The Role of the Business Unit CIO: A Study of the Interaction Between Corporate IT Governance and Local Leadership

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Abstract

Leading a business unit’s IT function is more challenging than leading a corporation’s IT function. At the business unit level, a CIO reports to the business unit’s manager and to the corporation’s CIO (Hodgkinson 1996). In comparison, the corporate CIO must establish a relationship with one boss - the CEO (DeLisi, Danielson et al. 1998; Kakabadse and Korac-Kakabadse 2000). A further problem is that researchers focus on the top management team relationship (Gupta 1991; Kakabadse and Korac-Kakabadse 2000) so the business unit CIO receives little advice.

This paper explores the complex leadership challenges facing a business unit CIO by drawing on a case study of a large bank (Wood 2005). The bank has multiple business units with the Institutional Bank (IB) as the research focus. IB has different technology requirements that sit awkwardly with corporate IT’s standardization and cost reduction goals. IB’s CIO leads a dynamic IT function struggling to reconcile IB’s vision of technology with corporate IT’s vision of technology. There is a great need for soft skills and the astute application of power. The result is a difficult environment for sustaining a leadership advantage.

Responding to Bryman’s (2004) call, the paper consciously builds on the IS leadership and IT governance literatures.

Introduction

IS leadership research focuses on the role of the CEO, CIO and the CIO’s executive peers in the top management team. However, in large organisations there are many CIOs with each business unit receiving one CIO. In practice, business units’ CIOs take responsibility for leading IT. These CIOs face a challenging environment because they report to two masters: the corporate CIO and the business unit head (Hodgkinson 1996). This paper explores the challenges facing business unit CIOs and illustrates these challenges with the case of a large bank. It draws on the IS leadership and IT governance literatures to develop a framework for analyzing the appropriate degree of autonomy for a business unit CIO.

The paper’s structure is as follows. First, it reviews the current situation regarding the IS leadership and IT governance literatures. Second, it explores the practical complications facing business unit CIOs and their complex organizational context. Third, it illustrates these challenges using a case study of a business unit embedded in a large bank. Finally, it presents a framework for analyzing the different IS leadership needs in different business units.

1 The authors thank Professor Philip Yetton and many CIOs for reading and commenting on this paper.
Literature Review

A business unit CIO leads an IT function that serves a particular business unit. These CIOs engage their business unit to advise the business on their demand for IT. On the supply side, they motivate and inspire their IT teams to deliver a cost effective service. Both of these activities take place within a governance framework that the corporate CIO establishes. This section explores the IS leadership literature and the IT governance literature to identify their application to business unit CIOs.

IS Leadership Literature Review

IS leadership research focuses on the CIO and the CIO’s relationship with the top management team (Karahanna and Watson 2006). Figure 1 depicts the reporting relationships that this research assumes for a typical large bank. The CIO’s peers include the head of retail banking and the head of institutional banking. The CIO has to use lateral influence behaviors to secure cooperation from other executives reporting to the CEO (Enns et al. 2003).

![Figure 1: The CIO's and executive peers' reporting relationships](image-url)

In comparison with executive peers, the CIO faces different leadership challenges. The CIO has to maintain operational stability (Earland Feeny 1994) in addition to building a shared understanding of IT by the top management team (Preston et al. 2006). The effective CIO uses rational persuasion and personal appeals to influence demand for IT from the business units. CIOs who aim to build an effective partnership with the business are typically also business competent in organizational understanding, interpersonal skills and management (Bassellier and Benbasat 2004). Leadership by the CIO requires the usual set of social, political and business skills but they are insufficient. Effective CIO leadership also needs IS intelligence (Smaltz et al. 2006).

IS intelligence is necessary to lead the IT function, which forms the supply-side of the IT equation (Broadbent and Kitzis 2005). Communication between business units and the IT function has been so poor that Weill and Broadbent (1998) describe it as two independent monologues. The CIO’s role is to straddle these worlds, creating a vision for the IT function out of a complex cross-business environment, while helping the business to reach IT investment decisions they are uncomfortable making (Karahanna and Watson 2006).

As the role of technology within organisations has shifted from efficiency to effectiveness, the role of IT leadership has also changed. IT is no longer a means to reduce operational cost but represents real strategic opportunities (Gupta 1991; Kakabadse and Korac-Kakabadse 2000) and, as such, IT leaders rely less on IS intelligence. Traditionally, there has been a focus within the IT industry on technical competencies (Gupta 1991; Kakabadse and Korac-Kakabadse 2000). Formal education and traditional career development have generally supported this view. This equips IT professionals to be technical managers but there has been little focus on the development of their general leadership capabilities (Kakabadse and Korac-Kakabadse 2000; Karimi et al. 1996). This lack of leadership contributes to a consistent distinction between “business” and IT, often causing the technology function to be considered ancillary to the organisation as a whole (DeLisi et al. 1998; Kakabadse and Korac-Kakabadse 2000).
IT Governance Literature Review

One tool for encouraging profit-maximizing behavior across business units is IT governance. Before exploring the IT governance literature it is worth briefly reflecting on why organisations establish business units. Large organisations are rarely simple, functional structures. Instead, large organisations create multiple business units because of the complexities of size (Williamson 1970; Williamson 1975) or to support differentiation strategies (Chandler 1962). For example, a large bank could have a institutional banking unit with a different outlook, culture and view of time than its retail banking unit (Reynoldsand Yetton 2005; Weiss et al. 2006). Making IT decision across such a heterogeneous landscape is challenging.

Organisations adopt complex structures, processes and reporting mechanisms to make IT decisions (Weilland Ross 2004b). Good IT governance is associated with a 20% higher return on assets (Weilland Ross 2004a, p14) and with Sarbanes-Oxley focusing executive and board attention on corporate governance (The Economist 2005), IT governance has become a priority for CIOs (Brownand Grant 2005). The challenge for a CIO is that centralized direction and co-ordination is in conflict with the need for local business unit discretion, which would disperse rights throughout the organisation (Boyntonand Zmud 1987, p61; Burlingframe 1961; Garrity 1963). Governing IT from the centre reduces local agility, whereas allocating power to the local business units leads to anarchy (Weilland Ross 2004a).

Attempts to overcome these limitations include hybrid structures (Brownand Magill 1994; Olsonand Chervany 1980). A significant example is the federal model (Hodgkinson 1996), which is a compromise between the centralized and decentralized, using matrix management for the business unit CIOs. Under this model, each business unit has a CIO reporting both to the centre and to the business unit head. These ‘mini-CIOs’ have input and decision rights over IT investments. However, the federal structure is not robust, having a tendency to emphasize first one and then the other of the underlying ideal types. Organisations then resort to elaborate balancing mechanisms in an attempt to achieve both goals reliably (Brownand Ross 1996).

A separate stream of research identifies contingencies in the selection of types of governance (Brownand Grant 2005). The logic is that specific types of governance fit certain organisations, improving organizational performance. Some contingency variables, for example, structure and size (see Ein-Dorand Segev 1982; Olsonand Chervany 1980), receive inconsistent support. Other contingency variables require complex analyses of interrelationships between, for example, corporate governance, scope and absorptive capacity (Sambamurthyand Zmud 1999).

Weill and Ross (2004) attempt to integrate these two streams and so develop a rich set of recommendations for practitioners. They identify five different decision areas: IT Principles, IT Architecture, IT Infrastructure Strategies, Business Application Needs, and IT Investment. For each of these decision types, they found that high performing companies share common patterns of governance for input and decision rights.

In parallel, practitioners are developing a number of complex normative frameworks. For example, the IT Governance Institute’s COBIT framework contains detailed prescriptive advice, including descriptions of 34 separate IT governance decisions. COBIT is now in its third edition and is being widely used throughout the world (Information Systems Audit and Control Association 2005). In addition, the UK government has developed ITIL, which is based on best practices for IT service management (Office of Government Commerce 2005), with PRINCE2 a separate framework for managing and governing IT projects (Office of Government Commerce 2002). For the practitioner, the list of recommendations is ever lengthening, with no clear rules for which guidelines to follow in which situations. The resulting complexity challenges managers and researchers to find effective structures that are both simple and hold the relevant managers accountable (Keen 1991; Weilland Ross 2004a).

Business Unit CIOs in Practice

The complication is at the juncture of IT governance and IT leadership. Large organisations typically adopt a federal model for IT governance, which places business unit CIOs in each business unit (Hodgkinson 1996). Figure 2 expands on Figure 1 by showing the business unit CIOs in a typical bank. The structure’s objective is to support decisions affecting the business units with each CIO have an in-depth understanding of their business unit’s peculiar needs.
When creating separate business units organisations make each address different business, social, political or technical needs. However, there are countervailing forces that encourage centralization. Centralization reduces costs when standardizing technology while decentralization allows flexibility to satisfy demanding business needs (Tavakolian 1989). In the banks we work with, the retail banking units have hundreds or thousands of branches, large processing centers and huge IT expenses that dominate IT expenses from the other business units. Understandably, when the corporate IT function determines standards to cut costs, those standards reflect the retail bank’s IT needs.

The other business units’ CIOs face a complex environment. Further, there is little research on the business unit CIO whereas in practice much of the IT leadership takes place at the business unit level. IT leadership research tends to focus on the top team and the corporate CIO. This IS leadership research into the corporate CIO does not generalize or extend to the business unit CIO because the business unit CIO faces two masters and receives an IT governance that fits the corporation’s need. Essentially, the business unit CIO’s organizational context is different to the corporate CIO’s context. Outside of Information Systems, the wider leadership literature recognizes the importance of organizational context. In emphasizing this point, Porter and McLaughlin (2006) found some 77 articles over the last 16 years.

The next section draws on a case study to explore the organizational context facing a business unit CIO at a large bank. The CIO faced a number of challenges in leading the Institutional Banking (IB) business unit’s IT function. The governance framework fitted the Retail Banking business that was large scale and changed slowly, while IB had a need for small and agile IT.
NationsBank

NationsBank is an old bank and one of Australia’s largest. It has a market capitalization in excess of US$20 billion and employs more than 20,000 people throughout the country. With a retail bank, institutional bank and funds manager, it offers an extensive product range. Geographically, the bank has presence throughout Australia and New Zealand. The institutional bank (IB) operates globally with substantial operations in New York and London.

Up until 2000 the various business units operated semi-autonomously. In 2000, the CEO restructured the bank, placing all IT functions under the corporate CIO. The IT function had a clear top-down strategy of cost consolidation and reduction. The corporate IT strategy explicitly supported this goal. In alignment with the strategy, the corporate CIO’s published objectives emphasized cost reduction and increasing operational efficiency. In 2001, the bank outsourced the entire IT infrastructure under a ten year contract with a global IT services firm.

The bank’s business units develop their strategies from the bottom-up. Each of the business units has a general manager who is part of the group executive. The general managers focus on growing a profitable business, which they measure in terms of economic profit (revenue minus expenses and cost of capital). This encourages strategies that are primarily bottom-up. The general managers set forecasts and budgets for each product, which rolls up to the business unit’s strategy.

Retail banking unit

Retail banking is NationsBank’s core business. For example, in 2005 this business unit contributed more than half of the bank’s profit. Retail includes an extensive branch network throughout Australia and New Zealand and employs more than 10,000 people. Retail banking in Australia is commoditized and competition is eroding profit margins. There is a constant threat of entry by large international players, with GE Money, ING and HBOS already operating substantial businesses.

Retail services hundreds of thousands of customers with their transactional banking requirements. This business unit targets personal and small business banking customers and develops products specifically for this market. Profits in this business unit are typically volume driven and economies of scale significantly increase profit margins. The volume of transactions and the number of customers makes Retail focus on processes. Operational stability is essential for this business and Retail manages change very carefully. Consistency is valued over flexibility.

Institutional banking unit

The institutional bank (IB) provides a wide range of services to corporate and institutional clients. IB offers a range of complex products from structured finance, through risk management to securitization. In comparison with Retail, IB focuses on a smaller number of customers (measured in the hundreds rather than the hundreds of thousands) and with 5% of the bank’s staff it contributes 20% of the profit.

As with Retail, IB has had to manage diminishing margins as some of the market for their core products mature. The strongest driver of profitable growth has been the development of new products. Substantial profits in IB are generally a function of a small volume of high value transactions. This type of business demands constant change and values innovation but requires an appetite for change.
IB had provided its own IT services, employing an IT organisation that was distinct from those that serviced the bank’s various other divisions. However, the new centralization strategy had absorbed much of that capability into the corporate function.

**Corporate IT**

Corporate IT maintains an enterprise focus. They are responsible for all of the bank’s IT infrastructure and commodity IT services. There is a consistent drive for operational efficiencies and economies of scale in the services they provide to ensure the lowest cost of delivery. The corporate IT strategy is to reduce cost for the whole bank, and then consider how to meet the IT requirements of the various business units.

For many of the bank’s business units this is a good alignment. For example, Retail needs vast quantities of commodity IT services to support their commodity banking products. This fits well with the corporate IT strategy’s stability and low cost goals. However, for IB this poses a challenge as corporate IT’s consistency and efficiency is often a tradeoff with flexibility and innovation, which underpin the IB business strategy.

**Cost Control**

For Retail, IT costs are a driver of business performance. These costs receive significant management attention. To reduce the costs, the services are standardized and simplified. For example, if a PC fails there is a single central help desk that receives a call, logs it, issues a service request and manages the resolution. The service levels are set to secure a low price.

For IB, direct IT costs are not a driver of business performance. When IB’s management is concerned about IT costs, it is in the opportunity costs. For example, if a commodity trading desk were unable to access the electronic market then the trader could forgo high value trades.

**Challenges for IB’s CIO**

The business unit CIO is the part of the bank where the top-down corporate IT strategy meets the bottom-up business unit strategy. The role bridges the gap between the IT organization and the business unit. In IB, this is particularly challenging given the lack of alignment between the corporate IT strategy of managing change and controlling IT’s direct costs, and the innovative high-value business unit. As one IB respondent said, “the IT silo has got its own dictate coming down its own path.”

IB’s CIO receives clear and explicit strategic plans from corporate IT but serves a business unit that is dynamically building its strategy from the bottom-up. There is little formal engagement with IB’s business. As one respondent commented, “Fundamentally, the direction that you have to point yourself and your people is determined by someone else. You sit at the leadership table but largely you are an influencer rather than a setter of policy direction.”

The IT governance constraints the business unit CIO from resource allocation that would drive up corporate IT costs. IB’s business needs for agile IT and the inability of corporate IT to provide agility results in a confusing organisational context for IB’s IT function. IB’s CIO has to answer the question “How can you lead an IT function unless you know what outcome you’re trying to achieve?”

Leadership in this context is so challenging that the CIO is often left to mediate and facilitate compromise between corporate IT and IB. If there is no room for compromise there is little room for the IB CIO to influence the outcome.

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2 The quotes have received edits, including combining phrases from different interviewees to protect confidentiality.
Respondents acknowledged that in many instances they abandoned compromise and the IB CIO took a position in the strategic debate. This situation called for people to evaluate the relationship between the business unit and IT. IB business outcomes took precedence over technology policy. The IT people in IB felt a strong affinity with IB.

I get strategic directions from IT, from architectural advisors, security, finance, and infrastructure. I get guidance from them but I’m in the business, I’m part of the business, it’s my job to understand what the business needs, what they want to provide a solution to them.

These IT people had little felt influence in the governance of IT. “The bit that made that difficult was the lines of accountability and responsibility not matching up and I think often they completely bypass the people that that power effects.”

Similarly, the IB CIO was reliant on corporate IT and the global services firm providing the outsourcing. The IB CIO was often not empowered to make strategic decisions. Lacking the necessary and sufficient decisions rights over IB’s IT the role of the IB CIO was called into question. What value could the IB CIO provide if constrained by the divergent strategic reporting lines?

You might as well give it to finance to run.

**Discussion**

There has been considerable research into the role of the corporate CIO, who formulates and delivers IT strategies that support the CEO’s vision for the corporation. At NationsBank, this involves driving down the cost of technology and focusing on reliably supporting the bank’s large consumer businesses. This strategy complements the business strategies of many of the bank’s business units and supports many of the federated IT organizations attached to the consumer business units. Figure 3 depicts these relationships. The CEO and corporate CIO share a focus on corporate strategy. The CIO aims to enable and execute the corporate strategy through an effective IT strategy.

For a large organisation with diverse business units the corporate strategy becomes abstract at the business unit level. Business units operating as a profit centre understandably focus on their markets and products. While they all contribute to the firm wide strategic intent, they may compete within the enterprise for resources and have incompatible technology requirements.

At NationsBank, the IB and the corporate IT organization follow two incompatible strategies. Where IB focuses on generating revenue and investing for maximum return, corporate IT focuses on cost reduction. The role of the IB CIO forms the intersection of these two parts of the bank and so has lines of accountabilities on either side of this strategic divide.

The business unit CIO may have to take sides and support the business unit or the corporate IT strategy. This may not be the case for all business units in the bank. For example, the corporate IT strategy fits well with the consumer-facing business units.

All business unit CIOs face different challenges than do their corporate masters. They are removed from the corporate strategy and yet operate within an IT context that derives from that strategy. This creates a challenge for those CIOs whose business units do not closely align with the corporate strategy.
For IS leadership research, the insight developed here is that the organizational context determines the ability to lead an IT function. If the business units are homogenous then IS leaders face a naturally aligned IT function. However, if their business unit does not align with the corporate strategy, IS leadership is challenging. Organizational context is a critical variable in analyzing leadership (Porter and McLaughlin 2006; Uhl-Bien 2006) and varies considerably for business unit CIOs.

For IT governance research, the challenge is to be cognizant of the context that governance creates. In centralizing IT, standardizing services and controlling costs, IT governance would restrict decision rights to stop fragmentation. Structuring the environment in this way makes business unit IS leadership a dependent variable.

Conclusion

This paper has explored the role of the business unit CIO, a CIO who reports to the business unit’s manager and to the corporation’s CIO (Hodgkinson 1996). It used a case study of a large bank’s Institutional Bank (IB) to illustrate the challenges. The literature review showed that there is little research on the business unit CIO whereas in practice much of the IT leadership takes place at the business unit level. Also, the IS leadership research examining the corporate CIO does not generalize or extend to the business unit CIO.

The key contribution has been to articulate the problem of the business unit CIO. These CIOs face a different organizational context to the corporate CIO’s context. They receive an IT governance framework, have complex reporting relationships and may have to straddle strategic divides.

The bank’s IB CIO faces a number of challenges in leading an IT function. The IT strategy is developed top-down from the corporate strategy while IB develop’s strategies from the bottom-up. IB is a technology-dependent business that values innovation and flexibility. However, the IT governance constrains resource allocations that would create flexibility but drive up IT costs.
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