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IT OUTSOURCING GOVERNANCE: ILLUMINATING ON THE INTERPLAY BETWEEN CONTRACTUAL AND RELATIONAL GOVERNANCE

Research-in-Progress

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Abstract

The aim of this paper is to provide insights into the interplay between contractual and relational governance in IT outsourcing arrangements. The study will demonstrate the value of the Foucauldian notion of “governmentality” into the examination of IT outsourcing relationships. Using this theoretical lens our study will attempt to show how the contract and the apparatus of governance it entails create visibility and transparency that not only render the outsourcing relationship amenable to government and intervention, but also facilitate trust and collaboration among the outsourcing partners. More specifically, our study will illustrate the role of the contract in generating not only formal control directed to monitoring behaviors and performance, but also a form of social control that manifests trust and collaboration.

Keywords: IT Outsourcing Governance, Foucault, Governmentality, Contractual Governance, Relational Governance, Control.
Introduction

With the advent of globalization and enhanced levels of competition, many organizations have acknowledged the difficulties of developing and maintaining the range of expertise and skills necessary to compete successfully. In such an era of turbulent marketplaces and volatile technology, firms are relying more and more on information technology (IT) to remain competitive. One consequence of this pervasive dependence on IT has been an important upsurge of IT outsourcing.

Interestingly, however, while the multi-billion dollar industry of IT outsourcing is flourishing, a number of IT outsourcing agreements have been terminated or have been under-performing. Earls (2004) reported that a fifth of contracts end prematurely, while Deloitte (2005) found that one in four organizations had brought functions back in-house. To make matters worse, according to Gartner, in 2003 fifty percent of outsourcing projects were considered unsuccessful by senior executives because they have not managed to deliver the anticipated value (Gartner, 2003).

Both academic and commercial publications regularly cite the poor governance and management of the on-going relationship between the outsourcing partners as the primary reason for the failure of the venture (Deloitte, 2005; Kern and Willcocks, 2000; McFarlan & Nolan, 1995). Nevertheless the on-going IT outsourcing relationship remains a relatively under-researched area (Goles & Chin, 2005). According to Kern and Willcocks (2002) it is a paradox that while the emerging outsourcing relationship has been widely acknowledged to be the most important determinant of the outcome of the venture only a limited number of studies have been concerned with it. The authors characterized our understanding of the operations of IT outsourcing relationships “limited at best” and called for more research in this area. Along the same lines Dibbern et al (2004) in their review of the IT outsourcing literature identified the IT outsourcing relationship as a relatively neglected, yet critical area for future research.

Literature Review

Fundamentally, outsourcing is a legal agreement in which a client relies on a supplier for a given service. This legal agreement is administered by a contract. While contracts outline the roles to be played by each parties and set a framework to the relationship they are limited by virtue of uncertainty about the future. Thus, there are other factors based on awareness and mutual understanding that become relevant to the governance of the on-going IT outsourcing relationship (Kern & Willcocks, 2002; Lee & Kim, 2003; Sargent, 2006). The following sections will provide us with the key contributions in the IT outsourcing relationship.

The Hard Side of the IT Outsourcing Relationship

The hard side of the IT outsourcing relationship refers to the development of a good contract (Barthelemy, 2003). The outsourcing contract provides a detailed specification of “the exchanges of services and/or products, financial matters, assets and/or staff transfers, communication and information exchanges, service enforcements and monitoring methods, key personnel, dispute resolution procedures and other formal issues” (Kern & Willcocks, 2000).

Several authors have pointed out certain attributes to a good contract. For example, according to Parkhe (1993), the more complete the contract, the smaller the exposure to the potential opportunism of the vendor and the smaller the probability that costly renegotiations will be needed. Aubert et al (2003) on the other hand, argued that in cases of activities that are not easy to predict or difficult to measure, more incomplete forms of contracts are required.

Gietzmann (1996) as well as Beulen and Ribbers (2003) appeared to be more concerned with the importance of flexibility at the contractual level, and argued that adjustments and changes may be needed at any point of the outsourcing relationship, especially in its early stages. Andersen and Christensen (2002) further underlined the value of flexibility by pointing out that “when making adjustments is costless the problem is trivial, but if adjustment entails costs in an uncertain environment, then the problem becomes much bigger”.

Saunders et al (1997) on the other hand, highlighted precision as an important attribute of a good contract. The authors explained that ill-defined contracts generally result in high IT costs and poor IT service levels. Allery (2004) further asserted that without clarity there is an element of uncertainty that, apart from legal problems, it can also cause operational problems and result in the creation of “hidden costs”. Bennedsen and Schultz (2005) went a step
further and indicated that an adaptive, “trial and error” approach when preparing the contract, may be a good way to prevent errors.

Still, a significant number of authors argued that there are no “one-size-fits all” clauses and thus that partnership quality goes to a large extent beyond the contents in the contracts (Barthelemy, 2003). Therefore, some researchers started to investigate other determinants of successful IT outsourcing partnerships and shed light upon the other, “soft” and “more human”, side of the relationship (i.e. Kern & Willcocks, 2002; Barthelemy, 2003; Lee & Kim, 2003; Tompkins et al, 2006).

The Soft Side of the IT Outsourcing Relationship

The soft side of the IT outsourcing relationship refers to the more human aspects that characterize the relationship between the client and the vendor (Barthelemy, 2003). The importance of trust was widely acknowledged as a key indicator of the quality of the outsourcing relationship (i.e. Lohtia et al, 2009; Mao et al, 2008; Barthelemy, 2003). Pruitt (1981) emphasized that trust is highly related to firms’ desire to collaborate while Zand (1972) highlighted the fact that its absence diminishes the effectiveness of problem solving. Anderson and Narus (1990) went a step further and noted that once trust is established “firms learn that joint efforts will lead to outcomes that exceed what the firm would achieve if it acted solely in its own best interests”. Sahay et al (2003) emphasized on the dialectical relationship between trust and control and supported that the need for control can be minimized in a trusting environment.

Relationships based on mutual trust provide grounds for the development of stronger bonds between the two parties (Lee & Kim, 2003). Trust has been found to enhance co-ordination and generate loyalty among trading partners (Lohtia et al, 2009; Krishnan et al, 2006). Barthelemy (2001) highlighted even more the importance of trust in outsourcing relationships by suggesting that in essence, it constitutes the antidote to opportunism. Once a party develops trust in the other, a pattern of commonality arises and both parties become increasingly ready to work cooperatively towards established goals and objectives (Brunard & Kleiner, 1994).

Trust is also of fundamental importance to an outsourcing relationship because it is interdependent with commitment (Mohr & Spekman, 1996). Greater commitment leads to greater trust and vice versa. Either party’s commitment to the outsourcing relationship is a clear indication that the party is willing to exert effort on behalf of the relationship and is motivated to make it a success (Mohr & Spekman, 1996). Furthermore, trust and relational ties were found to be particularly important in the management of uncertainty as well as the generation of co-operative norms and joint expectations of the behavior of each outsourcing partner (Zhou et al, 2008). Lohtia et al (2009) suggested that the demonstration of the supplier’s capabilities and benevolent intentions to contribute to the venture are critical in breeding relations of trust.

Several authors also highlighted the importance of communication in breeding relationships based on trust and commitment (Kern & Willcocks, 2002; Sahay et al, 2003). Only through honest and ongoing exchanges of information the outsourcing relationship can be effectively monitored (Tompkins et al, 2006). The study by Kotlarsky et al (2008) on global sourcing ventures emphasized on the importance of social mechanisms of co-ordination in the generation of social capital. Knowledge sharing has also been found to be important in breeding relationships of trust (Ghosh & Scott, 2009; Kotlarsky et al, 2008; Kotlarsky & Oshri, 2005). Furthermore, communication was recognized to be key for the settlement of conflicts and misconceptions, facilitation of solutions, reduction of uncertainty and generation of flexibility (Kern & Willcocks, 2002). The quality of communication, information sharing and inter-firm adaptation were found to be important generators of trust (Mao et al, 2008). Sahay et al (2003) studied offshore software outsourcing relationships and emphasized that IS development is “communication-intensive” even in conditions of co-location and physical proximity.

Another stream of researchers though, considered the power-play between the client and the vendor to be more important in determining the outsourcing relationship. The power-play in outsourcing ventures is mainly a result of dependency and tends to cause a power-control dilemma (Easton, 1992). According to Fitzgerald and Willcocks (1994), it is difficult to maintain partnerships in the field of outsourcing due to an asymmetry of resources and in the power relationship that favors the service provider. Service receivers initially have greater influence than service providers in their relationships. As the nature of the relationship between the service receiver and the provider changes from one that is relatively independent to one that is tightly coupled, service providers are likely to gain more power since service receivers will be facing important switching costs (Lacity & Hirschheim, 1993; Fitzgerald & Willcocks, 1994). Kern & Willcocks (2002) also pointed out that in total outsourcing deals, the supplier will
dominate the relationship from the start, as the client is totally dependent on the vendor’s services, whereas in selective outsourcing the situation may be more balanced. More recently Heiskanen et al (2008) identified the evolving power relations between the outsourcing parties as an important determinant of their possibilities for action and behavior.

Other authors on the other hand, stressed the pursuit of mutual benefits as a factor that can generate mutual dependency. When the interests of the client and the vendor are tightly coupled, the bonds in the outsourcing relationship are enhanced. The notion is that the closeness and achievement of mutual goals, the allocation of risks and the shared responsibility, generate a strong feeling of “chemistry” that strengthens the relationship between the client and the vendor (Mohr & Spekman, 1994; Kumar & Van Dissel, 1996).

Research Contribution

Drawing from the inter-organizational relationship literature, most research on the IT outsourcing relationship has treated the contractual and the relational dimension of the venture as two distinct aspects of governance (Sabherwal, 1999; Lee & Kim, 1999; Kern & Willcocks, 2002; Goles & Chin, 2005). On this basis, it was argued that, while the contract as a formal control mechanism is a very important element in the governance of the venture, there are relational norms such as trust and commitment that may become substitutes of the contract. The argument was that these relational norms manifest a form of social control that was equally important in directing individual behaviors.

Interestingly, a number of authors argued that the combined use of formal and relational governance is fundamentally problematic (Ghoshal & Moran, 1996; Bernheim & Whinston, 1998). Their reasoning was that formal contracts signal distrust while relational governance is based on trust. Contrary to this substitution position, Poppo and Zenger (2002) demonstrated in their empirical study that contractual and relational governance functioned as complements. The authors suggested that there is a need to explore further the interplay between contractual and relational forms of governance; this is going to be the departure point of our research.

The major point of distinction between our study and previous literature is going to be the consideration of contracts not as mechanistic transactional devices, but as social artifacts. Suchman (2003) suggested that contracts carry both technical and symbolic features. As technical artifacts, contracts establish the overall framework of procedures, rights and obligations in order to achieve desirable objectives. As symbolic artifacts, contracts evoke norms which are generated by the interpretation of the set of rules they carry.

Along these lines, in studying the IT outsourcing relationship our principal aim is to investigate the role of the contract in generating formal and social control upon the venture. More specifically, we will concentrate on the examination of how the contract exercises formal control by monitoring behaviors and measuring performance, but also how it manifests a complementary form of social control by developing shared norms, goals and values.

The Foucauldian Notion of “Governmentality”

Our study introduces into the study of IT outsourcing governance the Foucauldian notion of “governmentality” (Foucault, 1980). Foucault used this term to imply that governance is not only about directing, regulating and leading others, but also about leading oneself. From this perspective, government can be understood as a “reflexive self control, creating situations in which external sources of surveillance become unnecessary” (Clegg et al, 2002).

Miller and Rose (2008) distinguish between two elements in governmentality: “rationalities” or “programs” of government and “technologies”. Rationalities or programs of government are ways of thinking, ways of rendering reality thinkable in such a way that it becomes open to calculation and programming.

Bulkeley et al (2007) suggest that programs of government identify:

a. the objectives of government

b. the objects of government (what should be governed)

c. and the nature (how governance should take place)
Technologies of government are assemblages of persons, techniques, institutions, instruments for the conducting of conduct; they refer to all those devices, tools, techniques, personnel, materials and apparatuses that enable authorities to act upon the conduct of persons individually and collectively, and in locales that are often very distant.

Miller and Rose (1990) support that “knowing” an object in a certain way defines certain forms of visibility that in effect make the object of governance amenable to intervention, calculation and regulation. More analytically, they argue that: “Knowing an object in such a way that it can be governed is more than a purely speculative activity: it requires the invention of procedures of notation, ways of collecting and presenting statistics, the transportation of these to centers where calculations and judgments can be made and so forth. It is through such procedures of inscription that the diverse domains of “governmentality” are made up, that “objects” such as the economy, the enterprise….. are rendered in a particular conceptual form and made amenable to intervention and regulation”. (Miller and Rose, 1990). The authors also advance the notion that in order to govern a domain, it first needs to be rendered visible.

These ideas are particularly useful for a more in-depth investigation of the role of the contract as a technology of governance in the outsourcing relationship. However, our study will extend the concept of governmentality and will try to examine how it “seeks to make conflicting modes of rationality redundant by delivering economies in authoritative surveillance through building a collaborative commitment and transparency into the moral fibre of a project” (Clegg et al, 2002). In this way we will get to a more profound understanding of how the contract and the apparatus of governance it entails, exercise formal control, but also manifest a form of social control.

Methodology

The chosen research strategy for our study is the case study research method. The case study research method is considered suitable because it enables the researcher to study contemporary phenomena over which he/she has little or no control and examine the context within which these phenomena take place (Yin, 2003). Benbasat et al (1987) suggested that it is a particularly useful research strategy primarily for two reasons: First of all, the researcher is able to study information systems in a natural setting and achieve a better grasp of reality. Secondly, through the case study method, the researcher is given the ability to answer “how” and “why” questions and understand the nature and complexity of the processes taking place (Benbasat, 1987).

Along these lines, our intention was to conduct an in-depth case study that will enable us to examine and understand the role of governance in the IT outsourcing venture in conjunction with the contractual and the relational element of the supplier-client relationship. The participant organization is a global investment bank that will be called GIB in this paper. The case is anonymized for the purposes of publication at the request of the bank in question. Our study will also investigate the supplier’s perspective that will be called PV in this paper.

GIB is a major European bank with operations in more than 75 countries spread across Europe, USA and the Asia-Pacific. It has more than 80,000 employees and provides a range of investment and financial services to individuals, corporations and institutional clients. PV is a major IT company that provides a variety of products and services including software, BPO and infrastructure management services. It is based in India, it employs about 55,000 people and is one of the country’s largest IT services exporter.

At this stage the research is very much work-in-progress but revealing interesting provisional results. The data have been collected through documents and interviews. Documents were considered particularly important in order to understand the different processes that shape the execution of the organization’s outsourcing ventures throughout the outsourcing life cycle. The documents that we gathered include the company’s outsourcing policy, a draft of its master services agreement and a description of the project under investigation. This material allowed us to gain a better understanding of the way that the organization performs outsourcing. On the other hand, interviews allowed us to gain the reflections of people on how governance takes place in action and how people understand the role of the contract and relationships in the outsourcing venture. At this point, we have gathered 17 interviews. More specifically, we have interviewed:

- 3 client senior business managers
- 2 client senior IT manager
- 2 client lawyers
- 4 supplier senior business managers
- 2 supplier senior IT managers
- 4 supplier IT staff

Our interviews were semi-structured on the basis of our theoretical framework. More specifically our questions were around the objectives, object and nature of governance as well as the formal structures through governance takes place. Against this background we tried to elicit the views of our research participants on the softer aspects of their outsourcing venture, including reflections on trust, commitment and issues of power. The interviews were transcribed and resulted to about 200 pages of text. For qualitative analysis we used the NVivo software. The codes that we used were determined by the structure of our interviews in conjunction with the pattern of the given responses.

The project under investigation will also be anonymized and called X-RAY in this paper. X-RAY has got three objectives:

1. Support of a set of non-strategic applications under one managed service
2. Having a fixed cost for maintaining and running these applications
3. Decommissioning any of these non-strategic applications.

The project started officially on August 1st 2008 and is running under a three-year contract. Initially X-RAY would be hosting 150 from around 1000 applications that the bank has within its IT operations. These applications are servicing a group of users that do all the back office and some middle office activities within investment banking. Typically these applications are at the lower end of the investment scale. The idea was that by establishing a managed service on these non-strategic applications, more GIB management time can go on the more strategic applications. Latter on, after the transitioning of these 150 applications which was achieved around January 2009, the project entered a second phase where 150 more applications would be transferred to X-RAY.

**Preliminary Analysis of Findings**

*Transparency/ Visibility and Trust*

Governmentality scholars have long recognized that in order to govern a specific domain, it is necessary to make it visible. Only when a domain is visible, it can become amenable to government and intervention. Along this line, the concept of governmentality illuminates the role of the contract and its governance mechanisms in generating transparency between the outsourcing partners. A senior GIB business manager identified transparency as the most important feature of outsourcing governance. More specifically he suggested that:

“Governance mechanisms really ought to create transparency. Whenever you look or think about sourcing you recognize that the more you are able to create transparency across your sourcing portfolio the better you become in supporting issues, managing issues”.

Transparency was identified to be of vital significance for defining the expectations of each outsourcing partner. It was also identified to be very significant for the regulation of the venture. Only if both parties are open and discuss their issues transparently can the execution of the venture become effective. Non-transparent processes lead to the generation of mistrust, they hinder collaborative work and underpin the generation of misunderstandings and conflicts.

A senior PV business manager noted the importance of keeping a rigorous and well-documented governance process:

“All these governance meetings are documented in terms of what is discussed, what is agreed and then we track certain things. We go back next week and say what did we decide?... What have we achieved?... Then we say that we have achieved this, we haven’t achieved this, why we haven’t achieved this and what else we
need to do in order to achieve what was agreed… There is a fairly rigorous process of governance all the way up, from the execution layer to the strategic layer. It is very well documented and tracked”.

Nevertheless, a senior PV IT manager noted that excessive transparency and very tight governance can be problematic. He noted:

“… You have to make sure you are not over governing things. You need to have proper governance structures in place to get issues to be on top of information, to recognize issues early up front, but not getting too much details”.

Another senior PV business manager emphasized the role of governance mechanisms in facilitating trust between the outsourcing partners, by arguing that:

“…the governance in place HAS to facilitate trust, otherwise you are not working with the right governance”.

However, a number of managers, both from the customer’s and the supplier’s side, illustrated that although the contract does play a major role in facilitating trust through the transparency it generates, it can not make up for a broken relationship.

Common Understanding, Empowerment and Collaborative Commitment

As discussed by Clegg et al (2002), a key objective of governmentality is to make conflicting modes of rationality redundant by delivering economies in authoritative surveillance and building collaborative commitment into the project. Along these lines governance mechanisms in outsourcing relationships should be able to (1) facilitate a common understanding of how things should be done (2) reduce the need for authoritative surveillance by empowering people within the governance structure and (3) establish collaborative commitment in the project.

Regarding the first issue (i.e. the achievement of a common understanding between the outsourcing partners), a number of interviewees acknowledged the importance of governance mechanisms in facilitating a common view between the outsourcing partners. More specifically, a senior PV business manager commented:

“These are forums where you discuss what the client wants to do and what the supplier understands. The purpose of this is that there are no differences between what GIB expects from PV and what GIB thinks PV expects”.

Furthermore, the role of governance mechanisms in the alignment of visions between the outsourcing partners was highlighted by a number of interviewees. As a senior PV business manager said:

“Alignment of visions…. This is what we do in our quarterly stirring committee meetings. This consists of two parts. In the first part, we discuss how we have done in the past. In the second part we discuss what our vision of our account is…. At the same time, GIB is sharing with us at which direction they are moving and what is expected from us. We constantly align our objectives and goals to make sure that both are working towards achieving those objectives. This is why the KPI information is very important”.

On the same theme, another senior PV business manager noted that for the alignment of visions to come about, the venture has to benefit both parties. More specifically, he noted:

“When there is benefit to both organizations there is going to be collaboration… The other thing is that when you start working with the partner and you see them delivering products and working hard to deliver to you, obviously the trust factor will improve in the engagement. That trust factor will ultimately lead to higher collaboration levels”.

Regarding the second issue (i.e. the reduction of authoritative surveillance by the empowerment of people in the governance structure), a senior PV business manager highlighted that it is the empowerment of people that distinguishes a governance from a reporting mechanism:

“There is a chance that a governance structure may simply become a reporting mechanism. You don’t want that. You really want people in these roles to be empowered. Reporting is fine – you don’t mind to report there is a problem. But if you are not empowered to fix the problem, the governance is not important… If
somebody is reporting that there is a problem, then he should be empowered to take these decisions that will fix the problem. Its only then that governance makes sense”.

As far as the issue of collaborative commitment is concerned, a number of our interviews indicated that it is of extreme importance to maintain a live interest of both parties in the relationship. An outsourcing contract has to reflect upon this mutuality. On this issue, a senior GIB business manager noted:

“Creating win-win situations where both parties have a vested interest is of fundamental importance... You can not maintain a healthy relationship in the long-run without it...Common interests and mutual benefits is probably the most efficient measure of control in outsourcing...a proactive solution to managing problems”.

Conclusion

The aim of this working paper has been to provide insights on the interplay between contractual and relational outsourcing governance. The research attempts to demonstrate the value of the Foucauldian notion of “governmentality” into studying relationships of IT outsourcing and its relevance in the analysis of the dimensions of formal and social control that are embedded in the outsourcing contract. More specifically our study constitutes a preliminary attempt to show how the contract works as a governmental technology that seeks to define the IT outsourcing relationship, make it transparent and visible to both outsourcing partners and render it amenable to government and intervention.

Our research illustrated the importance of the contract and the governance mechanisms it entails in generating relationships of trust and collaboration between the outsourcing partners. In particular, it was shown that trust was an outcome of the transparency that governance mechanisms create, while collaboration was an outcome of working on the alignment of visions between the outsourcing partners. However, our research findings indicated that although the contract can be an important facilitator for the development of trust, collaboration and commitment in the outsourcing venture, it can not make up for a broken relationship. This is an important finding that adds to the literature that supports the complementarily between the contractual and relational governance.

Furthermore, our study demonstrated that governance mechanisms without empowerment can turn into reporting mechanisms. People in governance roles should be authorized to make decisions, otherwise the efficiency and flexibility of operations will be hindered and the relational element of the venture can be potentially damaged. For governance to make sense, clear authority structures should be in place and the people staffing these structures should be empowered to make decisions.

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