Chapter 1: Introduction

Information Technology (IT) outsourcing is a business trend ostensibly aimed at reducing costs and enabling companies to concentrate on their core competencies. The *Outsourcing professional body of knowledge* suggests that the business case for IT outsourcing provides the mechanism for the decision to outsource. Defining an objective measurement for the management to focus on is difficult when identifying comparative costs and savings against a current baseline, which should be relatively straightforward. Barthélemy (2001) and Hannon (2009) argue that this may not necessarily be the case since unanticipated costs often emerge once the outsourcing contract is in place. These hidden costs lead to operational management challenges for IT outsourcing (Juras, 2009). These challenges fall broadly into two categories: Team integration challenges such as the delegation of greater authority across global teams, instilling trust, and ownership while maintaining morale in the higher-cost countries, and organizational structural issues relating to governance and relationship management.

Previous research has approached these issues through a combination of the transaction cost theory (Williamson, 1979) from the financial perspective and the agency theory (Knapp, & Dalziel 2007) from the perspective of governance. Young (2007) concludes that the transaction cost and agency theories do not capture the complexities involved in understanding outsourcing issues. Service, Science, Management, and Engineering (SSME) refers to “the study of service systems and value propositions by the integration of many service research areas and service disciplines such as economics, operations, management, computing and service measurement,” (Maglio, Kieliszewski, & Spohrer, 2010, p. 701). This research uses the SSME, an emerging interdisciplinary technique to explore how organizations manage outsourcing contracts to offer insights into the complexities of the issues not available when using more archetypal approaches.

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Background

Offshore IT outsourcing refers to the purchase and provision of IT services by an organization from a foreign supplier, usually to gain the benefits of labor arbitrage (Brown, & Wilson 2005). Cohen & Young (2006) note cost savings and efficiencies that relate to outsourcing, contribute significantly to sustaining companies' profitability and controlling costs. In short, outsourcing works. It works because of the asymmetry between knowledge workers' wages in developing countries such as China, Brazil, and India, and those of their counterparts in the developed countries such as the United States, and the United Kingdom. The financial viability equation is dependent on the savings made from lower wages being greater than additional risk and management costs. Aron, Clemons & Reddi, (2005) suggest that underperformance, resulting from geographic separation, limited communication, and cultural differences are additional risks typically associated with operating virtual teams and a fallout of outsourcing. The negation of prospective cost savings accruing from IT outsourcing due to unanticipated costs, such as the management of the ongoing contract, however, is a probable risk (Barthélemy, 2001).

Since the management's emphasis shifts from the internal process to an external one, vendor management activities need to include monitoring contractual performance and service levels, negotiating penalties when these are not met, and negotiating contract-change requests to accommodate changes in the business environment. The complexities of the new process serve to make outsourcing-contact management, an expensive proposition (Windrum, Reinstaller, & Bull, 2009). The economic argument is compelling, however, to be successful, IT outsourcing requires delegation of greater authority across global teams, instilling trust, and ownership while maintaining morale in the higher-cost countries. This represents a significant problem for the Chief Information Officers (CIOs), who have to deal with the realities of delivering on the promise of the outsourcing business case, while maintaining

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domestic relationships and operational performances. This study aims at being helpful to the CIOs in the operational management of IT outsourcing processes.

Problem Statement

IT outsourcing is a growing trend that has transformed the IT business environment. *Forrester* (2007) estimates the size of the European market between 2004 and 2006 as being over $20 billion (USD), and *Gartner* (2008) identifies the Asia-Pacific market size in 2007, to be $12.2 billion (USD) and growing at 9.2%. The largest market, North America, at $27.8 billion (USD) in 2008 is forecast to grow at 5% despite the recession (Plunkett Research, 2010). According to Wang, Gwebu, Wang, and Zhu, (2008) there are many reasons for outsourcing, such as, the need to reduce operational costs, improve the quality of service, gain access to skills and technology, and enable increased flexibility and focus.

There are, however, potential negative financial consequences associated with this practice. Overby, (2003) states that companies need to understand the hidden costs of offshore IT outsourcing that occur during vendor selection, transition, layoffs, cultural, ramping up, and managing the contract. The hidden costs of outsourcing are an important topic for managers because they can challenge the rationale for outsourcing (Barthélemy, 2003, p. 94). The proposal is a descriptive, qualitative study determining how hidden costs affect the operational management of IT outsourcing. Swanborn, (2010) defines this as "descriptive research as what or how questions," (p. 28). An interview design allows in-depth exploration of senior management perceptions of the impacts on his or her team.

Purpose Statement

The purpose of this qualitative research study using an open interview format is to explore the effects of the more ethereal aspects of outsourcing such as the effects interlocking the management of virtual global resources with the local team, and the dynamics of contract

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management with governance of the new partnership. This study analyzes outsourcing agreements as enacted at the operational management phase of the lifecycle with reference to the SSME theory. The study draws on the outsourcing experience of ten informed personnel from companies in North America (United States, and Canada), Europe (United Kingdom), and China (Hong Kong).

The diversity of the research group will help to uncover high-level social, organizational, and cultural attitudes toward outsourcing, for example, O'Hara-Devereaux, & Johansen, (1994) note in *Globalwork* the difficulty of completing tasks on time when there are different concepts of time and different ideas about what it means to be complete: The consequences of this can make contractual management, arduous. Cooper, & Schindler, (2008) suggest that to understand the different meanings individuals place on their experiences "requires research techniques that delve more deeply into peoples' hidden interpretations, understanding and motivation." (p. 170) The research adopts a qualitative approach. This method is appropriate for showing how and why events happen as they do. The data collection stage will use semi-structured, in-depth, individual interviews which will permit comparison of results using content-analysis of the written record of the interviews. Neuman, (2006) suggests content-analysis can reveal themes and characteristics which are difficult to see through a casual observation and therefore help to achieve an in-depth understanding of the situation. The participants will be informed personnel within their companies, and some scheduling challenges may be anticipated owing to differences in geographical locations and time zones. An in-person interview is a preferred approach to record verbal and non-verbal responses to uncover normally-intuitive and less-than-quantifiable truths.

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Significance

Conventional IT strategy advocates tighter integration of IT with business (Turban, Leidner, McLean, & Wetherbe, 2007), and the significance of IT outsourcing is that it appears to do exactly the opposite "emphasizing de-integration as internal functions are moved out of the organization," Abebe (2007, p. 197). Prima facie the two approaches appear mutually exclusive. Previous studies have addressed the issue of initiation and transition management aspects of outsourcing such as, defining what to outsource, work and team design, and virtual team performance, from the buyers' perspective. Few studies specify the views of the IT providers. Murthy, (2004) cites a unique opposing perspective by suggesting consideration of outsourcing as an alliance and not a short-term fix which also requires an appropriate governance model in place to be successful.

This study's unique approach lies in considering the problem further in the lifecycle, which is the operational management of the outsourcing process. An investigation of the operational context can be undertaken from the new interdisciplinary perspective of the SSME, an approach that integrates aspects of established fields, such as, computer science, operations research, engineering, management sciences, business strategy, social and cognitive sciences, and legal sciences (Teboul, 2005). IT outsourcing is an integrated service that brings together service providers, and clients, connecting the parties through shared information within a contractual agreement. By combining the managerial and technical perspectives, the SSME addresses the multidisciplinary issues arising because of outsourcing; right from relationships to service delivery management to innovative service technologies, and the social culture within the organization in order to help identify the complexities and the dependencies associated with outsourcing.

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