubert et al. [5] adopts the notion of risk exposure, which is defined as a function of the probability of a negative outcome and the importance of the loss due to the occurrence of this outcome:

Risk Exposure = P(NO) * L(NO)

where P(NO) is the probability of a negative outcome, and L(NO) the loss due to the outcome.

The loss due to a given undesirable outcome can be approximated either via quantitative analysis or via