Rolls royce plc it outsourcing marketing essay

In 2000, as part of a cost reduction and new technological restructure, Rolls-Royce plc outsourced its IT operation to EDS in an exclusive £1. 2 Billion deal extended until 2012. This “ mega outsourcing” required 90% of Rolls-Royce Plc. in-house IT services and a staff of 1, 220 to be governed and trained under EDS which reports to the remainder of the IT department heads[1].

EDS is required to help the company move from the mainframe as the central solution to an outsourced hosted environment and took responsibilities for developing e-business systems, infrastructure, network, systems, applications and end-user support. This strategic alliance gave Rolls-Royce the opportunity to focus on its core competencies in manufacturing and achieve significant cost savings.

This report setups up to evaluate the decision of outsourcing the IT department by analyzing the strategic alliance and its implication to Rolls Royce’s future strategies using the Resource Based View and the Transaction Cost perspectives.

strategic decision

strategic alliances arrangement

The strategic alliance undertaken by Rolls-Royce and EDS is managed through a definitive 12 year, large-scale outsourcing contract. This is an extension of the 1996 outsourcing agreement which in the initial phase will focus on enabling business integrations and work-share collaboration[2].

EDS’s scope will include developing and integrating e-business solutions, development of three portals covering supply chain, design collaboration and corporate information, consulting-led business initiatives for the global supply chain, innovative application service provision offerings and further improvements to the legacy IT services.

EDS is also responsible for the Rolls-Royce IT infrastructure, network, systems and application and the end-user support.

The nature of long-term contracts has been argued to lack the flexibility to change with the evolving technology and business needs of the clients, thus the agreement has “ termination” get-out clauses, to reflect the supplier’s investment in the client’s IT systems and Rolls-Royce will also retain control for their overall IT strategy.

opportunity and challenge

As part of Rolls-Royce continuous improvement ‘ Keisen’ strategy, the 2000 IT outsourcing contract was a major milestone in the development of the legacy systems 1996 contract. By partnering with EDS, Rolls-Royce can leverage on their professional expertise of providing modern, innovative and competitive IT infrastructure. This will also endorse several opportunities explained in details in Appendix A.

The motive for Rolls-Royce to outsource was to achieve a cost savings of approximately 10% in the IT costs. Rolls-Royce lacked the economies of scale in the IT services department; these inefficiencies inflated the costs of the department which were also further subjected to increasing operational control costs, and expanding overhead costs. Gottschalk & Solli-Saether (2005) investigated that in addition to these costs “ the strategic issues underlying the outsourcing decision were also internal IT capabilities, and the need for a change agent.” These issues justified the need to outsource the IT department.

However, the challenge is the costs associated with the management of the strategic alliances relationship. For any alliances, especially one with a long-term and large-scale commitment, Rolls-Royce could be vulnerable if (1) EDS folds and (2) lack of flexibility in the system implemented to change with the business needs. In addition, Rolls Royce IT director, Luc Schmitz (2003) admitted to the difficulties in planning and managing long-term contracts but advocated that by the use of specific legal contracts, it hopes to off-set any hold-up problem.[3]All these issues could propose significant transaction costs and negate the cost savings initiative of Rolls-Royce

The other issue could also be that Rolls-Royce might be underestimating the possibility of its in-house IT systems developing into a competency. A large company as Rolls-Royce has the potential to generate economies of scale and scope internally by reproducing methods of vendors, and thus defining it simply in terms of procurements activities fails to capture the true strategic discussion.

In addition there are other challenges facing Rolls-Royce’s decision to outsource, but these 2 are regarded as the main concerns and are discussed in the perspectives mentioned below.

Transaction Costs Economics Perspective

About the perspective

The Transaction Costs Economics (TCE) principle is fairly simple: Efficient firms focus on minimizing the sum of their production costs and transaction costs. Production costs are costs of inputs (raw materials, labor, machinery, etc.) that are used in the production process, while transaction costs are referred to the costs incurred indirectly for using markets such as cost of searching, negotiating, contracting, monitoring, payments etc.

The concept of TCE was first coined by Coase (1937) who used it to develop a framework to predict when certain economics tasks would be performed in-house by a firm or when they would be sourced using the market. During this time transaction costs were limited to tangible factors considered during the processes of buying and selling and lacked the behavioral perspective. Williamson (1975; 1985) further developed the argument by: (1) posing internal organization and markets as alternative ways of coordinating transaction and (2) exploring the determinants of transaction cost.

Williamson identified uncertainty, asymmetric information and small number bargaining as conditions generating high transaction costs due to bounded rationality and opportunistic behavior that lead to costly haggling, disputes and disruption of trading, as well as expensive safeguarding measures. Subsequent studies by Klein, Alchian, Teece etc. added asset specificity (asset specific to particular task), which points out contracting party underpinned by the specific asset are vulnerable to hold-up. Several other factors such as frequency of repetition, and its underlying uncertainty and complexity of product / service also influence the level of transaction cost.

Facing among alternative organisational arrangements, such as the familiar “ make or buy” decision, Williamson purported that “ make” preferred to “ buy” when transaction costs and frequency are high. Empirical results do suggest asset specificity plays a key role in transaction cost and that " make" dominates. The real world diversity however weakens this proposition. Technological advances and innovation impact directly on transaction cost and hence the transaction form, while the cost of alternative modes of organisation vary across countries and cultures, and even firms within the same countries.

In effective, TCE looks at transaction cost determinants as explanation for scale and scope of organisation. Its application has been widely extended to the studies of various economic and contractual relationships include vertical and horizontal, corporate finance, marketing, HR, organisation of work, commercial contracting, franchise etc.. The main insight and prediction of TCE is the importance of governing transaction. (Selanski 1995)

Strategy Assessment

As stated in section earlier, Club Med must have anticipated a net positive value before it engaged in the agreement of opening resort in China. The assessment focus here is not to justify the decision by verifying the transaction costs involve in opening the resort, instead we look at how the two challenge affecting Club Med's chance of winning using TCE perspective.

Strategic alliances

The $3 million investment in China Yabuli Resort from Club Med represents a relation-specific asset that could only be deployed for its ski resort operation for the 10 years tenure, subject for renewal of management agreement. The degree of asset specificity is high in that such investment would be non-recoverable or sunk if Club Med decides to walk away. Indeed, any investment in resort is a form of physical asset specificity (assets may have to be designed specifically for the particular transaction).

According to TCE, internal organisation or “ make” is preferred when asset specificity is great. But Club Med decided to operate via strategic alliance, i. e. a “ buy” decision. However, this does not mean that it is in contradiction with TCE. The transaction cost of “ make” by buying and operating resort via the wholly owned subsidiary could be much higher considering the legitimate framework, culture difference and uncertainty of operating environment in China, hence the decision to alliance. But the asset specificity would expose Club Med on hold-up problem.

Club Med would have incorporated necessary restriction and penalty clause such as dismantling property upon contract termination, exclusive use of property design, no compete rule, priority acquisition etc. so that the asset would also become non-deployable to MCR upon its exit and hence promote mutual sustained cooperation.

When relationship-specific investments are more important, both transaction parties would make longer commitment to the term of future trade and rely less on repeated bargaining (Joskow 1987), hence the 10-year tenure arrangement here. However, a key feature of long term contract is their incompleteness as it is impossible to specify every contingency in contract and this creates exposure to MCR’s potential opportunism.

Also, facing with high cost (and relative inefficient) of court adjudication, firms are reluctant to resort to courts or other third party policing mechanism. Firms often devise self-enforcing agreements (Williamson 1983) in such a way that if one party violates an agreement, the other party's only recourse is to terminate it. Such an arrangement implies high mutual interdependence and exposure to partner's potential opportunism. (Parkhe 1993)

Scholars have increasingly challenged the " opportunism" assumption and there has been criticism on TCE for over-emphasizing hold-up problem. Business is not one shot game, and the repetition of interaction tends to promote co-operative approach, as MCR would need to safeguard its reputation for future business viability as well as cooperation potential.

Also, Club Med would be in control of the operational procedures, records and more importantly cash flow. Such intact operation control as well as payment term of management fee[4]would be a source of safeguarding measures, enabling Club Med more responsive to potential defection.

competitiveness

The application of TCE might be less obvious on competitiveness which is a positioning issue. However, a superior transactional system can be important source of competitive advantage and TCE could be used to assess the efficiency of its system against market and within various options, to identify the best operational arrangement.

Our question here is whether Club Med could attain superior efficiency than local players.

One of the operational key features for Club Med is its multi-culture " GOs"[5]who are from different countries and speak multi-languages. Such operation requirement inevitably invites higher operational complexity and hence transaction cost. However, the multi-nation " GO" enables Club Med to serve its global customers better, particularly in China where language is a huge problem. In this context, this key operational feature becomes the competitive advantage.

The effectiveness of the GO operation lies with its recruitment procedures. Club Med has a fixed policy of recruiting GO regionally (Asia Pacific) twice a year[6], with a relocation policy of every 6 months to 1 year, to other Club Med resorts worldwide. The opportunity of working at different countries represents attractive offering to young talent and enable Club Med to have good bargaining price. Also, the GO is multi-tasking[7]and not task specific[8]. Hence, Club Med is able to keep staff level low and adjust the peak season requirement via staff mobility. Such procedures enable Club Med to keep operation lean while maintain superior customer service, whereas most local operators either keep staffs level high to cope with peak season requirement or tackle the problem with temporary staffs in which case jeopardize the service level.

Another aspect is the pricing arrangement. Club Med pursues " All-inclusive" holiday concept, this means that there would be one price charge, which is inclusive of accommodation, meals, facilities, activities, ski pass and ski school. Guests also pre-select " conditional" activities such as excursion and spa, and settle the vacation fee in full prior to departure. The price bundling and upfront payment features greatly reduce the transaction costs associated with different charges such as bank charges and administration, both to selling offices and resort. More importantly, it free up resources in resorts enabling more focus in customer service as well as flexible operation. However, bundling is desirable only if customers appreciate the different elements and perceive the package price as more value for money. The local culture suggests that Club Med may need to justify the huge price gap or bring the price down.

The operational flexibility arising from the pricing arrangement, staffs mobility and transactional process enabling Club Med attain superior efficiency, for the level of offerings – upscale service with multi-culture experience. This in turn enables more flexibility in pricing and promotion strategy and hence insures its competitiveness. The remaining question is how long it could sustain the competitive advantage.

overall assessment

The alliance is of with MCR is of strategic importance to Club Med. It enables Club Med to earn time in building the dynamic efficiency for its future expansion plan. The asset specificity put Club Med into vulnerable of hold-up problem. However, contract provision for non-deployable asset and intact operation control could have alleviating the problem. In some context, TCE might have over-emphasized hold-up. In business world, the repeated games with parallel transaction elsewhere mean cooperative approach dominates.

Club Med’s competitive advantage lies on its “ All-inclusive” business concept and GO culture. The assessment suggests Club Med does attain efficiency via the operational flexibility. The premium pricing could be an issue but offset by its superior operational efficiency that allowing for more pricing flexibility.

effectiveness of tCE

TCE is based on simple rule: minimise transaction costs. The problem however lies with the definition and measurability. Transaction costs are future oriented and managers would have different subjective costs estimates for many of the activities involved in setting up trades. Some transactions costs might even not directly observable (e. g. governance cost).

Hence, TCE is usually taken as an indirect form, in that they merely explore relationship between contractual outcomes and assumed determinants of transaction costs and not the costs themselves. (Lockett et. al 2007)

TCE tends to hold that transaction costs are technologically determined. However, innovation – both transactional and process, weakens the argument. Lower communication / transport cost and increasing difficulty in wholly owned ventures etc might lead to increase in contracting. As in this case, the asset specificity does not lead to internal organisation. Specific factors such as country (political, social) and cultural differences could play important role. Furthermore, TCE focuses only on one side of a transaction – the costs, and seems to ignore the benefits of a transaction, particularly the social aspect. These call for more comprehensive studies before making any decision made.

comparison

perspective comparison

The theoretical ground and effectiveness of the two perspectives have been discussed in respective section above, and their respective advantages and disadvantages could be summarized in table below.

The two perspectives are very different and yet in some aspect, there is an essential connection. The connection is " between the transaction cost notion of opportunism and asset specialty and game-theoretic notions of defection and sucker's payoff, which integrates behavioural uncertainty with interdependence and vulnerability in the pursuit of self-gain through joint action" (Parkhe 1993: 821), in which the implication is clearly witnessed in the strategic alliance issue.

assessment comparison

Both the perspectives do not directly answer the question of whether the resort opening decision is justifiable. At the outset, opening resort in China is a " must", as China provides the highest growth potential to Club Med, due to its population and earning potential. The questions are then in what form and how it could preserve its' competitiveness, and these are the issue we examine in this report.

For the first issue, Game Theory examines the interaction with MCR for prospect of sustained cooperation while TCE looks at the cost determinant to justify whether the arrangement is optimum. In respect of competitiveness, Game Theory examines the value net and evaluates possible action by changing the PARTS of the game; whereas TCE ascertains the competitiveness by evaluating its operational efficiency.

The assessment could be summarised in diagram below.

As illustrated, Game Theory does not provide concrete answers but portray probable strategies based on a set of assumptions, which with insights from TCE comprehend the strategic evaluation.

Conclusion

A business decision often gives rise to many other issues, and there are many way of looking at a strategic issue. In this case, we examine the decision (opening resort in China) in respect of two challenges (strategic alliances and competitiveness) using Game Theory and TCE. Both the perspectives offer different angle of assessment, but worth noting is they are not contradicting but could complement each other. Game Theory could be used to highlights various circumstances that may arise in the context of TCE (such as hold-up problems), similarly TCE could supplement Game Theory by analysing the implication of transaction cost on various possible strategies, e. g. in response to competitors pricing move.

There could be many other issues (operation, financing, governmental) confronting Club Med following its resort opening, which calls for other perspectives for more comprehensive assessment. The essence of multi-perspectives is to challenge established thinking, for creating new insights, new ideas, and new opportunities into a business situation. Nonetheless, the perspectives shall not be viewed independently but as an integrated set of business solutions.

appendix

about club med

Club Med is French based multinational vacation club operator and travel organiser. It operates in 40 countries with 80 resorts on 5 continents and a cruise ship (Club Med 2). Club Med was the inventor of holiday club concept, it operates resorts as Villages" which provide " All-inclusive holidays" including accommodations, services and activities.

The special feature of Club Med is its unprecedented vacation style where every guest or Great Member (GM) could unwind though contact with nature, sports and others, surrounded by the friendliness of the staff or Gentils Organisateurs (GO). GOs and GMs play, dine, drink and dance together every day and night, with extensive participation in daily themes and evening show. This form the basis of Club Med's holiday experience – " Where Happiness means the World"[9]

During 1990s, Club Med business was declining as the competitor imitated the concept and facing more demanding expectation from the guests. A strategy which transformed Club Med from holiday Village Company to service company was undertook from 1997 but it was not successful. In 2003, under the leadership of Henri Giscard d'Estaing[10], Club Med announced a change of strategy – returning to focus on holiday village, and reinvent itself as world specialist in " upscale, friendly and multicultural" holidays.

Since then, Club Med aggressively developed new markets, particularly in China where the first representative office (RO) was set up in May 2003[11].

Club Med FOOTHOLD IN CHINA

Xx

(Confidential company data)

about MCR

MCR is Canada-based investment holding company, which is engaged in the development and operation of mountain resorts and provision of hotel services in China. MCR is transforming existing China ski properties into world-class, four seasons luxury mountain resorts with excellent real estate investment opportunities for discerning buyers.

MCR owns the resorts in Sun Mountain Yabuli, which is the resort under study. In February 2009 the Yabuli Resort was awarded Best Resort Makeover in Asia by TIME Magazine. (MCR Press Release 2010)

MCR has entered agreement to acquire the Sky Mountain Beidahu in November 2007, but due to withdrawal of its financial partner, the deal is terminated in October 2009 (MCR Press Release 5th Oct 2009).

Recently, it completed the private placement with Wisecord Holdings Limited in April 2010 which brings in capital injection of RMB 15 million.

yabuli ski market

Skiing has been getting popular in China. According to China's Ski Association, there will be 20 million skiers in the country by 2014, compared to just 5 million 5 years ago. Yabuli, located in China's Heilongjiang Province, is one of the most popular skiing destination in China. It has the Asia's longest Alphine ski run, and the local government reportedly spent US$ 400 million in upgrading.

Yabuli has expanded into China's first ski town, with multiple resorts from 2 star to 5 star. Accomodations price start from RMB 600 range in the old Windmill Inn (part of Yabuli Sun Mountain) and smaller hotels that cater primarily to Chinese Tour groups, with the upper end rooms cater for international guests sell at RMB 1200 – 2000[12]. In general, Yabuli's facility is much advanced than skiing resorts from other area (e. g. Beidahu, Wanglong, LiJiang etc.), so do the price range.

Club med yabuli resort

The following information extracted from Club Med Press Release.

As with other Club Med Resort, Club Med Yabuli provides " All-Inclusive" holiday experience – from ski passes, ski school for all ages above 4 with highly qualified instructors and the highest quality ski equipment to children's club facilities, fabulous food, unlimited " Bar & Snacking" concept as well as club activities.

Club Med Yabuli will be opened all year with a winter and a summer season. The ski season begins in mid-November and ends in early April. The Resort offers over 30 kilometres of trails for all abilities with a vertical drop of about 530 metres; it's also the longest mountain trail in China, ideal for skiers of all levels. The ski field is just a step out from the door, provide the guests with easy, direct access to the slopes for a more enjoyable ski experience.

The Resort will have a total of 284 luxurious and spacious rooms including 27 Suites with spectacular views of the splendid mountains and daily breakfast in room service; 22 Deluxe Rooms and 235 Superior Rooms. Guests can enjoy contemporary, simple elegance in different types of rooms featuring one double or twin beds, work desk, flat TV screen plus bath and shower with modern amenities. Internet access is also available in the rooms.

The Resort is also equipped with facilities for families. Petit Club and Mini Club provide a range of activities for younger ones. It also offers 6 conference rooms and 1 large ballroom for conventions, seminars and private dinners.

Club Med Yabuli would be in operation from November. The published price is expected from RMB xx per person per night. The policy about the " retail price" is yet to be finalized.

Reference

Brandenburger, A. M., & Nalebuff, B. J. (1995), ' The Right Game: Use Game Theory to Shape Strategy', Harvard Business Review, 73(4), 57-71.

Cabantous Laure (2010) Does Strategic Management need Game Theory, lecturer notes

Camerer, C. (1991), ‘ Does Strategy Research Need Game Theory?’, Strategic Management Journal, 12, 137-152.

Ghoshal, S. & Moran, P. (1996) ‘ Bad for Practice: A Critique of the Transaction Cost Theory’, The Academy Of Management Review v 21, No 1 (January 1996), 13-47

Joskow, P., (1987) ‘ Contract Duration and Relationship-Specific Investments: Empirical Evidence from Coal Markets’ American Economic Review v77 (1987) pp168-185

Klein, B., Crawford, R. G. and Alchian, A. A. (1978) ‘ Vertical Integration, Appropriable Rents, and the Competitive Contracting Process’ Journal of Law, Economics and Organisation, 21 (1978) 297-326

Lockett, A. and Thompson, S., ‘ Transaction Cost Economic Perspective’ Advanced Strategic Management : A multi-perspective approach Cha 7, Edited by Jenkins, M., Ambrosini V. with Collier, N., 2nd. ed. Basingstoke : Palgrave Macmillan, 2007

Mintzberg, H. Ahlstrand, B. and Lampel, J., Strategy safari: the complete guide through the wilds of strategic management, 2nd ed. New York : Pearson Prentice Hall, 2008

Parkhe, A. (1993) ' Strategic alliance structuring: A Game Theoretic and Transaction Cost Examination of Interfirm Cooperation', Academy Of Management Journal; 36 (4) 794 – 826

Regan, S., ' Game Theory' Advanced Strategic Management : A multi-perspective approach Cha 6, Edited by Jenkins, M., Ambrosini V. with Collier, N., 2nd. ed. Basingstoke : Palgrave Macmillan, 2007

Selanski, H. and P. Klein, ' Empirical Research in Transaction Cost Economics: A Review and Assessment', Journal of Law, Economics and Organisation, 11 (1995) 335-361

Thompson, S. (2010) Transaction Cost Economics: What insights can transaction cost economics (TCE) offer strategic management? Lecture notes

Walley, K. (2007) ' Coopetition: An Introduction to the Subject and Agenda for Research', Int. Studies Of Mgt. & Org., v37 no. 2 Summer 2007, pp 11-31

Williamson, O. E. (1979) ' Transaction Cost Economics: The Governance of Contractual Relations' Journal of Law and Economics v22 (1979) 233-261

About the Company News

CBOnline (22 Mar 2010) Club Med Hosts Major International Media Event at Sun Mountain Yabuli; Launches Club Med Yabuli 2010/11 Winter Marketing Campaigns" [Online] Available At: http://www. canadianbusiness. com/markets/cnw/article. jsp? content= 20100322_080502_6_cnw_cnw (Accessed 2 April 2010)

ChannelNewsAsia. Comm (31 Mar 2010) First Club Med snow resort to open in Yabuli in Nov" [Online] Available at: http://www. channelnewsasia. com/stories/eastasia/view/1046998/1/. html (Accessed 2 April 2010)

China Ski Tours, LLC " China's Original Ski Town – Yabuli" [Online] Available at http://www. chinaskitours. com/skiinginchina/yabuli. html (Accessed 2 April 2010)

Club Med Corporate Website [Online] http://www. clubmed-corporate. com/?lang= en (Accessed 2 April 2010)

Club Med Press Release (20 Mar 2010) " Club Med Yabuli Resort Enjoy Its Charm and Prestige" [Online] Available At: http://www. clubmed-corporate. com/wp-content/uploads/2010/03/Yabuli-press-release_20-mars-10. pdf (Accessed 2 April 2010)

Melco China Resort Press Release (17 Feb 2010) " First Club Med China to be opened at Sun Mountain Yabuli" [online] Available at: http://www. melcochinaresorts. com/news/press-releases. html? year= 2010 (Accessed 14 April 2010)

Tai, B., Tang, J. and Hu, B. (21 May 2009) " China: China Adopts New Travel Agency Regulations And Lifts Restrictions On Foreign-Invested Travel Agencies" [online] Available at: http://www. mondaq. com/article. asp?articleid= 80068 (Accessed 14 April 2010)

TraveldailyNews. com (26 Feb 2010) " The first Club Med in China" [Online] Available at: http://www. traveldailynews. com/pages/show_page/35790-

Club-Mediterranee-and-Melco-China-Resorts-sign-agreement-to-open (Accessed 14 April 2010)

TravelWeekly (1 Mar 2010) “ Club Med, Melco to open first Club Med ski resort in Yabuli” [Online] Available at: http://www. travelweeklyweb. com/article/Club_Med_Melco_to_open_first_Club_Med_ski_resort_in_Yabuli. html (Accessed 14 April 2010)