

TRANSFORMATIONS IN CLIENT-VENDOR RELATIONSHIP IN THE IT OUTSOURCING LANDSCAPE

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ABSTRACT

The type and characteristics of relationship between clients and vendors have substantially transformed during a relatively short history of information technology (IT) outsourcing. For example, both IT outsourcing clients and vendors have shifted considerably from arms-length approach to more strategic alliance and knowledge sharing. The purpose of this paper is to explore transformations in specific attributes of IT outsourcing client-vendor relationships.

Keywords: *IT outsourcing, offshoring, globalization, strategic partnership, knowledge sharing.*

INTRODUCTION

IT outsourcing is generally embraced as an integral component of corporate strategy in today's organizations. More and more companies are looking beyond their own data centers and technical expertise to achieve their business objectives [16]. Organizations turn to IT outsourcing for a number of reasons. In previously conducted surveys, as much as 80% of the respondents cited the desire to reduce IT costs as a key reason for outsourcing all or part of their IT operations [17]. Another common reason for resorting to IT outsourcing is a firm's desire to focus its resources on those activities that are considered its strengths, often referred to as core competencies. Organizations further support their outsourcing decisions by reasoning that vendors possess economies of scale that are unavailable to an individual firm. Vendors have access to more powerful equipment, are able to negotiate better deals with hardware and software providers, employ a very specialized labor force, and operate at much higher levels of production [1].

By signing outsourcing agreements, firms expect to reduce their overall IT costs, focus on their core competencies, and gain superior technical resources. However, considerable shifts in role and significance of these incentives and subsequent changes in various IT outsourcing attributes have created a new landscape of contemporary IT outsourcing practice. For example, among all reasons to outsource the one that has emerged as the prime reason in recent years is to gain competitive advantage through partnership by sharing information and knowledge [27]. While IT outsourcing practices during late 80's and 90's have predominantly encompassed routine, transaction-based type activities such as program coding and help desk activities, more and more of recent outsourcing contracts are on higher-level, knowledge-based IT activities such as business processes and ERP.

Review of literature indicates interesting changes in various attributes of IT outsourcing clients, vendors, and their relationships. Besides the shift from cost-justification, there exist a host of other interesting changes in the trends of IT outsourcing. For example, as organizations have gained more experience in outsourcing their IT activities, and outsourcing companies became more seasoned in offering IT services, new types of outsourcing deals and contracts have emerged. Furthermore, the changing trend in client-vendor relationship has deemed a new set of IT-related skills and activities such as knowledge management and relationship management necessary. *What specific changes can be observed in the*

relationship between IT outsourcing clients and vendors? This paper is a preliminary attempt to shed some light on these questions by exploring relevant elements of a framework that can explain the changing landscape of IT outsourcing.

CHANGING ATTRIBUTES OF IT OUTSOURCING

Review of outsourcing literature indicates a number of noticeable shifts in IT outsourcing attributes as related to clients, vendors, and client-vendor relationships. It appears that although most, if not all, of factors that have influenced the decision to outsource in the 80's and 90's are still valid, there is a shift in the order of significance of these factors. Also, new attributes such as knowledge-sharing and strategic alliance are gaining significant role in shaping the IT outsourcing landscape. Following presents a discussion of changes as related to client-vendor relationships.

A Shift to Knowledge-Based Collaboration

The early outsourcing practices involved mainly handing over routine and structured IT functions such as program coding to vendors to complete and deliver the job. Recent outsourcing activities, on the other hand, encompass a considerable level of knowledge-sharing between clients and vendors [8]. Knowledge-sharing strategy for IT outsourcing is more encompassing than mere exchange of information. Clients are not simply passive recipients of completed jobs; they proactively are involved in, and influence, all stages of design and development process [10]. Furthermore, IT outsourcing has become a possible and plausible way to integrate and enhance client-vendor knowledge. This perspective would help nurturing the organizational learning capability [23]. Therefore, the shift to knowledge-sharing strategy implies a considerable change in IT outsourcing practice in terms developing and using knowledge management skills. To take advantage of the full benefits of knowledge-sharing, however, both service provider and service receiver must be ready and willing to collaborate to build a successful partnership in creating, sharing, and using knowledge [27].

Global Collaborative Work

The relationship between IT outsourcing vendors and clients is gradually shifted from simply an arm's length transaction in search of higher cost efficiency to global collaborative work [2]. The shift to strategic collaboration has elevated benefits of IT outsourcing beyond the limits of arms-length transaction strategy, and when implemented properly, provides both clients and vendors greater rewards than merely lower development costs [14]. However, proper implementation of effective collaboration is a challenging task, particularly for offshored projects, due to status differences and rigid boundaries that exist among organizations. Despite this challenge, effective collaborations have been achieved through open communication among participants attempting to freely share their viewpoints and "re-negotiate" boundaries and status differences [18].

Emergence of Industry Association and Standards

In the short history of IT outsourcing, the industry has emerged as a highly competitive and profoundly established industry with professional associations, certification programs, and strong public relations media. The industry participants can collectively influence shaping the structure, strategy, magnitude, and direction of IT outsourcing [12]. The Outsourcing Institute is one of the major professional associations established in 1993 and "tracks and forecasts the rapid evolution of outsourcing while providing new services and programs to assist buyers and sellers of outsourcing services as well as

industry influencers.” (<http://www.outsourcing.com>). The institute serves as the industry catalyst, as hub for information exchange, and as a “go-to” place for collaboration. It provides free membership, conducts research, and provides publications and information on the outsourcing industry. The IT outsourcing industry is adequately established to provide practice guidelines and offer professional certifications [20]. Furthermore, there are various collective efforts to strengthen the industry stands on various fronts and address industry-related issues. For example, there is a recent initiative by a service firm to launch “outsourcing bill-of-rights” covering issues ranging from transparency in the financial viability of an IT vendor in order to gain industry support in establishing standardized rules of engagement for clients and vendors in their IT outsourcing deals [15].

Protection of Clients by Vendor’s Host Country

Alongside industry-wide associations and professional organizations, closer interest and support of the vendor’s host country government as well as international organizations has emerged to be substantial. For example, among major challenges for organizations engaged in IT outsourcing are protecting privacy of the clients and information security of the firm as well as safeguarding the firm’s intellectual property [26]. There are steps being taken to legally, and through various regulatory agencies, establish favorable regulations and law enforcement procedures. For example, in the fall of 2006 the Indian Cabinet cleared the amendment to the “IT Act 2000” that paved the way to subsequently introduce a Bill addressing security and privacy concerns [21]. Also, the *World Trade Organization* has added regulatory procedures on intellectual property (*Trade-Related Aspects of Intellectual Property Rights*) that must be adhered by all member countries [3].

Move Towards Generating Business Value

The predominant incentive for companies to engage in IT outsourcing has initially been cost efficiency [17]. Development costs have often been cited in the literature as the major factor that has significantly influenced global outsourcing particularly in the 90’s [4] [5] [11]. For example, a U.S. based ASP with a ratio of 25 IT workers on-site to 75 workers in India was expected to pay a blended hourly labor rate of about \$37, compared with an average rate of \$75 to \$100 for U.S. teams [13]. However, the cost structure has changed considerably, mostly due to rapidly increased demand of qualified technical workers overseas. While the prime driver of earlier outsourcing practices has been the need to control IT costs, a main incentive for many recent outsourcing agreements has shifted towards the need to leverage the investment in IT for business value such as improved quality, increased speed to market, strategic alliance, and enhanced customer value [9]. Therefore, management decisions to outsource IT functions are justified more on the bases of where the highest overall value can be realized than merely where the cost is cheapest.

Relationship Management:

IT outsourcing clients and vendors have come a long way in management of their outsourcing relationships. Lessons learned from the past outsourcing deals as well as the changes in outsourcing motivation, among other factors, have led to a noticeable maturity in, and effective management of, outsourcing relationship [24]. Traditional approach to implementation of IT outsourcing deals has emphasized preparing a complete and comprehensive formal contract in order to minimize associated risks. While this view is still relevant and valid, formal contracts are more and more being complemented by unwritten inter-organizational exchanges that are conducive to building mutual trust

and social identification [7]. Managing client and vendor relationship in order to enhance mutual trust and commitment have demonstrated positive impact on IT outsourcing success [22].

Shifting Client-Vendor Structure

Major players in the IT outsourcing practice in the beginning included almost exclusively large organizations such as Kodak, Microsoft, and General Motors. The role of small and medium-size enterprise (SME), however, is becoming more and more significant in the contemporary IT outsourcing market. According to Gartner, approximately 90 percent of all new businesses in the USA are SMEs and the trend is toward their increasing use of outsourcing [19].

Furthermore, outsourcing IT functions is not exclusively practiced by business organizations any more. Government organizations, at both federal and state level are increasingly engaged in IT outsourcing as well [6]. It is has been estimated that government spending on outsourced IT functions to increase by an annual compound rate of 8.3 percent from \$11.7 billion in 2004 to \$17.4 billion in 2009. Government participation in IT outsourcing has increasingly gained momentum in recent years. For example, In 2006 San Diego officials approved a \$667 million IT outsourcing contract, and Virginia officials approved a 10-year, \$2 billion agreement with Northrop Grumman Information Technology to manage their IT operations [25].

SUMMARY AND CONCLUSIONS

IT outsourcing has become an integral component of corporate strategy in today's organizations. Review of outsourcing literature indicates a number of noticeable shifts in IT outsourcing incentives and practices during the past three decades. The following table presents a summary of some of these changes. It appears that although most of factors that have influenced the decision to outsource in the 80's and 90's are still valid, there is a shift in the order of significance of some of these factors like cost incentive. Also, new factors such as knowledge-sharing and strategic collaboration have received increased attention in various outsourcing decisions. Furthermore, a learning-curve phenomenon is effectively influencing changes in outsourcing practices.

Table 1: Changes in Client-Vendor Relationships

Attribute	Description	Reference
A Shift to Knowledge-Based Collaborations	The shift to outsourcing of knowledge-intensive tasks, and knowledge-sharing strategy implies a considerable change in IT outsourcing practice in terms developing and using knowledge management skills.	Gottschalk and Solli-Saether, 2005 Grant, and Baden-Fuller, 2004 Shi, et al, 2004 Willcocks et al, 2004
Global Collaborative Work	The shift to strategic collaboration has elevated benefits of IT outsourcing beyond the limits of arms-length transaction strategy, providing both clients and vendors greater rewards than merely lower development costs.	Cederlund <i>et. al.</i> , 2007 Koh, Ang, and Straub, 2004 Levina and Vaast, 2008
Emergence of Industry Associations and Standards	IT outsourcing has emerged as a profoundly established industry with professional associations, certification programs, and strong public relations media. The industry participants can collectively influence shaping the structure, strategy, magnitude, and direction of IT outsourcing.	Grimshaw and Miozzo, 2006 http://www.outsourcing.com Kolbasuk McGee, 2009 Pratt, 2006

Client Protection by Vendor's Host Country	Support of the vendor's host country government as well as international organizations have emerged to be substantial in protecting privacy and security interests of the outsourcing clients.	Das, 2008 Rustad and Koenig 2007 Vijayan, 2004
Move Towards Business Value	Initial focus on reducing cost has shifted to the need to leverage the investment in IT outsourcing for business value such as improved quality, increased speed to market, strategic alliance, and enhanced customer value.	Dibbern, Winkler, and Armin, 2008; Cederlund et. al., 2007 Fantasia, 2000 Greenemeier, 2000 Gottschalk and Solli-Sæther, 2006 Lacity and Willcocks, 1998
Relationship Management	Lessons learned from the past deals have led to a noticeable maturity in, and effective management of, outsourcing relationship.	Solli-Sæther and Gottschalk, 2008 Goo and Huang, 2008 Sabherwal, 1999
Shifting Client-Vendor Structure	The shift to outsourcing of knowledge-intensive tasks, and knowledge-sharing strategy implies a considerable change in IT outsourcing practice in terms developing and using knowledge management skills.	Gottschalk and Solli-Saether, 2005 Grant, and Baden-Fuller, 2004 Shi, <i>et al</i> , 2004 Willcocks <i>et al</i> , 2004

NOTES:

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2. A complete paper including references, tables, and figures is available upon request.