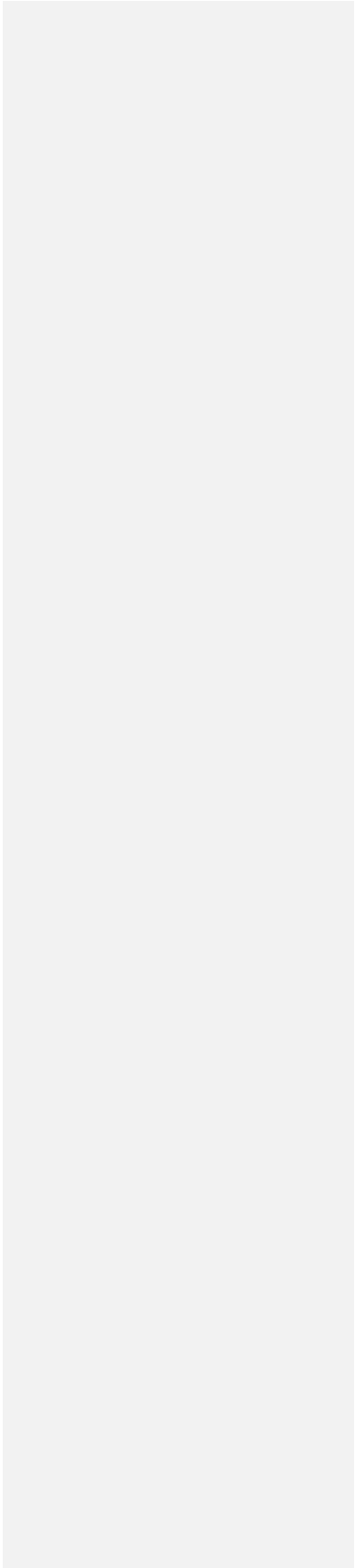


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How Hidden Costs Affect Operational Management of IT Outsourcing

Abstract

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## How Hidden Costs Affect Operational Management of IT Outsourcing

### 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

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## How Hidden Costs Affect Operational Management of IT Outsourcing

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.

### 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 and 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 and 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 of 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, &

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## How Hidden Costs Affect Operational Management of IT Outsourcing

Bull, 2009). The economic argument is compelling. To be successful, however, 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 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 expected 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

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## How Hidden Costs Affect Operational Management of IT Outsourcing

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 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, and 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, and 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

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## How Hidden Costs Affect Operational Management of IT Outsourcing

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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## How Hidden Costs Affect Operational Management of IT Outsourcing

### 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 may 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

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## How Hidden Costs Affect Operational Management of IT Outsourcing

outsourcing. Information technology outsourcing is a business trend ostensibly used to reduce costs and enable companies to concentrate on their core competencies. The *Outsourcing professional body of knowledge* suggests the business case for IT outsourcing provides the mechanism for the decision to outsource but defining an objective measurement for management focus is difficult whereas identifying comparative costs and savings against a current baseline should be relatively straightforward. Barthélemy (2001), and Hannon (2009) argue that this may not necessarily be the case as unanticipated costs often arise once the outsourcee contract is in place. These hidden costs lead to operational management challenges for IT outsourcing (Juras, 2009). These challenges fall broadly in two categories: team integration challenges such as 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 transaction cost theory (Williamson, 1979) from a financial perspective and agency theory (Knapp, & Dalziel 2007) from a governance perspective. Young (2007) concludes that transaction cost theory and agency theory do not capture the complexities involved in understanding outsourcing issues. Service, science, management, and engineering (SSME) is “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 will use SSME, an emerging interdisciplinary technique to explore how organizations manage outsourcing contracts to offer insights into the complexities of the issues not available using more archetypal approaches.

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## How Hidden Costs Affect Operational Management of IT Outsourcing

### Background

Offshore information technology (IT) outsourcing is 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 developed countries such as the United States, and the United Kingdom. The financial viability equation is dependent on the savings gained from lower wages being greater than additional risk and management costs. Aron, Clemons & Reddi (2005) suggest underperformance, resulting from geographic separation, limited communications, and cultural differences are additional risks typically associated with operating virtual teams as a result of outsourcing. However, the negation of prospective cost savings accruing from IT outsourcing by unanticipated costs, such as the management of the ongoing contract is a probable risk (Barthélemy, 2001).

Because the management emphasis shifts from the focus on internal process to management of an external process, vendor management activities include monitoring contractual performance and service levels, negotiating penalties in which 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 outsource contract management an expensive proposition (Windrum, Reinstaller, & Bull, 2009). Nonetheless, the economic argument is compelling, but to be successful IT outsourcing requires delegation of greater authority across

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## How Hidden Costs Affect Operational Management of IT Outsourcing

global teams, instilling trust, and ownership while maintaining morale in the higher cost countries. This represents a significant problem for Chief Information Officers (CIOs), who have to deal with the realities of delivering on the promise of the outsourcing business case, and maintaining domestic relationships and operational performance. The information found by researching this topic will be of use to CIOs in operational management of IT outsourcing.

### Problem Statement

The adoption of 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 over \$20 billion (USD), and *Gartner* (2008) identifies the Asian Pacific market size to be \$12.2 billion (USD), in 2007, growing at 9.2%. The largest market is North America at \$27.8 billion (USD) in 2008 and still forecast to grow at 5% despite the recession (Plunkett Research, 2010). According to Wang, Gwebu, Wang, & Zhu, (2008) the reasons for outsourcing are reducing operational costs, improve quality of service, access to skills and technology and allowing increased flexibility and focus.

However, there are potential negative financial consequences associated with this practice. Overby (2003) states that companies need to understand the hidden costs of IT offshore 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 to determine how hidden costs affect operational management of IT outsourcing, Swanborn (2010) defines, “descriptive research as what or how questions,” (p.

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## How Hidden Costs Affect Operational Management of IT Outsourcing

28). An interview design allows in-depth exploration of senior management perceptions of the impacts to 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 dynamic of contract management with governance of the new partnership relationship. This study will contain an analysis of outsourcing agreements as enacted at the operational management phase of the lifecycle by reference to SSME theory. The study will draw on the outsourcing experience of 10 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 cultural attitudes toward outsourcing, for example, O'Hara Devereaux, & Johansen (1994) notes 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 experience "requires research techniques that delve more deeply into peoples hidden interpretations, understanding and motivation" (p. 170). The research will adopt a qualitative approach, this method is appropriate to showing how and why events happen as they do. The data collection stage will use semistructured individual in-depth interviews, this 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

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## How Hidden Costs Affect Operational Management of IT Outsourcing

difficult to see with casual observation and therefore helps to achieve an in-depth understanding of the situation. Participants will be informed personnel within their company, and some scheduling challenges because of geographic location and time zones are anticipated. An in person interview will be preferable to record verbal and nonverbal responses to uncover normally intuitive and less than quantifiable truths.

### **Significance**

Conventional IT strategy advocates tighter integration of IT to the 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 from the buyers perspective initiation and transition management aspects of outsourcing such as, defining what to outsource, work and team design, and virtual team performance. Few studies give the IT providers view, Murthy (2004) is an example that gives a unique opposing perspective, suggesting consideration of outsourcing as an alliance and not a short term fix and requires an appropriate governance model in place to be successful. This study’s unique approach is to consider the problem further into the lifecycle, the operational management of outsourcing. Investigation of the operational context will be from the new interdisciplinary perspective of 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, clients, connecting the parties through shared information in a contractual agreement. By combining managerial and

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## How Hidden Costs Affect Operational Management of IT Outsourcing

technical perspectives, SSME can address the multidisciplinary issues arising with outsourcing from relationships to service delivery management to innovative service technologies, and social-organizational culture to help identify the complexities and the dependencies. The significance it holds to for leadership practice is to help in enabling the CIO to understand key concerns, such as, how to keep his or her team interested and engaged while managing costs through outsourcing IT--work to developing countries.

### Nature of the Study

Exploring This research explores the IT outsourcing strategy put into practice by companies and this research contains asks the specific question, of how hidden costs affect operational management of IT outsourcing. A qualitative method using multiple case studies is appropriate because of the descriptive nature of this research. According to Cooper, & and Schindler (2008), numerous approaches are compliant for a descriptive investigation of management questions. This research study will use individual-depth interviews with individuals combined in combination with case studies for an in-depth detailed contextual analysis. Yin (2008), describes the use of case studies as, "an empirical enquiry that investigated contemporary phenomenon within real-life context when the boundaries between phenomenon and context are not clearly evident and in which multiple sources are used," (p. 158). Cooper, & and Schindler (2008) categorize this approach as an experience survey. The benefits of using this approach for this the research is that lies in the fact that what information is known of about the IT outsourcing is to an extent proprietary to an individual organization and thus, not accessible to a researcher outside of the that organization. By seeking out information from informed personnel and drawing on their experiences and memories, the researcher can is

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## How Hidden Costs Affect Operational Management of IT Outsourcing

able to gain insights into hidden costs ~~effecting-affecting~~ operational management of IT outsourcing, ~~which-that~~ would ~~not~~ otherwise ~~not~~ be available.

In an experience survey, an open-ended format of ~~the~~ questions supports a detailed investigation ~~of-into~~ the complexity of issues and ~~allowing-allows~~ a ~~deep-~~dive when appropriate. The intent ~~will-be~~is to send the questions ahead of time to the interviewees, ~~allowing-enabling~~ an opportunity ~~to prepare for an~~ interview ~~preparation~~, and ~~making-make~~ best use of the limited time available. Cooper, ~~&-and~~ Schindler (2008) suggest that explorative studies are, “less interested in a representative cross section then in getting sources that might be insightful,” (p.

149): The anticipation is the interview group will encompass ~~the project-Project~~ ~~manager-Manager~~, IT ~~directors-Directors~~, ~~finance-Finance~~ personnel, and IT specialists.

According to Cooper, ~~&-and~~ Schindler (2008), the theoretical sampling limits of this method are a minimum of four cases and ~~a~~ maximum of 15 cases; ~~-this-This~~ study will investigate ~~10-ten~~ outsourcing agreements. The intent is to conduct ~~interviews~~ in-person or ~~over the~~ telephone ~~interviews~~. Conducting cross ~~case-case~~-analysis using content analysis techniques will ~~help~~ identify similarities ~~or differences~~ in results ~~or-differences~~ for predictability reasons. Bruns (1998) suggests that the outcome of ~~a~~ multiple case ~~study-study-research~~ is often illustrative of best practices ~~ion~~ the topic ~~under investigation-being investigated~~. Fortunately, IT outsourcing is particularly suited to field study with standardized and repeatable processes that permit examination of comparability between different organizations. This presents an opportunity for the development of field research~~ed~~-based best practices.

### Research Questions

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## How Hidden Costs Affect Operational Management of IT Outsourcing

The case study informants will participate in a semi-structured interview that focuses on obtaining information on how hidden costs ~~effect-affect~~ operational management of IT outsourcing. The questions will take three tracks: ~~understanding~~ Understanding the benefits ~~expectations-expected~~ and the hidden costs, understanding the management of the ~~Service~~ service provider's team and the local team, and understanding the dynamics s of contract management and partner relationship -management. The interview questions are specified in Appendix A: Interview Protocol. The interview should last no more than one hour. Scheduling of the interviews will be at the participants' convenience, and will take place over the telephone or in--person at a location convenient ~~for-to~~ the participant ~~or-by~~ phone.

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## Conceptual / Theoretical Framework

The objective of this study will be to determine how hidden costs affect operational management of IT outsourcing. Recent studies by Haried, ~~&-and~~ Ramamurthy (2010), and Young (2007) provide insights ~~from-through~~ lessons learned ~~and-from~~ the outsourcing -decision process. The theoretical framework for these studies is a combination of the transaction cost theory and the agency theory. However, Young (2007) claims that this framework is inadequate in explaining the complexities of outsourcing, and attempts to bridge the gap by introducing a political perspective. The result is a move toward a more holistic perspective but there ~~remain~~ remains business factors pertinent to IT outsourcing though excluded from the research, such as, business strategy and process, human resources, fundamental technology, financial measures, legal implications, and innovation (Abe, 2005). These factors ~~have-an-influencing~~ effect influence ~~on-~~ the success of IT outsourcing. SSME is an interdisciplinary method that

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focuses on service as a system of interconnected parts that includes people, technology, and business (Maglio, Kieliszewski, & Spohrer, 2010). According to Demirkan, Kauffman, Vayghan, Fill, Karagiannis, & Maglio (2008) SSME is a theoretical framework that “draws on ideas from existing disciplines such as computer science, cognitive science, economics, organizational behavior, human resource management, marketing, operations research, and IS,” (p. 4). The breadth of the SSME framework makes it an appropriate method for the study of the complex interactions of in managing IT outsourcing.

SSME is an emergent theoretical framework with several converging definitions currently under debate. Fitzsimmons, & Fitzsimmons (2006) considers service from a number of dimensions, such as, defining the service enterprise, and managing service operations, and attributes as laying the foundations for the SSME debate. Spohrer, Spohrer, & Maglio (2006), suggest the aspects of business and social science aspects contextualize IT to give yield an operational answer for to business problems, and this is the essence of SSME. The University of Berkeley's definition of SSME considers the life-cycle context of a service from strategy to design and operational management (Glushko, 2008). Demirkan, Kauffman, Vayghan, Fill, Karagiannis, & Maglio (2008), suggest several research directions for SSME, of which direction number 1one is, “the commoditization of hardware, software and business processes,” (p. 26) and direction number 7seven is, “relationship and productivity, metrics and pricing, and contract specification approaches,” (p. 34), which allude to operational management of IT outsourcing services. Whichever Irrespective of which model of the SSME is under consideration, there is an agreement that service scouring, the make-versus-buy-decision for

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## How Hidden Costs Affect Operational Management of IT Outsourcing

services includes outsourcing, contracts and SLAs- ~~thereby~~ placing operational management of IT outsourcing firmly in the bailiwick of the SSME theoretical framework.

IT outsourcing fits the SSME's definition of a service system. According to Maglio, Kieliszewski, ~~&-and~~ Spohrer (2010), "Service systems are dynamic configurations of resources (people, technology, organizations and shared information) that can create and deliver service while balancing risk taking and value co-creation," -(p. 702). The references to ~~the~~ dynamics of the system are the negations to changes that ~~effect-affect~~ the system- ~~this~~ This translates in the case of outsourcing to the limited flexibility of contracts to adjust to fluctuations in business and the need for renegotiation of ~~service\_-level agreements~~ (SLAs) or development of change- requests to add new services. A siloed approach would overlook the depth of inter-relational complexity in this seemingly innocuous example. Decomposing the renegotiation in the style of the post modernist Jacques Derrida requires an appreciation of relationships (people and culture), finance (new and hidden costs), legal (contractual obligations), business strategy (alignment of new processes required), and fundamental technology (can the existing technology accommodate the change). The comprehensive nature of SSME ~~allows-enables~~ the researcher to understand the issue in terms of a system of systems. Maglio, Kieliszewski, ~~&-and~~ Spohrer (2010), refer to this as a service system network, service systems connecting to other service systems to form relationships that as individual systems have competing values.

Maglio, Srinivasan, Kreulen, ~~&-and~~ Spohrer (2006), consider the complexities of representing service systems using ~~a-the~~ SSME approach in which the defining characteristics of ~~the~~ outsourcing service systems are a complex collection of people, technologies, and organizations. Extending this line of thought, Chen, Lelescu, ~~&-and~~ Spohrer (2008) analyze

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## How Hidden Costs Affect Operational Management of IT Outsourcing

factors in relation to the lifecycle of the outsourcing process to conclude that maintaining the right “mindset and activity dynamics” establishes and governs the intentions and actions of the parties involved. Chen, Lelescu, ~~&-and~~ Spohrer (2008) use ~~a-the~~ SSME theoretical framework to demonstrate how ad hoc, short-lived, and ill-understood outsourcing engagements, fail to transition through the lifecycle, especially when the environment is complex and rapidly changing. Through the development of a comprehensive stakeholder framework for IT ~~service~~ service-management, Bardhan, Demirkan, Kannan, ~~&-and~~ Sougstad (2010) tie their SSME research to developments in IT outsourcing such as offshoring, grid and cloud computing, and vendor managed-infrastructures. Using and SSME framework the discussion considers the interrelated nature and consequences of decisions ~~in-of~~ negotiation, contracts, valuation, execution, and risks. This research will use ~~a-the~~ SSME theoretical framework to help understand the issues of how hidden costs affect operational management of IT outsourcing, more distinctly, ~~of how hidden costs affect operational management of IT outsourcing~~.

### Definitions

1. Outsourcing—: This is a long-term, results-oriented business relationship with a specialized service provider (*Outsourcing professional body of knowledge*, p. 13).
2. Offshore outsourcing—: Also known as off shoring, it is the performance or sourcing of part of an organization’s activities at or from a location outside the company’s home country (*Outsourcing professional body of knowledge*, p. 17).
3. Captive center—: This is created by companies ~~create captive centers~~ at an off shore location in which where employees work for them (*Outsourcing professional body of knowledge*, p. 17).

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## How Hidden Costs Affect Operational Management of IT Outsourcing

4. Business case—: This is the first stage of the outsourcing process and provides an analysis of the provider's market pace to confirm that the anticipated benefits are indeed real. Also, this provides a plan for the remaining stages (*Outsourcing professional body of knowledge*, p. 51).
5. Activity-based costing—: This is the optimum method to capture current costs for an activity, or a set of activities or end-to-end business processes under consideration for outsourcing (*Outsourcing professional body of knowledge*, p. 107).

### Assumptions

An assumption about outsourcing is that outsourcing it includes large enterprise resource management systems implementations undertaken by the outside-external provider. Another further assumption is that although offshoring implies crossing the ocean, however, it simply means performing the services from another country or location. A recent nuance in the outsourcing the industry terminology is *near shoring*, where say a company based in the United States can offshore work to Mexico or Canada, but because of the proximity of the locale location where the work is performed, of the performance of the work this is also known as near shoring. The assumption is these that these terms: off-Off shoring and near shoring are interchangeable terms.

### Scope, Limitations, and Delimitations

The scope of the research is-encompasses outsourcing decision makers and chief-Chief information-Information officers-Officers (CIOs). A limitation of the study is the potential

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## How Hidden Costs Affect Operational Management of IT Outsourcing

negative effect of the global economic recession on the outsourcing market. For example, the United States government could introduce further restrictions on outsourcing in an attempt to stabilize jobs, within the timeframe of the study (Drenzer, 2004). Such a pessimistic limitation could lead to measurement issues. Durvasula, ~~&-and~~ Lysonski (2009), suggest that ~~influencing perceptions of offshore outsourcing are~~ patriotism, ethnocentrism, cultural animosity, and ~~the~~ impact of economic threat ~~influence greatly the perceptions of offshore outsourcing~~. The research will therefore need to be sensitive to these attitudinal influences and potential effects on the ~~answers from the~~ interviews ~~s-answers~~. A delimitation factor will be criteria for subject inclusion. The real life ~~size-extent~~ of outsourcing opportunities and ~~the~~ numbers of IT staff impacted may vary considerably resulting in issues with ~~generalizability-generalization~~ across situations.

### Summary

As business and government strive to enhance efficiency and effectiveness in the use of IT, they increasingly look to commoditizing this asset through outsourcing (Paus, 2007). However, the foremost reason for outsourcing is cost savings (Murthy, 2004) with secondary ~~considerations-consideration being~~ given to access to skills, management focus, and innovation. Corbett (2004) suggests the value proposition of using ~~outside providers~~ is compelling: ~~improved~~ ~~Improved~~ service for lower capital investment. However, Kumar, & Eickhoff (2006) note companies are often, "focused on cutting costs without thinking of the impacts of other, harder to quantify risk factors," (p. 257). Juras (2009) sees the foundation of these risks in hidden costs that led to issues in operational management together with relationship and governance challenges. This study's unique approach ~~is-aims to-at~~ consider~~ing~~ the problem further in~~to~~ the

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## How Hidden Costs Affect Operational Management of IT Outsourcing

outsourcing lifecycle; the operational management of outsourcing. Previous research has used the transaction cost theory and agency theory to explain the phenomenon but has fails-failed to capture the complexities of outsourcing situations (Young, 2007). SSME provides a more inclusive approach to the issues by considering multiple perspectives from both, business and technology. The proposal is a descriptive, and a qualitative study to determine how hidden costs affect operational management of IT outsourcing. The study's focus enhances the IT leadership's understanding of key concerns, such as, how to keep his or her team interested and engaged while managing costs through outsourcing IT work to developing countries. The hidden costs of outsourcing are an important topic for managers because they can challenge the rationale for outsourcing (Barthélemy, 2003, p. 94).

Chapter ~~two~~ Two ~~contains a discussion of~~ discusses the literature pertinent to outsourcing and ~~relates~~ relating to how hidden costs ~~effect~~ affect operational management of IT. The literature review outlines the outsourcing market size, and identifies reasons why companies pursue ~~outsouree~~ outsourcing strategies. The literature review ~~contains a consideration of~~ considers the research question from seven ~~different topics~~ areas: How outsourcing outsourcing changes the dynamics of the provision of IT services, approaching the issue of outsourcing, business case management, additional tasks for the management to deliver the business case promises, various dimensions to of the outsourcing issue, and what is service, science, management, and engineering (SSME).

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## How Hidden Costs Affect Operational Management of IT Outsourcing

### Chapter 2: Review of the

#### Literature Literature Review

Outsourcing has grown beyond the bounds of an emergent business ideal to become an acknowledged business practice with a market that *Forrester* (2008) estimates is worth circa \$120 billion (USD) a year for information technology (IT) infrastructure and application support alone. Outsourcing has evolved from the provision of IT infrastructure and application support to include everything from business process to research and development to innovation, and finance. *The Harvard Business Review* (1997, September/October) cites outsourcing among the most influential management ideas of the century, and globally, businesses and governments have embraced the outsourcing business practice, primarily driven by the goal of cost reduction. However, IT offshore outsourcing is not without managerial issues epitomized by both benefits and inter-organizational problems.

~~This Chapter is organized according to~~The organization of this chapter is by the various factors that influence the ~~savings-savings-and-and-benefits-benefits~~-business case for IT offshore outsourcing. The ~~chapter-Chapter begins with a review~~s of the size of the market, and the reasons ~~why~~ companies pursue an ~~outsourcing-outsourcing~~ strategy. ~~Presentation of the IL~~literature on-influencing variables ~~is discussed in seven separate-is in seven discussion~~ topics, such as: ~~outsourcing-How outsourcing~~ changes the dynamics of the provision of IT services, approaching outsourcing, business case management, additional tasks for the management to deliver the business case promise, various dimensions ~~to-of~~ the outsourcing issue, and what is service, science, management, and engineering (SSME)-)? Previous studies have identified ~~important~~ ~~influencinginfluential~~ factors ~~enabling not only the choice of the-as making the~~ correct

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## How Hidden Costs Affect Operational Management of IT Outsourcing

outsourcing provider ~~but also highlighting choice including~~ the importance of relationship management and organizational change management (Windrum, Reinstaller, & Bull 2009, April). The literature review contains a discussion of those factors as they pertain to delivering ~~on~~ the business case. According to Contractor, Kumar, Kundu, ~~&-and~~ Torben (in ~~press~~ Press) *Global outsourcing and offshoring: An integrated approach to theory and corporate strategy*, outsourcing involves interrelated and simultaneous decisions that can change the organizational configuration of a company. SSME is an emergent discipline characterized by informed analysis ~~drawn~~ from numerous business perspectives and ~~forms forming~~ the theoretical underpinnings of the discussion.

## The Size of the Outsourcing Market

Many of North America's iconic companies dominate the outsourcing industry. ~~The 2009 global outsourcing 100 reports:~~ <sup>4</sup>Accenture ranked the number one outsourcing provider followed by IBM and Sodexo, but it is the offshore outsourcing that evokes the most debate. In particular, consumer ethnocentrism and economic threat are the main contributors ~~to of~~ unfavorable attitudes toward outsourcing (Durvasula, & Lysonski, 2009). Gupta ~~&-and~~ Sao (2009), for example note that changes to local economies as a result of offshore outsourcing have given rise to opposition to this business practice compounded by conflicting state and federal legislation in the United States ~~state and federal legislation~~. Offshore outsourcing involves a company using a provider in a different country predominantly India, and China, to deliver some of its work, ~~predominantly by India, and China~~ (Engardio, 2006) but alternatives to *Chindia* include Russia, Brazil, and Argentina. Between them, these countries represent a market that generates around \$15 billion (USD) a year and predictions show annual growth of around 20%

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## How Hidden Costs Affect Operational Management of IT Outsourcing

(Murray & Crandall, 2006). The four major offshore outsourcing players in India, which were founded in the early 1980s, are: Tata Consulting Services (TCS), ranked fourth, Wipro ranked fifth, and Infosys ranked ninth, as ranked by *The 2009 global outsourcing 100*. In China Bleum and Shinetech represent the leading IT outsourcing companies. The alternative major IT offshore outsourcing providers include Russoft, an association composed of 80 companies in Russia, Paradigma in Brazil, and Belatrix, and Accelerance in Argentina.

Global outsourcing revenues are continuing unabated delivering a reported \$500 billion (USD) in 2008 (Plunkett Research, 2010). Moreover, Plunkett Research notes: ~~the~~ The size of outsourcing deals is increasing, bringing in a total contract value of \$89.4 billion (USD) for contracts over \$25 million (USD). The majority of the top ~~40~~ ten outsourcing providers are in the United States and India, and they “average \$1.7 billion in annual outsourcing sales,” (Outsourcing: 20 Indian firms among the world top 100, 2008, para 4). Of the total outsourcing market, IT accounts for \$102.7 billion (USD), representing a 21% market share, ~~the~~ The Indian market alone has a value of \$39.8 billion (USD), capturing 39% of the global IT outsourcing market (Plunkett Research, 2010). The research predicts growth of 18% for 2009 demonstrating the strength of the Indian IT outsourcing sector in the light of the global economic downturn. The adoption of IT outsourcing remains 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 Asian Pacific market size to be \$12.2 billion (USD), in 2007, growing at 9.2%. The largest market, however, is North America at \$27.8 billion (USD) in 2008 and still forecast to grow at ~~5%~~ five percent despite the recession (Plunkett Research, 2010). According to Parker (2007), there is no clear trend on the

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## How Hidden Costs Affect Operational Management of IT Outsourcing

length of ~~deals~~ that range from three years to nine years in length. Parker (2007) also notes a growing trend led by the financial services industry ~~for in~~ bundling outsourcing deals, ~~and~~ combining desktop services with help-desks and infrastructure.

### Reasons Companies Outsource

The raison d'être why a company would opt to outsource its IT function is an enigma in that it simply seems at odds with conventional wisdom, ~~which that~~ suggests tight alignment of IT functions with the business, (Turban, Leidner, McLean, & Wetherbe, 2007). Abebe (2007), notes that in following an IT outsourcing approach, a company is effectively, “emphasizing de-integration as internal functions are moved out of the organization” (p. 197). ~~Nonetheless,~~ Corbett (2004), ~~however,~~ suggests the value proposition of using outside providers is compelling: ~~improved-Improved~~ service for lower capital investment. Reducing costs appears to be ~~the~~ number one reason cited for pursuing an IT outsourcing strategy, but there are other tangible benefits that ~~enter-feature in~~ the decision making process. These reasons include, ~~resourceerresource~~-based decisions based on internal resources’ constraints, or access to skills and capabilities, and freeing up staff to focus on ~~the~~ primary business activities, (Kumar, & Eickhoff 2006). Brown ~~&-and~~ Wilson (2005), ~~note-state~~ that the reasons for outsourcing are often tied to company restructuring to generate immediate cost savings, remove the need for investment, and remove head count. According to the *Outsourcing professional body of knowledge* the main reasons ~~a company engages infor engaging in~~ IT offshoring are ~~reducing-reduced~~ operating costs to become more efficient, or to address resource-related issues. When correctly performed, outsourcing has a positive effect on a company’s bottom line and can deliver substantial savings.

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## How Hidden Costs Affect Operational Management of IT Outsourcing

~~however, v~~Value, ~~however,~~ is pivotal to the decision and the answer to the value question is different for every company in every situation (Roehrig, 2008).

Whatever the underlying reason for IT outsourcing, the result of the course of action changes the dynamics of the provision of IT services within the company. ~~Beeause-Since the~~ management's emphasis shifts from ~~a the~~ focus on internal processes to management of an external process, ~~the~~ management's activities change to include monitoring contractual performance and service levels, negotiating penalties in which these are not met, and negotiating contract-change requests to accommodate changes in the business environment (Aron, & Singh, 2005). The skill sets required to manage this new dynamic is different from the extant if companies are to realize the benefits ~~from-accruing from~~ IT offshore outsourcing, and Hannon (2009) argues the skills needed to manage internal resources are different from those needed for external resources. The new management skills needed ~~in-managing anfor IT~~ offshore outsourcing contracts may not be available in the current organizational makeup, which means additional expense of either training or bringing in new talent. Ominously, this results in one of a series of hidden costs.

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## Outsourcing Changes the Dynamic of the Provision of IT Services

The skill sets required to manage this new dynamic is different ~~if companies are to realize the benefits from IT offshore outsourcing. It takes distinctive skills to manage in that there is a need to manage~~ external resources, team integration, virtual team management, and governance of the contract.

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## Different Skills Needed to Manage External Rather Than Internal Resources

## How Hidden Costs Affect Operational Management of IT Outsourcing

Hannon (2009) and Wang, Gwebu, Wang, ~~&-and~~ Zhu, (2008), suggests the skills needed to manage internal resources are different from those needed for external resources. The most fundamental instrument of leadership and management is communication, ~~-, leaders~~ Leaders must communicate effectively: ~~they~~ They communicate to direct and inform, to motivate and inspire, and to strengthen confidence and move people to action (Harvey-Jones, 1994). In an IT offshore outsourcing arrangement, the company's management has to ensure that the provider understands the intended message and responds appropriately.

Communication skills affect the climate of a team (Abrashoff, 2008) and therefore the effectiveness of the contract. The definition of climate here, is how well the two organizations, work together, focusing on those, aspects of the workplace that directly affect people's ability to perform their best. Hargrove (1998), suggests collaboration skills are essential in creating a climate characterized by clear communication, which is ideally a joint responsibility of the company and the provider ~~responsibility~~. "A failure to communicate" is the clichéd cause for many problems. The cliché makes it no less true, and it is a failure that companies using IT offshore outsourcing cannot afford. Quite simply in communication, the sender transmits a message to a receiver, ~~it-which~~ is effective only if the receiver receives the message as intended, ~~too~~ Too often, they do not (Lipnack, & Stamps, 1997). Communication skills can minimize conflict in outsourcing ~~agreements, agreements~~; however, they cannot entirely remove conflict. During the course of the contract, disagreements will inevitably arise and the skill set needed to diffuse these situations include mediation and negotiation. Eisenhardt, Kahwajy, ~~&-and~~ Bourgeois [111] (1997), suggest this entails, "an understanding of the various causes and

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## How Hidden Costs Affect Operational Management of IT Outsourcing

outcomes of conflict, together with the styles and communication involved in the negotiated resolution of conflict,” (p. 78).

Managing outsourcing finances actively ensures discipline and centralized control in planning, budgeting, and forecasting of initiatives; and executive management teams often consider this a key indicator of a team's successful performance. Determining whether an outsourcing team is effective purely on profitability is difficult. Less than satisfactory financial performance is usually an indicator of other problems ~~on~~ in the team (Gutek, 1995). Moreover, outsourcing teams will most likely have different levels of profitability depending ~~in~~ on which phase of the lifecycle, the project is in ~~its lifeeyele~~. For example, cost savings could be higher during development and the initial stages of the contract. To ameliorate the effects of this perspective, some companies attempt to measure performance through business value (Robinson, & Kalakota, 2004). Carefully planning, implementing, and evaluating business value metrics that provide a calculated, observable basis for assessing team performance can reduce risk.

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## **Obstacles to Change ~~when~~ When Integrating Global Resources to the Team Mix**

By interlocking the local team with new ly contracted global resources in a delivery model, offshore IT outsourcing introduces a number of operational risks such as geographic separation and limitations of communications systems (Aron, Clemons, & Reddi, 2005). Misaligned teams are an unwelcome reality for outsourcing executives and create *troubled* outsourcing account teams. Misalignment of teams can lead to ineffectiveness and represents not



## How Hidden Costs Affect Operational Management of IT Outsourcing

only significant financial exposure but also puts at stake future services ~~are at stake~~ if the organization's reputation deteriorates because of client dissatisfaction. When left unaddressed, these problems can lead to inter-team conflicts. LaRue, Childs ~~&~~ and Larson (2006) note, "making lasting change is not easy because irrational and political resistance doesn't dissipate readily," (p. 73). ~~the~~ The authors' ~~implication is that~~ implication is that to achieve maximum effect, solution teams need to act in a holistic and integrated way. The *IBM Remediation Guide* (2007) suggests teams become misaligned from their implicit goal for a number of reasons ~~;~~ such as service delivery problems e.g., service level agreement SLAs not being met, relationship issues e.g., distrust and minimal communication, financial issues e.g., low profitability or return on investment being lower than expected, contract issues e.g., lack of clarity on scope. ~~Of course~~ Recognizing when teams are moving out of alignment is fundamental, though.

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## **Different Approaches Required to Manage Virtual Teams**

When the Web first gained prominence in the mid-1990s, the academic and technical origins as well as a grassroots culture tended to overshadow its potential for business. Innovative models for business, the rapid growth of users, Websites and work-related applications, and technology standards led Internet technologies to weave themselves into the fabric of outsourcing (Tidd, & Bessant, 2009). One of the major paradigm shifts to occur because of the advent of new communication has been the phenomena of virtual teams. Responsive enterprises need to quickly assemble ~~quickly~~ teams with experienced and talented people to address urgent matters from systems support to problem-resolution, from ~~in~~ product design and business processes, to customer issue resolution (Katzenbach, & Smith, 1994).

## How Hidden Costs Affect Operational Management of IT Outsourcing

~~Because~~Since such work is more intellectual than material, and the personnel best matched to it are scarce, access to skills is a key reason for outsourcing. However, the resources are often geographically distributed, and this is one of the drivers for teams being both global and virtual. Virtual teams, working in different locations, and sometimes, different time zones, face challenges, which are different in quality and intensity from those faced by traditional teams. Team members may belong to different organizations, each of which may have different procedures, processes, agendas, and cultures. Mankin, Cohen, ~~&-and~~ Bikson (1996), argue that there is an array of different kinds of telecommunication and distributed connectivity technology that supports teams, but issues related to trust, authority, fairness, and empowerment affect the efficiency of the tools used within such teams. Lipnack, & Stamps (1997), note the leadership of virtual teams requires a different approach, “People must play old team roles in new ways. This is particularly true for the central role of leadership,” (p. 119). The authors conclude that virtual teams require more leadership than conventional ~~teams-ones~~ and are only successful when everyone on the team understands and takes upon his or her part of the leadership obligation. King (2004), reinforces this view suggesting that the changes required are endemic: ~~that-That~~ companies ~~who-which~~ outsource IT activities needs employees who have hybrid skills, who can combining-combine technical understanding with business knowledge and ~~have-possess~~ the personal temperament to work with service providers.

## **Outsourcing Governance Structures**

The outsourcing of the governance structure is a dyadic relationship between contract-based management concomitant with acting in a partner mind-set. Organizationally Follett (cited

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## How Hidden Costs Affect Operational Management of IT Outsourcing

in Graham, 1995) would see the outsourcing management process as an extension of her integration theory in which she introduces the notion of interweaving of knowledge through cross-functional teams as, “we all have understanding and experience of an internal dynamic but is different when it occurs in the social domain.” (p. 211). Follet suggests softer technologies such as metaphors to build and meet collective responsibility and maintain unity in cross-functional teams involving activities such as operations and strategy. Collaboration is an integral part of operations and strategy development in which team members can play a pivotal role. For example, technological know-how is an important factor that influences strategy, and it should combine market and business insights to influence effective operations.

Team members should be aware of the significance ~~that of~~ effective communications ~~plays~~ in collaborative activity, and as Harvey Jones (1994) suggests, “many information technology (IT) workers do not speak business, they speak technology. Business leaders, on the other hand, speak the language of the business,” (p. 76). This hybrid-skilled team member will be able to look at economic, technological and organizational elements of the business and synthesize elements from all three perspectives. The ~~outsource-outsourcing service~~ provider ~~has~~ may have the technical knowledge but although technology has a vital part to play it cannot function at a business leadership-level in isolation. Technology is a catalyst that requires two other elements; the right organization structure and the right economic factors to drive successful business execution (Tidd, & Bessant, 2009). The governance model that can understand and master these aspects can span business functions and contribute to both operations and strategy.

### **Approaching Outsourcing**

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## How Hidden Costs Affect Operational Management of IT Outsourcing

Based on the common objectives for outsourcing namely, cost savings, improved technology, a ~~to~~ focus on core competencies, quality, and access to skills, Corbett (2004) suggests, “Many organizations view outsourcing as an operational decision made only in response to the business’s strategy,” (p. 78). However, a company has a number of ways to approach outsourcing, and each has different associated risks.

### Outsourcing Strategies

Aron, Clemons, ~~&-and~~ Reddi (2005), see ~~the~~ strategy as trying to manage the long-term risk-adjusted rate of return rather than outsourcing as much as possible at the lowest price. Offshoring has some additional benefits over outsourcing in it that; it can be a lower cost-option but risks such as concerns about intellectual property, increase. ~~increase such as concerns about intellectual property.~~ Companies need to understand and balance all the risks to enable their outsourcing strategy. Outsourcing literature (Barthélemy, 2003; Beulen, Roos, & Ribbers, 2006, Juras, 2008; Haried, & Ramamurthy, 2010) agrees on two aspects, ~~:- first~~ First, the most important choice as-being that of which vendor to contract with. Second, companies should not outsource core competencies, which are ~~the~~ activities ~~that -athey-company do well -does well-~~ and which gives ~~it-them~~ a competitive advantage. Kumar, ~~&-and~~ Eickhoff, (2006), have developed a closed-loop decision model that considers all these relevant factors and ~~systematized~~ systematizes the decision-making process. In contrast, Murthy (2004), approaches the issues from the perspective of the outsourcing provider ~~perspective~~. Murthy (2004), develops a framework for assessing global IT outsourcing that comprises products and services, people, and processes. Murthy (2004), identifies the foremost reason for outsourcing as cost saving, and asks two questions; what IT services is it possible outsource successfully? ~~and w~~ When can firms

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## How Hidden Costs Affect Operational Management of IT Outsourcing

realize benefits from outsourcing. Murthy (2004) concludes that a successful outsourcing of services should consider the extent and effect of support for organizational-specific applications together with the importance of intellectual property rights. Murthy's discoveries suggest that the development process is only successfully outsourced when in which requirements stable and best requirements are adopted incrementally to allow the parties to build a working relationship.

Murthy (2004) cites appropriate governance model as a key success factor in the people-component of the evaluation model. Murthy (2004) theorizes, supported by a maturity model that benefits will not begin to accrue from outsourcing until year three into the contract. This gives time to put the appropriate governance model in place and establish relationships.

Postmodernism-Postmodern theory suggests that an approach should take account of multiple perspectives and Murthy's analysis is unique in that it offers the perspective of the outsourcing IT provider. Whichever-Irrespective of the approach is taken, Kobayashi-Hillary (2004) argues that the strategy should introduce management change to ensure the outsourcing program is a success.

## Risks Associated with Outsourcing

Moving a company's technology to a provider halfway round the world is not an easy task. Briefly put, short offshore outsourcing is a risky business. Kobayashi-Hillary (2004) categorizes the risks as search, metrics, change, culture, security, public relations, and infrastructure. The company will need to invest time and money into the selection process to ensure the selection of the right style of provider, and at the right cost. Barthélemy (2001) suggests that this could be as much as 6% six percent for contacts with a total contract value (TCV) for contracts under \$10 million (USD). Barthélemy (2001) further notes that the costs

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## How Hidden Costs Affect Operational Management of IT Outsourcing

fall to 0.25% for engagements with a TCV of over \$100 million (USD), but that still leaves a search cost of around \$4 million (USD). Once the engagement is under-way, tracking quality and service levels through service-level agreements (SLAs), benchmarks and key performance indicators (KPIs), reduces risk.

Brown, & and Wilson (2005), suggests there is a risk when a company derives the metrics in isolation, and state that they develop either too many or irrelevant SLAs and KPIs or irrelevant ones. A further risk is change management, and how to introduce the new operational style to both the internal teams and the external stakeholders. Articles such as *Offshore outsourcing worse than reported* continue the emotive argument that jobs created overseas by outsourcing providers equates to-with jobs lost in the buyer country. Durvasula & and Lyonski (2009), caution that firms should, “continue to monitor sentiments of protectionism against offshoring as expressed by ethnocentrism, patriotism, and perceived economic threat,” (p. 30); as these sentiments can by-be vocal and attract unwanted publicity. The risk of backlash from this type of publicity, such as in the form of -customer defections will require quick actions through a public relations exercise. Internally, the cultural aspects of dealing with a diverse team delivering services may be a risk, depending on the location of the offshoring performance. Cost may be the impetus for choosing India over an outsourcing competitor based in Ireland, but the internal team may have to adopt more to work with an Indian team structure (Kobayashi-Hillary, 2004). Outsourcing literature frequently cites risks of security, data protection, and intellectual property concerns, (Aron, Clemons, & Reddi, 2005; Aron, & Singh, 2005; Cohen, & Young, 2005; Engardio, 2006; Kouloupoulos, & Roloff. 2006). This risk can be a *minefield* with aspects ranging from national legislation in some countries to adoption of standards such BS 7799 or

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## How Hidden Costs Affect Operational Management of IT Outsourcing

ISO17799 and is an area that the purchasing company needs to appreciate in relation to their particular circumstances.

The idea of moving technology services to an ostensibly developing nation raises the ~~questions-question of~~ risk associated with infrastructure. From the obvious telecommunications to reliability of power supply to the not-so-obvious transportation issues, if the company does need to visit the offshore provider how easy will that be, ~~asks~~ Greaver (1998). To portend the idea of offshore outsourcing, ~~the~~ -management needs to sell the idea internally to gain support because there is risk in moving offshore, which is difficult to justify on the basis of cost alone.

### **Managing the Risks**

Brown, ~~&-and~~ Wilson (2005), summarize the strategic ~~ally important outsourcing~~ success factors in outsourcing as selecting the right vendor, managing the relationship, and properly structuring the contract. Outsourcing is simply another way of doing a job that arguably the company is already doing. Managing the risks identified above through the steps of vendor selection, contract negotiation, quality and service level agreements, ~~change-changing~~ and adapting the organization, communications, and culture ~~is-are~~ tactically necessary for successful outsourcing Corbett (2004). To assuage these risks Kobayashi-Hillary (2004), identify five success criteria for outsourcing: ~~have-Having~~ the right people in place, relationship management, metrics, forward--looking KPIs, and benchmarking. To ameliorate the risks with knowledge transfer, Kobayashi-Hillary (2004), ~~argues~~ the practice of locating a manager from the company at the provider's site, although this may not be as necessary when using companies, ~~such as,~~ Wipro or TCS as they tend to have experience working in the United States ~~experience~~.

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## How Hidden Costs Affect Operational Management of IT Outsourcing

Conversely, Aron, ~~&-and~~ Singh (2005), recommend the setting--up of captive centers, “offshore companies set up by organizations to provide internal services and in some cases to sell those same services to clients,” to reduce these risks. The authors found that over the course of their two-year study, captive centers were ~~a-becoming~~ catalysts for improving performance in the extended organization. Brown, ~~&-and~~ Wilson’s (2005) approach to metrics is to understand the organizational and behavioral characteristics in relation to the financial benefits, ~~as-since~~ not everything lends itself to discrete measurement. The emphasis should be on realistic and relevant metrics and KPIs, as once ~~these are~~ negotiated, ~~they will~~would be in place for the whole contract. The outsourcing literature overwhelmingly points to the importance of relationship building between the company and provider; ~~the~~ master--slave relationship is an untenable position in outsourcing (Barthélemy, 2003; Murthy, 2004; Oshri, Kotlarsky, & Willcocks, 2007; Windrum, Reinstaller, & Bull, 2009). For example in *Managing dispersed expertise in IT offshore outsourcing: Lessons from Tata consultancy services*, TCS ranks the relationship challenge as number one in importance and ~~have-has~~ developed a number of practices to ensure the building of client relationships correctly, from the outset of the imitative.

### **Other Risks Not Evident at the Outsourcing Inception Phase**

The outsourcing body of knowledge does not address other difficulties that may be prevalent mid-outsourcing contract life cycle, suggesting there is a gap in the research literature.

An extensive body of outsourcing literature exists but has a tendency to be front-end ~~process~~ ~~process~~-oriented. However, some recent studies are emerging such as Haried, ~~&-and~~ Ramamurthy (2010), who from a theoretical framework of three different perspectives developed ~~the~~ 12 lessons learned from the offshore IT outsourcing experience. The perspectives include an

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## How Hidden Costs Affect Operational Management of IT Outsourcing

economic viewpoint that draws on the transaction cost theory to support financial concerns and the agency theory to understand governance concerns, and a strategic viewpoint that takes a resource ~~base-base~~-view and a relational perspective to relationship issues that span firm boundaries. Other mid-life risks include morale problems among in-house survivors of outsourcing that can lead to productivity issues (Juras, 2008). Overby (2003), suggests that in addition to ramping up costs of developing new processes a company can expect cultural costs to account for additional spending of up to 27% annually based on productivity lags. Gorla, ~~&-and~~ Lau, (2010) empirically study the relationship among IT outsourcing risk factors, the negative outcome of these risk factors, and their effect on future resourcing decisions. The authors develop a model with four risk factors, each containing 26 items relating to outsourcing vendor competency, client firm competency, vendor attitude, and client-vendor coordination or relationship. In line with other studies into outsourcing risk, the theoretical underpinnings of the study are transaction cost economics and the agency theory.

### **Business Case Management**

Thoresen (2010), argues that because the outsourcing market has matured, the business case is no longer all about reducing costs: ~~cost~~-Cost savings are part of the business case along with value of outsourcing.

### **Building the Business Case: Capturing Current Costs**

Corbett (2004), suggests that making ~~the-a~~ business case for outsourcing is simultaneously simple and complex. ~~Simple-It is simple~~ in that the main reason cited for outsourcing is to reduce costs (Mani, Barua, & Whinston, 2010) therefore it becomes a matter of comparing “as is” financial data against those of the proposed outsourcing ~~in~~initiative. The

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## How Hidden Costs Affect Operational Management of IT Outsourcing

complexity occurs for companies ~~in when~~ identifying all their current costs in performing a current process, forecasting benefits, and ~~the~~ mid-lifecycle hidden costs not apparent at the outset. The problem in identifying current costs ~~lies in is that a~~ process made up of activities across many departments, ~~and include~~ which may include hidden costs, such as, a portion of the overheads of departments such as finance and human resources.

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One technique that attempts to answer these questions is ~~activity--based costing~~ (Mansuy, 2000). Activity-Based Costing is a cost accounting technique that identifies the resources and activities ~~consumed-utilized~~ in the production and delivery of products and services. The ABC method analyzes cost behavior ~~by of~~ activities, linking actions to the consumption of cost and enabling the identification of factors that cause expenditure (Emblemsvag, 2003). ~~Activity-Based Management~~ (ABM) is a management philosophy that focuses on operating and structuring business entities based on detailed cost and performance information (Roztocki, 2010). ABM reflects the utilization of activity-based costs and cost driver data to improve operational and financial performance. A company that has ABC and ABM in place can understand the “as is” costs to make an informed decision on the cost--value of outsourcing (Hill, & Friday-Stroud, 2009).

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## Missing Costs

Barthélemy (2001), examines lessons from 50 companies ~~who which~~ undertook outsourcing and shows that unforeseen costs that managers cannot pinpoint can undercut anticipated benefits. Barthélemy (2001), notes companies new to outsourcing are not aware of all of the associated costs and ~~identify-identifies~~ four hidden costs categories: ~~search-Search~~ and contracting, transitioning in, ongoing management, and transitioning out. Barthélemy (2001),

## How Hidden Costs Affect Operational Management of IT Outsourcing

suggests that spending time and money on the search can reduce future hidden costs and advises incorporating incorporation of reversibility and evolution clauses into the contract. A. Hannon (2009) suggests that companies have the visibility to scrutinize the largest portion of hidden costs during when managing the effort. The hidden costs fall into three areas: monitoring Monitoring contractual obligations, bargaining and sanctioning, and negotiating change requests, and these account for about 8% eight percent of the yearly annual contract rate.

Barthélemy (2001) discusses tactics for reducing hidden costs, such as not against not outsourcing idiosyncratic IT activities and sharing knowledge of outsourcing throughout the organization to build experience. However, Overby (2003) though observes hidden costs at a far more granular level than Barthélemy, and the premise of the Overby's research is to debunk to popularist notion that a company can save up to 80% by offshore outsourcing. Overby (2003) notes that it takes years of efforts for offshore outsourcing to work correctly and the saving will be closer to 20% when considered in a total-cost model. The article systematically addresses the cost of selecting a vendor, transitioning, layoffs, culture, ramping up, and managing the contract. Overby (2003) provides a bottom line percentage cost for each of these categories estimating over and above or the hidden costs of outsourcing. For example, Overby (2003) suggests a company can expect to spend an extra 3%- three percent to 27% on productivity lags because of cultural costs. Overby (2003) attributes the reasons to a high turn at the vendor and not challenging what the company is asking for, but simply doing it even when it may make little sense. Overby (2003) provides examples to support the assertions and points made but no evidence of a comprehensive ly researched study is evident. For example in transition, offshore employees may work in the United States during which phase, they are paid

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## How Hidden Costs Affect Operational Management of IT Outsourcing

the prevailing rate. ~~The~~This costs the company double the price for each employee assigned to the contract, the offshore worker and the trainer, and this is without the opportunity cost as neither employee is producing anything during the training period.

Juras, (2008) examines the premise that outsourcing arrangements fail to deliver expected cost savings through the lens of failure to calculate total costs, including risks. The author argues that whereas activity-based costing can help identify direct support costs, the manager may not see all the costs associated with outsourcing. The risk-based costs are more difficult to identify, quantify, and therefore, represent hidden costs. The author develops a decision framework that identifies and weights the risks that represent thea hidden cost of outsourcing. The framework presents a series of business questions sorted by type of information type: why Why, what, who, how (much), where, and when. The author suggests, who Who questions” and the related risks can be addressed by either either the in-house outsourcing team, the surviving team, or the vendor team.

Of particular note is the risk Juras identifies with employees who survive that outsourcing: ~~the~~The demoralizing effect can lead to high employee turnover or “operational indifference.” In the question-framework this translates to, “how are the risks associated with in-house survivors of outsourcing being addressed?” Juras argues that the framework can help in deciding whether or how to outsource and move from quick -fix to a more long-term solution. For example of the “what to outsource?” question, Juras notes that a tactical outsourcing service is likely to be uniform among competitors whereas a strategic service creates a competitive advantage for the company that distinguishes it self from others in the marketplace. The research

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## How Hidden Costs Affect Operational Management of IT Outsourcing

highlights the significant risks in themes associated with strategy, selection process, contracting, implementation, and relationship management.

### **Delivering on the Business Case**

The typical business case contains budget, project value assessment, scope, risks, resourcing profiles, business risks, business measurement, and valuation (Robinson, & Kalakota 2004). The *Outsourcing professional body of knowledge* suggests that one approach to quantifying these benefits is to determine their likely economic effect in terms of one or a stakeholder-value category such as cost or revenue and develop a contextual calculation for project-level of impact. ~~However,~~ The justification can, ~~however,~~ cause-create a dilemma for the delivery management team- surrounding how best to after realization of initial cost savings ~~how to~~ sustain cost savings and accommodate any additional effort involved to make good on the business case, after realization of the initial cost savings. Two aspects to be considered by the ~~for the~~ management team ~~to consider~~ are- first-First, the business value, which Robinson, ~~&-and~~ Kalakota (2004) describes in terms of “cheaper resources, and faster development” (p. 73), which in summary refers to contractual obligation delivery management.

Hsu, ~~&-and~~ Wu (2006), provide a counterview ~~point~~ from ~~how~~ studies of how US companies typically manage, which emphasizes s performance measurement against contractual obligations- the-The authors argue that when evaluating the performance of IT outsourcing it should be by reference to organizational strategy. Second, total cost of ownership ~~that includes~~ must include the cost of implementation of outsourcing and the cost of ownership (Robinson, & Kalakota 2004). ~~Notwithstanding-Though~~ the issue with hidden costs ~~that~~ can make delivery on the business case unachievable, the management team notwithstanding this ~~has to~~ must contend

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## How Hidden Costs Affect Operational Management of IT Outsourcing

with the inter-relationship of issues and dependencies that will enable them to determine where on the spectrum between contract management and partnering lies the effective balance that aligns outsourcing with the business case.

*Managing outsourcing relationships to maximize value: Evolving relationship*

*management practices* found that the most important contribution to-in realizing the value of the business case to-bewas developing the quality of the relationship. Faems, Janssesns, Madhok, & and Van Looy (2008), examine alliances between firms to understand partnership governance-environments; from a structural and relational perspective. The purpose of the study is threefold; to determine how contracts with broad and narrow adherence trigger differing trust dynamics, how trust evolves in relation to contract application and how previous experience influences contract design. The authors identify a link between structural and relational aspects and conclude that these aspects reciprocally influence each other-reciprocal-way.

This would appear consistent with the advice that tightly-written contracts are a tool to reduce IT outsourcing risk and are the main cause of hidden costs (Hsu, & Wu, 2006). However, the author's make a further observation that even after negative trust has emerged, partners may decide to continue with collaborative projects and by-replacingreplace key individuals. This technique claims to revitalize teams and help partnership-governance become successful. This study demonstrates that partnership-governance can be an effective method for managing environments providing-provided a level of trust is present between the parties and the legal department does not inhibit them. The inference is a "pre-nuptial agreement" will encumber the undertaking and send the wrong signals to all involved.

**Additional Tasks for the Management to Deliver Business Case Promises**

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## How Hidden Costs Affect Operational Management of IT Outsourcing

The most fundamental instrument of leadership and management is communication.

Leaders must communicate effectively: ~~they~~ They must communicate to direct and inform, to motivate and inspire, and to strengthen confidence and move people to action (Harvey-Jones 1994). Additional tasks for management include contract ~~-~~management through performance metrics, SLAs, and baselines. This involves team performance, ~~where~~ where the provider resources need to integrate with the remaining ~~company~~ resources of the company to provide the service contracted for (Beulen, Roos, & Ribbers, 2006). This may require skills, which the company ~~does may~~ not have currently ~~have and~~ along with organizational changes to support the new business model.

### **Communication**

In an IT offshore outsourcing ~~arrangements~~ arrangement, the company's management has to ensure that the provider understands the intended message and responds appropriately. The communication skills affect the climate of a team (Abrashoff, 2008) and therefore the effectiveness of the contract. Haried, ~~& and~~ Ramamurthy (2010), ~~discussion~~ discuss ~~of the~~ lessons learned from IT offshore outsourcing and show that some issues only become apparent once the contract is underway, for example, some of the hidden costs associated with outsourcing. The authors note that, "for many of the client firm stakeholders the beginning of the relationship was full of misconceived perceptions in regard to the pros and cons of outsourcing," (p. 22). The discoveries conclusively show that communications ~~is~~ form an important aspect of successful outsourcing.

Mechitov (2009), links communications and culture as the cause of many operational management problems in IT outsourcing. Mechitov (2009), assesses Russian culture to be closer

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## How Hidden Costs Affect Operational Management of IT Outsourcing

to the West than Indian culture but, “Russians like to question and discuss all steps of the project and are rather vocal in their criticism,” (p. 135). This lack of perceived political correctness together with English as a second language puts Russia at a disadvantage compared to India in offshore outsourcing. Rao (2004), arrives at a similar conclusion noting that near-shore alternative outsourcing countries, such as, Mexico can present considerable communications problems because English is a second language. Rao notes, “Fluency in English is often confused with an understanding of idiomatic expressions,” (p. 19). -Outsourcing projects are communications--intense and the ability to communicate in the same language is as important as the communications skills.

## Performance Management and Evaluation

Turban, Leidner, McLean, ~~&-and~~ Wetherbe, (2007), suggest it is best to track the critical few and not the trivial many key performance indicators to gauge performance between projects. Managing an outsourcing contract's finances eventuates adherence to service level agreements SLAs, and executive management teams often consider this a key indicator of a team's successful performance. Determining whether an outsourcing contract is effective purely on profitability is difficult. Less than satisfactory financial performance is usually an indicator of other problems on the team. Outsourcing contracts will likely have different levels of profitability depending on the point in the contract lifecycle. For example, Windrum, Reinstaller, ~~&-and~~ Bull, (2009), suggest that savings in the first year may reduce in the subsequent years by because of unforeseen costs such as being incurred like transition and contract management costs.

Oshri, Kotlarsky, ~~&-and~~ Willcocks (2007), identify one of the challenges in clients adopting their best practices as client--quantified understanding of the benefits the client

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## How Hidden Costs Affect Operational Management of IT Outsourcing

receives from the provider's expertise. The authors suggest building into the contract, in financial terms, the benefits, which will accrue. This gives a tangible performance-measurement of the benefits receivable by the company and the ~~benefits the provider will receive~~. Oshri, Kotlarsky, ~~&-and~~ Willcocks (2007) note, "when there is a large difference between the two, the deprived party's commitment to delivering on the expertise management strategy falls off," (p. 64). The lesson from practical experience is that full disclosure is necessary for performance-measurement and evaluation.

### **Team Integration**

Teams with a common purpose are more productive than groups because their members can focus and commit to delivery of defined results. A team is more than just a group of individuals who work together. Katzenbach ~~&-and~~ Smith (1994), in *The Wisdom of Teams* define a team as, "a small number of people with complementary skills who are committed to a common purpose, set of performance goals, and approach for which they hold themselves mutually responsible." Parker Follett addresses the problem of business co-ordination through an appeal to the concept of integration, "If you go into business you will have to integrate with someone almost every day." (Parker Follett cited in Graham, 1996, p. 189). Parker Follett argues that the two obvious, but sub-optimal methods of settling differences are either dominance or compromise. Each resolution has its own negative aspects; the result of one side winning over another is characteristically a short-term victory, leading over time to a desire for reciprocal behavior by the losing side.

On the other hand, no one wins in a compromise solution resulting in eventual frustration for both sides; the issue is typically subject to frequent revisits and can linger on thus becoming a

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## How Hidden Costs Affect Operational Management of IT Outsourcing

point of dissonance. Follett's concept of integration introduces a third course of action to resolve team conflict; an option that offers both sides what they require without the need to give up anything. As she explains, "the clever thing is to recognize this and not to let one's thinking stay within the boundaries of two alternatives which are mutually exclusive." (Parker Follett cited in Graham, 1996, p. 189). Parker Follett's suggested techniques for resolving conflict between two differing perspectives is the integration of the two points of view to bring the sides to agreement and spirit of cooperation. Parker Follett recognizes some of the practicalities of the operational business situation, cautioning against suppression of viewpoints and opinions as this leads to frustration that manifests itself in what Katz and Kahn (1978) call passive/aggressive behavior. This is an evident in the approach in which when an individual outwardly complies with a given direction or policy but works to "derail" the decision by numerous small contrary acts.

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## New Skills

The skills necessary to manage external resources, team integration, virtual team management, and governance of the contract, are different to from managing an in-house IT operation and these skills may not be available within the company (Windrum, Reinstaller, & Bull, 2009). Murray, & and Crandall, (2006), suggest IT offshore outsourcing requires a project management approach to help reduce risks. Murray, & and Crandall, (2006), succinctly outline the motivation for outsourcing, and identifies identify the top risks, "cost savings do not materialize, data security, loss of business knowledge, vendor failure to deliver, scope creep, government oversight and regulation, culture adjustments, turnover of key personnel, need for knowledge transfer, and political instability of foreign governments." (p. 4). Murray, & and Crandall, (2006), point indicate a study by Kern & and Willcocks (2003) that shows 38% of

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## How Hidden Costs Affect Operational Management of IT Outsourcing

outsourcing ~~succeeds~~ succeeding and 35% failing. The authors argue that these low success rates may be in part, ~~due to because of the failure to failing to~~ link outsourcing projects in a program management effort. For example, ~~the~~ Murray, ~~&~~ and Crandall, (2006) state the project management process involves managing both, the system development life cycle and the offshore outsourcing provider. The concept is appealing but may contains fundamental flaws, for example, ~~in~~ during outsourcing, the company is buying a service and the method of delivery of that service is generally within the bailiwick of the provider, unless the contract includes such client oversight. The inference is that managing an offshore outsourcing project requires a number of skills and the management should consider assigning dedicated resources to managing the outsourcing relationship and contract management (Poppo & Zenger, 2002).

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## **Organizational Changes**

Organizational changes to reflect the new model and boundaries to support the new tasks are necessary ~~To support the~~ management wants to to deliver ~~ing on~~ the business case promise requires organizational changes to reflect the new model, and boundaries to support the new tasks. Oshri, Kotlarsky, and Willcocks, (2007), ~~examines~~ the relationship and organizational challenges of managing expertise in offshore outsourcing contracts from the perspective of eight practices that Tata consulting Consultancy services Services (TCS) employs. The practices ~~include~~ setting up a mirror of the client's organizational structure to facilitate knowledge transfer, ~~this~~ This is similar to an approach that IBM uses, called partnering in the company's vernacular. Black, Draper, Lococo, Matar, ~~&~~ and Ward (2007), ~~suggest~~ it is essential to set up a common understanding in delivering IT services from technology to process, and organization. In a short discussion, Oshri, Kotlarsky, ~~and~~ Willcocks, (2007), ~~address~~ relationship challenges

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## How Hidden Costs Affect Operational Management of IT Outsourcing

in doing so and introduce the notion of “boundary spanning,” ~~this-which~~ relates to the concepts outlined in *Organizations and organizing: Rational, natural, and open system perspectives*.

Hesselbein, Goldsmith, ~~&-and~~ Beckhard, (1997), in *Organizations of the future* offers a counter-viewpoint suggesting that as the business environment changes, the organization adapts new internal structures to accommodate the change as teams ~~get~~ formed around the new problem.

What Hesselbein et al. (1997) describe is an organization model with evolving roles and responsibilities; a matrix organization in which reporting structures and stakeholder relationships can be complex. Matrix organizations are different; ~~the~~ The first thing most people notice about matrix organizations is that people receive work direction from two or more people and splitting leadership responsibilities demands more coordination and communication. Matrix A matrix can look chaotic, since work tasks here tend to be undertaken simultaneously rather than sequentially (Jones, 2007). To maintain order and accomplish multiple tasks ~~requires~~ necessitates organizational skills as well as information-sharing and speedy communication, which sometimes means making decisions without ~~all the complete~~ information being available. Conflict can ~~generate-begin~~ among the sub-units, as one side of the matrix concerns itself with schedules or costs whereas the other focuses on quality (Gerstner2002). Mature matrix organizations use precedents to resolve some conflicts, while other conflicts are resolved through and-problem-solving and negotiation skills-to resolve others. Another type of conflict can occur when people put their function or their team ahead of higher needs, such as the company or the client. Known as sub-optimization, if left unchecked, this behavior will sabotage a matrix company (Gerstner2002). Gerstner (2002), suggest techniques for countering sub-optimization;

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## How Hidden Costs Affect Operational Management of IT Outsourcing

Some of these techniques are strong management, good business judgment, and a sound understanding of higher-level priorities.

### Dimensions ~~to~~of the Outsourcing Issues

Dealing with the realities of delivering on the promise of the outsourcing business case, ~~and~~-maintaining domestic relationships -and operational performances means, accordingly addressing issues of team integration and organizational structure~~structuring the organization~~ accordingly.

### Team Integration and Global Resources

A key enabler ~~in the trend of~~ globalization ~~in of~~ business practices is the expansion and enhancement of communications networks. Krauss (2003)<sub>2</sub> notes that, “The Internet's speed and reliability have made it possible to do work remotely in a way that just a few years ago was either impractical or impossible,” (p. 582). This has led to the phenomena of outsourcing, which is supplied by global markets, and involves working in virtual teams. Business teams typically comprise of people who have never met, from different countries, cultures, and backgrounds that come together, in a virtual sense, to undertake projects, and assignments. While the concept of multi-cultural teams is not new, businesses can conduct operations in real-time ~~as~~since technology removes the barriers of time and distance. Kuhn (1996)<sub>2</sub> notes that in scientific theory, over time, anomalous results build up to a stage in which crisis develops, ~~the~~The implications of ~~which these~~ force a change in our philosophy to a “new paradigm”- that becomes the accepted framework. A postmodern perspective is that global business is in the midst of such a revolution, although Kuhn (1996)<sub>2</sub> would probably argue, “Paradigms gain their status because they are more successful than their competitors in solving a few problems that the

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## How Hidden Costs Affect Operational Management of IT Outsourcing

group of practitioners has come to recognize as acute,” (p. 23). Responsive enterprises need to assemble teams quickly with experienced and talented people and outsourcing can help. **Because** **Since** such work is more intellectual than material, and the personnel best matched to it are scarce, ~~they the work is~~ are often geographically distributed, and this is one of the drivers, ~~for making which makes~~ teams both global and virtual. Virtual teams, working in different locations, and sometimes, different time zones, face challenges different in quality and intensity from those faced by traditional teams. Team members may belong to different organizations, each of which may have different procedures, processes, agendas, and cultures. Mankin, Cohen, and Bikson (1996), argue that there is an array of ~~different kinds of the kinds of~~ telecommunication and distributed connectivity--technology that support teams, but issues related to trust, authority, fairness, and empowerment affect the efficiency of the tools used within such teams.

A plethora of tools support local and global teams, Fisher, ~~& and~~ Fisher (1997), suggest that it is crucial to understand the critical role of technology in this work structure. Common collaboration tools include telecommunication's voice services such as audio conferencing, **and** web distribution lists, ~~which used to~~ manage work group access or give visibility in a “same time” chat. Haried, ~~& and~~ Ramamurthy (2010), note that one of the lessons learned from offshore IT outsourcing is identifying creative ways for effective communication and **therefore**, **they** suggest the use of **instant messaging-messengers (IM)** to negate issues associated with accent differences. An innovative way of using distributed connectivity to enable effective group communication and **collaboration is by** making use of Web3-D ~~Internet-Internet~~ virtual worlds such as Second Life. Earlier this year the Web3-D Internet technology moved further toward distributed connectivity through the availability of Virtual Collaboration for Lotus

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## How Hidden Costs Affect Operational Management of IT Outsourcing

Sametime. Virtual world technology represents one area that redefines the nature of online meetings offering new ways for teams to engage and collaborate. The interactive tools offer functionality that is not available on the market today ~~to thereby provide offering~~ an immersive experience ~~for meeting to~~ attendees ~~of meetings~~ who can actively participate in ~~such online sessions~~. Moore (2008), suggests virtual collaboration supports ~~;~~ better connections ~~s~~ between globally dispersed teams, ~~a~~ faster response to issues through real-time collaboration on tasks, decreased travel and venue costs, secure, behind-the-firewall collaboration, and ~~an~~ improved access to key experts across an organization. The benefits of virtual collaboration are available to any team, ~~who which~~ requires ~~to develop~~ content ~~development~~ as a team activity. Some of the primary uses ~~for of~~ this functionality include ~~;~~ ~~project project~~ office functions, in which project managers manage virtual ~~teams~~, and consulting firms, ~~who need to~~ conduct visioning or strategy workshops, ~~and~~ facilitated sessions for clients. In short, the new distributed connectivity of Web3-D Internet ~~enables allows~~ businesses to collaborate as ~~a a~~ community by using the technology in an innovative way beyond its original inception.

Remote leadership is a new aspect of mobile communication ~~s~~ and requires a specific skill set to be an effective virtual leader. O'Hara-Devereaux and Johansen (1994), highlight the importance of four management competencies for global team leaders: ~~ability~~ Ability to understand and communicate across many cultures ~~;~~ ~~technological competence~~ ~~;~~ ~~creating creation~~ and ~~sustaining sustenance of~~ teams in a global setting ~~;~~ ~~and~~ facilitation. A further consequence of the new technology is that 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. ~~A-This is a~~ technology ~~enabled and driven~~ dilemma for the

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## How Hidden Costs Affect Operational Management of IT Outsourcing

business that ~~have~~has to deal with the realities of delivering on the outsourced business case~~promise of the outsourcing business case~~, while maintaining domestic relationships and operational performance.

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## Organizational Structure and Outsourcing

Standardized outsourcing offerings can be adapted through contract parameters for delivery within a company's organizational structure that inevitably will need to change to accommodate the new way of working. Scott (2007) defines three organizational paradigms: ~~rational~~Rational, natural, and open system in this connection. According to Scott (2007), the key features of a rational system perspective are specific goals and formalization of rules and accompanying structures in which to achieve those goals. A counter-organizational paradigm that Scott describes is the natural system ~~that Scott describes as~~ characterized by informality, and it values relationships more than formal structures.

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A third perspective of organizational paradigms is the open system view, which sees organizations in the context of demanding, changing, and unpredictable environments. It would be unusual for all of an explanation of an organization's paradigm by reference to all three of the predominant paradigms. Dramaturgical and institutional theory offers a valuable way to view such environments (Freeman, & Peck, 2007). The theory uses theater as a metaphor for understanding organizations and their environments Bolman and Deal (2003) suggest, "most organizational life is carefully scripted, we play our scenes in organizationally approved dress code and play the game by acceptable roles of conduct." (p. 296). With a typical open system focus on social interaction and internal situations, the concept considers the performative aspect of governance of the outsourcing ~~governance~~process. The influential and symbolic roles of joint

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## How Hidden Costs Affect Operational Management of IT Outsourcing

management committees ~~form~~ offers a new environmental perspective and a dramaturgical analysis can be undertaken to examine the interactions ~~of what that~~ Bolman and Deal refer to “as symbolic frames of reference which are instrumental in delivery.” (p. 297):

Another useful concept for gaining an appreciation of this working environment is the “political dynamics of the ecosystem,” that requires s an understanding of ~~;~~ agendas ~~Agendas~~, relationships with allies and foes, a and a negotiation of alliances and accords. The same factors that produce politics inside the company also create political dynamics within the outsourcing provider organization. The environment is ~~one of~~ replete with internal politics and agents with ~~his~~ or her their individual agendas, resources, and strategies. The interactions are predominantly ones of divergent interests and agendas albeit set to environmental rules in which the “actors” are dependent on this environment for support and resources. Faems, Janssens, Madhok, ~~&~~ and Van Looy (2008), argue that both structural and relationship perspectives are important in alliance governance ~~governance~~-models. Their study demonstrates that partnership governance can be an effective method for managing environments ~~providing~~ provided a level of trust is present between the parties and ~~providing~~ provided there are no constraints of overly formal goals and roles. Other researchers such as Haried ~~&~~ and Ramamurthy, (2010), appeals to the agency theory to explain the nature of this relationship. Scott (2007), recognizes the importance of multiple perspectives and brings goals and power together to show the social and organizational inter-relationships ~~between these factors~~. The appeal of the postmodern view is ~~lies in it~~ that it represents succinctly the dilemma of the outsourcing partnership of “getting things done.”

### A Postmodernist Perspective

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## How Hidden Costs Affect Operational Management of IT Outsourcing

Thomas Kuhn in *The Structure of Scientific Revolutions* observes moments in history when changes in the body of knowledge radically altered the accepted view and in doing so ushered in a new way of thinking, which became basic to the modern world. Each change brings with it new attitudes and institutions created by the new knowledge. Our modern view is a mixture of present knowledge and past viewpoints that have somehow remained valuable to us in new circumstances (Calhoun, 1993). Today conceivably such an inflection point exists, outsourcing. ~~IT outsourcing's roots are~~ The roots of outsourcing can be traced to Ross Perot's founding of EDS in 1962 and the seminal 1989 deal between Eastman Kodak and IBM leading to the take-over of their data center ~~that marked the start today's outsourcing market~~ (Rao, 2004). Postmodern theories have helped reveal the hermeneutic nature of knowledge, toward the characterization of value by interpretation and context; assisted by consultative mediations to gain a consensus view (Sarup, 1993). Despite the attractiveness of the perspective through counter-viewpoints, postmodernism creates significant challenges and concerns, ~~in~~ In particular, the turgid style of postmodern writing and formulation of ideas makes the work inaccessible thus creating practical difficulties in the application of the theories to business practices.

For the quintessential postmodernist philosopher Jean-Luc Nancy, the theme of community is one of the main and most interesting values with regard to outsourcing. The values of a business are usually in their history and frequently derived from those who initially set up the company. As Peters ~~&~~ and Waterman (1992), demonstrate, the value system transcends business situations and eventually permeates the beliefs of practically everybody in the organization. Even though values are durable, their application in different circumstances

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## How Hidden Costs Affect Operational Management of IT Outsourcing

requires constant adaptation, application and thought. ~~the~~ The value system is the basis for the whole relationship ~~of-between~~ a business ~~with-and~~ its people, and ~~of-among~~ all its people ~~with one-another~~. The value system is one of the prime means of transferring ownership of problems

to the team (Hargrove, 1998). The people themselves reinforce the integrity of the system and

therein ~~lay-lies~~ the problem. Although business value ~~is derives-derived~~ from the beliefs and ~~philosophy-philosophies~~ of the leaders at a specific time, essentially, the values of the company should reflect both the business needs and ~~its~~ competitive characteristics ~~of the business~~.

Outsourcing operations are far broader, both in ~~terms of the~~ range of product and geography than company value systems ever envisioned or sought to cope with. Whereas one option is to

encourage differences ~~s~~ within the company ~~+, a~~ difference of approach, attitudes ~~s~~, and of styles, Fisher, ~~&- and~~ Fisher (1997), suggest the reality is that every group of people must have a shared set of values ~~-, if-If~~ this is not so, then, they do not exist as a team. The leadership skill is to recognize this fact, build on ~~it~~, and enhance the values, which will be helpful to ~~the achievement of~~ future success. The difference from other business situations is that these “soft” issues involve emotions and deeply ~~-~~ held beliefs. Working on corporate values calls for sensitivity and persistence to adjust the business to ~~the-a~~ changing world.

## What is Service, Science, Management, and Engineering (SSME)?

Recent studies by Haried, ~~&-and~~ Ramamurthy (2010), ~~and and~~ Gorla, ~~&-and~~ Lau (2010), provide some excellent insights into IT outsourcing. The theoretical underpinnings of Haried, ~~&-and~~ Ramamurthy (2010), and Gorla, ~~&-and~~ Lau's (2010) studies are ~~based on the~~ transaction cost theory and agency theory to support and explain financial validation ~~s~~ for outsourcing, value, and relationship management. This goes some way ~~to-in~~ explaining the whole picture but does not

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## How Hidden Costs Affect Operational Management of IT Outsourcing

offer a single viewpoint that combines the elements of culture, technology, intellectual property, security, legislation, and legal contractual ties. SSME adds value by completing the picture.

### **Definitions of Service, Science, Management, and Engineering**

Spohrer, ~~& and~~ Maglio (2006), examines the shift in businesses over the past ~~over the~~ ~~past~~ decade toward a concept of service innovation in which they determine that the mix of skills necessary to succeed include IT, business, and ~~the~~ social sciences. Spohrer, ~~& and~~ Maglio (2006), suggest ~~that~~ business and social science aspects contextualize IT to give an operational answer ~~for to~~ business problems, and this is the essence of service science. By considering the economic shift, the authors demonstrate through numerous literature references, the expansion of the service market and note the conflicting array of definitions of the “services.” No one definition is seen as dominant, however, Service, Science, Management, and Engineering (SSME) ~~is are~~ intertwined with the theory of co-production and the responsibilities of the client in the relationship. According to Fitzsimmons, ~~& and~~ Fitzsimmons (2006), “many definitions of service are available but all contain a common theme of intangibility and simultaneous consumption,” (p. 4). Abe (2005), attempts to describe the meaning of service by offering numerous descriptions from the body of knowledge, finalizing the discussion by conceding that the difficulty in a standard description is confusing to clients and contributes to a lack of perceived value. Abe (2005), shows the underdevelopment of service as an economic asset and introduces service science as the response, using Spohrer’s definition of SSME. Abe (2005), cites business strategy, business process, human resources, and technology as the four main fields of service science that attempt to improve the predictability of services, by using models to synthesize the human element with scientific models. ~~Nonetheless, t~~The concept, ~~however,~~

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## How Hidden Costs Affect Operational Management of IT Outsourcing

remains elusive. Spohrer, ~~&~~ and Maglio (2006), draw a parallel with, “the development of computer science that combined software and algorithm complexity theory with hardware and logic design into a new specialty that increased understanding of computation in technological systems,” (p. 22). By extending the service science approach to include management and engineering Spohrer, ~~&~~ and Maglio suggest that this better reflects the tasks that organizations perform for each other as “services.”

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## Why is SSME ~~is~~ an Appropriate Approach?

Glushko (2008), shows Berkley’s approach to SSME in order to encompass a life cycle matrix that identifies strategy (planning), design (innovation, specification, composition, and realization), and operation (deployment, management, evaluation, optimization, and evolution):

~~all~~ All the components ~~parts~~ of outsourcing. Chen, Lelescu, ~~&~~ and Spohrer (2008), observe, from numerous case studies, the symbiotic nature of services ~~s~~ outsourcing engagements: ~~the~~ The client

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benefits through reduced costs and efficiencies whereas the provider benefits through creation of new channels and marketplace offerings. The authors identify three attributes that make this possible: ~~the~~ The value co-creation principle, the balancing innovation and the commoditization activity dynamics, and the configuration of resources—people, organization, technology, and shared information. ~~-~~By analyzing these factors in relation to the lifecycle of the service the research concludes that maintaining the right “mindset and activity dynamics” establishes and governs the intentions and actions of the parties involved. Chen, Lelescu, ~~&~~ and Spohrer (2008), use the SSME theory to demonstrate how ad hoc, short ~~-~~ lived and ill ~~-~~ understood outsourcing engagements fail to transition through the lifecycle, especially when the environment is complex and rapidly changing. The conclusions appear self-evident, ~~the~~ The concepts are easy to

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## How Hidden Costs Affect Operational Management of IT Outsourcing

understand in theory but difficult to execute in practice and the authors offer four lessons learned from service engagements. Chen, Lelescu, ~~&-and~~ Spohrer (2008) identify additional areas for further study such as understanding the value co-creation artifacts and metrics, and practices that help ~~the~~ balance ~~between~~ innovation and commoditization activities, and methods to configure resources, optimally.

Maglio, Srinivasan, Kreulen, ~~&-and~~ Spohrer (2006), consider the complexities of representing service systems using ~~a-the~~ SSME approach in which service systems where the definition of outsourcing is a complex collection of people, technologies, and organizations.

Maglio et al., (2006), argue that measurement of work and value in such systems and current modeling tools is inadequate. Through an examination of four ~~-service value-~~scenarios Maglio et al., demonstrate how ~~a-service~~ scientists would approach the problem. The three-step approach has similarities to that of a consulting engagement ~~-approach-~~ where interview stakeholders ~~to~~ identify the boundaries (scope), create a model (component business modeling), and envision the new service system (process redesign). One example worked out through by using this approach is that of an IT service delivery center ~~and~~ which could serve as a template for examining outsourcing. Maglio et al., (2006), conducted interviews and data is analysis in terms of work practices, tools, and organizational structures. The results identify a number of informal activities including negotiating work items and schedules, providing expert advice, ~~and~~ sharing tools, ~~s,~~ and practices. By not including these add-ons in cost analysis, the implication this represents is a positive hidden cost for the client, ~~but which is however,~~ negative ~~to~~ for the vendor. The results also suggest that technology makes s these activities more effective. The authors conclude that the approach has the benefit of showing not just the interconnectedness of

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## How Hidden Costs Affect Operational Management of IT Outsourcing

all service systems ~~and~~ but also the need to identify boundaries, stakeholders, problems, and opportunities.

## How **does** SSME Helps to Understand the Issues More Distinctly?

Hidaka (2006), states that one of the objectives for SSME is to solve problems associated with intangibility, simultaneity, and heterogeneity. SSME offers some unique insights into the emblematic characteristics of service and outsourcing that would be lost in a siloed approach. For example, Demirkan, Kauffman, Vayghan, Fill, Karagiannis, ~~&~~ and Maglio, (2008), examine service-orientated technologies such as application development, software as a service, and ~~on~~ on-demand computing by considering the value of the service approach from a client perspective. Demirkan et al., -(2008), poses several inter-related questions that attempt to answer questions of service-orientated technologies that will help managers engage these new practices. A review of the growth of the service economy draws a relationship between service-orientated technologies and SSME, based on the interdisciplinary qualities of both. Demirkan et al., (2008), emphasize that SSME considers the alignment of IT with business and identify characteristics of service, such as intangibility, perishability, customer contact, simultaneity, heterogeneity, demand fluctuation over time, customization, and complexity. These characteristics develop a model of how services are evolving with a service orientation. The approach offers multiple perspectives, and “an integrated view, a relief map of he business, and the key issues appear more distinctly,” (Teboul, 2005, p. 119).

## **Conclusion**

As a distributed enablement technology, the Internet ~~is~~ lays the foundation for many innovative models for business, and none is more pervasive than the model for IT outsourcing

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## How Hidden Costs Affect Operational Management of IT Outsourcing

~~model~~, which has woven itself into the fabric of business over the past decade. The benefits that accrue can be substantial, ~~in terms of reduced costs, improved quality of by reducing costs,~~ ~~improving quality of~~ service, ~~a providing~~ wider access~~ibility~~ to skills and new technology, and ~~greater~~ focusing on core competencies (Mani, Barua, & Whinston, 2010). The success of the outsourcing business model relies on choosing the right IT offshore outsourcing provider, and making the correct ~~provider~~ choice ~~for the company's business scenario~~ requires careful consideration (Haried, & Ramamurthy, 2010). Murray ~~and, & Crandall, (2006)~~, suggests there is a low success rate in IT outsourcing with failure rates as high as 38%. The body of knowledge offers numerous reasons but hidden costs are ~~consistently held responsible for thematic throughout the text and can account for~~ additional costs at all stages within the outsourcing life cycle, ~~right~~ from vendor selection to contract management to ~~the~~ cultural costs that lead to productivity gaps (Overby, 2003). These costs are difficult for companies to predict ~~accurately with any precision~~. An IT offshore outsourcing engagement is a complex undertaking that typically involves representatives from sales, contracts and negotiations, finance, legal, human resources, service delivery, global engagement services, and procurement (*Outsourcing professional body of knowledge*, 2008). SSME can help understand and define the issues ~~more clearly with clarity~~ through an emphasis on ~~co-creation of~~ service value ~~co-creation~~ as a corollary of ~~the~~ perspectives derived from the intersection of technology and business (Maglio, Kieliszewski, & Spohrer, 2010).

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## Summary



## How Hidden Costs Affect Operational Management of IT Outsourcing

The impact of advances in communications and information technology, and the globalization of the economy are clearly illustrated in the phenomenon known as IT offshore outsourcing. According to Oshri, Kotlarsky, ~~& and~~ Willcocks (2007), revenues from IT offshore outsourcing were estimated at \$25 billion (USD) in 2008, with continued market growth projected at 20%. Aron, ~~& and~~ Singh (2005), argue that ~~the~~ limiting the reasons to outsource to cost savings produces little ~~in the way of~~ strategic advantage. Rather, companies expect to benefit ~~by through~~ customized services, reduced development timelines, and improved profit margins. This ~~takes entails~~ organizational change and demands new skills to manage ~~the new~~ processes. Skills Hannon (2009), suggests ~~the company companies~~ may not have skills, such as those to lead and manage global virtual teams. Whereas diversity is generally seen as adding value to a team's performance, diversity is more likely to lead to conflict within the team and is difficult to resolve successfully in a virtual setting thus emphasizing the importance of relationship management and contract governance (*Managing outsourcing relationships to maximize value*, 2010).

The exercise that exposes the costs, benefits, risks, and staffing impacts and is the inflection point for the decision to proceed with outsourcing, is the business case (Wang, Gwebu, Wang, & Zhu, 2008). The critical value-~~enabler~~ is the measurement of future value derived from outsourcing against the information in the business case-~~because of~~ Due to the complexities of the number of facets involved in outsourcing, it is difficult for the business case to be accurate. According to Juras (2008), there are a number of hidden costs missed, which can skew future metrics and undermine the initiative at a number of levels from relationship to contract performance. To understand the issues more distinctly ~~requires necessitates~~ an approach

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## How Hidden Costs Affect Operational Management of IT Outsourcing

that appreciates the inter-connectedness of the subject matter, and Abe (2005). suggests the

SSME can fulfill this role ~~as~~ since the discipline considers the confluence of business strategy, process, human resources, and technology. As SSME is an interdisciplinary approach to value

co-created by clients and providers, and service innovation, it is an appropriate research method for the complexities of outsourcing. Chapter ~~three~~ Three provides details on the selection of an appropriate method, design and analytical tools to investigate this contemporary problem.

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## How Hidden Costs Affect Operational Management of IT Outsourcing

### Chapter 3: Research Methods

The purpose of this qualitative research study conducted 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 dynamic of contract management with governance of the new partnership relationship. This study will contain an analysis of outsourcing agreements as enacted at the operational management phase of the lifecycle by-with reference to SSME theory. The study will draw on the outsourcing experience of 10-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 cultural attitudes toward outsourcing, for example, O'Hara-Devereaux, &-and Johansen (1994). notes 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-The consequences of this can make contractual management arduous. Cooper, &- and Schindler, (2008), suggest that to understand the different meanings individuals place on their experience "requires research techniques that delve more deeply into peoples hidden interpretations, understanding and motivation." (p. 170). The research will adopt a qualitative approach and, this method is appropriate to showing ing how and why events happen as they do. The data collection -stage will use semi-structured, individual in-depth individual interviews, this-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 difficult to see-perceive with through casual observation and this therefore helps to achieve an in-depth understanding of the

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## How Hidden Costs Affect Operational Management of IT Outsourcing

situation. Participants will be informed by personnel within their company, and some scheduling challenges may be anticipated because of geographic location and different time zones are anticipated. An in person interview will be preferable-preferred to recording both, verbal and non-verbal responses to uncover normally -intuitive and less -than-quantifiable truths.

This ~~chapter~~ Chapter contains a rationale ~~of~~ for the choice of research method together with ~~a-why the chosen rationale of why the research~~ method is appropriate for this particular research question. In doing so, this ~~chapter~~ Chapter also contains an explanation of why the proposed multiple case study design will accomplish the study goals and why design is the best choice for this particular research question.

### Research Method and Design Appropriateness

The research method adopted by this descriptive study is a multiple case study design with cross -case analysis to determine common relationships across cases. The themes will emerge ~~from the~~ when analyzing the data ~~when analyzing~~ through cross -case techniques identified by Yin (2008) and Stake (2006). Augmenting the process through use of the NVivo8 software will help to reveal the patterns and relationships in the data-sets and reduce bias. Qualitative research explores, therefore it discovers those themes that will help to answer the research question. Yin (2008), notes that, ~~“~~“Unfortunately case study research designs have not been codified,” (p. 26); ~~nonetheless-yet~~ an overview model of the approach to collecting data, analyzing evidence, and reporting ~~that~~ will be used in this study. This is illustrated is at in Appendix A.

### Rationale for Choosing the Method

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## How Hidden Costs Affect Operational Management of IT Outsourcing

Yin (2008)<sup>1</sup> suggests that the choice of research method depends on three variables, “the type of research question, the control the researcher has over actual behavioral events, and the focus on contemporary as opposed to historical phenomena,” (p. 2).<sup>2</sup> Using this as a framework to determine the most appropriate method for use in this study, ~~deliberation of~~ numerous research approaches, both quantitative and qualitative were ~~undertaken~~deliberated upon. Yin (2008)<sup>1</sup> notes the research method preference as a case study when research questions ask “how,” when the researcher has no control over events, and the study focus is on a contemporary problem in a real-life setting. The key elements of this study closely align with Yin’s criteria for using the case study method. Consequently, this study will use a case study research method.

Yin (2008)<sup>1</sup> argues that in case studies the complexity of the observable facts and breadth of the real-life circumstances lead the study to consider ~~of~~ multiple sources of evidence: ~~multiple~~Multiple case studies triangulate the problem. Stake (2006)<sup>2</sup> argues that the triangulation process gives assurance that, “the meaning gained by the reader from their interpretations ~~is~~ the meaning they intended,” (p. 33). A multicase study begins with a concept that ~~a~~-links the case together, ~~is~~In this study, that concept is the idea that hidden costs affect operational management of IT outsourcing. According to Stake (2006), “An important reason for doing a multicase study is to examine how the phenomenon performs in different environments,” (p. 23) and the study will include an examination of ~~10-ten~~ different cases: ~~10-Ten~~ different companies that have IT outsourcing agreements. The difference to the single case in which the goal is to show the distinctiveness of the case and situation, the multiple case study aspires to demonstrate both commonalities and differences to each case. The cases represent an opportunity to study the

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## How Hidden Costs Affect Operational Management of IT Outsourcing

problem at the level of an individual occurrence ~~level~~ but the value of the method lies in the fact ~~that~~ the cases permit cross-case analysis to get a line of sight on the bigger picture.

The supposition is the complexities of the IT outsourcing market are explainable because of the particular activity and context of each case. For example, the supposition is that a case has a challenge of the delegation of greater authority across global teams, instilling trust, and ownership while maintaining in the higher cost countries. Although any case will be similar to another case in many respects ~~it may there are there may be~~ unusual features, ~~perhaps Perhaps~~ this case has the senior management is commitment committed to making the contract work and has little objection to funding additional change ~~--~~requests which ameliorates these effects. Discovery of assertions, through cross ~~--~~case analysis will help to explain the how hidden costs may effect-affect operational management of IT outsourcing ~~may occur~~. The study will conclude with the development of field research ~~--~~based best practices. Stake (2006), suggests, “Some of the discoveries will be context-bound,” (p. 41): ~~the-The~~ use of the NVivo8 software will reduce this risk and reduce researcher bias.

### Rationale for Design Appropriateness

Yin (2008), describes the choice of using a case study as, “an empirical enquiry that investigates contemporary phenomenon within real-life context when the boundaries between phenomenon and context are not clearly evident and in which multiple sources are used,” (p. 18). The study will contain ~~40-ten~~ case studies in a multiple case holistic design, pooling the data collected for analysis across the cases. According to Yin (2008), the holistic design is beneficial when the case study’s underpinning theory is holistic, and SSME is an inclusive theory. Yin (2008), identifies five aspects of case study research design: ~~the-The~~ study question, the

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## How Hidden Costs Affect Operational Management of IT Outsourcing

propositions, unit of analysis, the link between the data and the proposition, and interpretation of results. The study's question is: ~~how~~ How do hidden costs affect operational management of IT outsourcing? Although the study question captures what is of interest, in answering this, the study proposition points to relevant evidence, understanding the management of the service provider's team and the local team, and understanding the dynamic of contract management and partner relationship management. The design of the questions protocol ~~at-in~~ Appendix B permits this approach and keeps it within scope of the investigation. According to Yin (2008), "The use of theory, in doing case studies, is an immense aid in defining the appropriate research design and data collection," (p. 40). This study will use the SSME theory to help define the link between the data and propositions and the NVivo8 software will help analyze the data. Eisenhardt (1989), suggests ~~the data~~, "strong theory-building research should result in new insights," (p. 548) and ~~the outcome of its outcome~~ will be ~~a~~ multicase assertions for the development of field ~~researched-research~~-based best practices.

In exploring the IT outsourcing strategy put into practice by companies, this research contains ~~the-a~~ specific question: ~~how~~ How do hidden costs affect operational management of IT outsourcing? This research is descriptive and according to Swanborn (2010), ~~and~~ a qualitative method is appropriate for studies of this nature (Cooper, & Schindler, 2008). This research study will use ~~individual-in~~-depth individual interviews to gather information on the cases, ~~Cooper, &~~ and Schindler (2008), note the multiple case study approach as compliant for descriptive investigations of management questions. Cooper, ~~& and~~ Schindler (2008), categorize this approach as an experience survey. One difficulty with the research topic is that knowledge of IT outsourcing is to an extent proprietary to an individual organization and thus not accessible to

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## How Hidden Costs Affect Operational Management of IT Outsourcing

a researcher outside ~~of~~ the organization. By seeking out information from informed personnel and drawing on their experiences, the research will contain insights into how hidden costs affect operational management of IT outsourcing, which would~~that would not~~ otherwise not be available. Sake (2006), reinforces this rationale noting that, “We seek better description of the whole, but the characterization will be seen differently in different situations,” (p. 27). The multiple case study helps to place events in different contexts as the qualitative approach draws on the experiencess of informed people.

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## **Population under Analysis**

According to Cooper,~~& and~~ Schindler (2008), the theoretical sampling limits of the multiple case study method is a minimum of four cases and a maximum of 15 cases. This research will contain a study of ~~40-ten~~ cases, ~~including those~~ companies that have IT outsourcing agreements. The companies are in North America (United States, and Canada), Europe (United Kingdom), and China (Hong Kong). Cooper,~~& and~~ Schindler (2008), suggest that explorative studies are, “less interested in a representative cross section then in getting sources that might be insightful,” (p. 149). The interview group will encompass ~~project~~Project ~~manager~~Managers, IT ~~directors~~Directors, ~~finanee~~Finance personnel, and IT specialists who have working experience of managing IT outsourcing contriacts.

## **Units of Analysis**



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According to Baxter ~~&~~and Jack (2008), the unit of analysis equates to the case. Baxter ~~&~~and Jack (2008), suggest that: “

-Asking yourself the following questions can help to determine what your case is; do I want to “analyze” the individual? Do I want to “analyze” a program? Do I want to “analyze” the difference between organizations? Answering these questions along with talking with a colleague can be effective strategies to delineate further your case.” (p. 545).

In this research, the case is the company’s IT outsourcing contractual arrangement ~~is the case~~. The interconnection of attributes, themes, and assertions is ~~a~~ facet of the data analysis process. Interlinks between assertions, themes, and attributes will be documented in a matrix (see Appendix D). The units of analysis for this study are the themes that become apparent through content analysis of the case interviews. This unit of measure will identify common themes ~~of~~ across cases, providing a degree of comparative understanding.

### **Data Collection**

According to Yin (2008) and Stake (2006), there are six sources of data for case studies: ~~documents~~Documents, interviews, observation, archival records, physical artifacts, and participant observation. ~~The collection of d~~Data for this study will be collected from key informants through either a face-to-face or a telephonic interview. ~~in an interview either in person or by telephone.~~ An introductory e-mail will be sent to the participants outlining the process and this will also contain a consent form. The participants will engage in a semi-structured interview that will focus on obtaining information on how hidden costs ~~effect~~affect

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## How Hidden Costs Affect Operational Management of IT Outsourcing

operational management of IT outsourcing. The questions will ~~take-move along~~ three tracks: ~~understanding-Understanding~~ the benefits, expectations and hidden costs, understanding the management of the service provider's team and the local team, and understanding the dynamics of contract management and partner~~ship~~ relationship~~-~~management. The interview should last no more than one hour.

Once the consent forms are returned, ~~return-of the consent form-scheduling of~~ the interviews will be scheduled at the participants' convenience, at a location convenient for them or over the phone. ~~and be take place at a location convenient for them or by phone.~~ This allows the interviewees an opportunity ~~for the interviewee~~ to prepare, making best use of the limited time available. The anticipation is that the interview group will encompass ~~project-Project~~ managersManagers, IT ~~directorsDirectors~~, ~~finance-Finance~~ personnel, and IT specialists. Using a ~~telephone~~ headset during the ~~telephone-telephonic~~ interview will make it easier to take notes~~allow for ease of note-taking~~. Reviewing the interview notes at the conclusion of the interview with the informant will reduce follow-up actions, which may be difficult because of limited availability. An additional benefit ~~is-of this method is that it will act as a quality assurance step and~~ as a quality assurance step, to ensure that the interviewer interpreted "what was said" correctly.

## **Data Analysis**

~~According to~~ Baxter ~~&-and~~ Jack (2008), state "As in any other qualitative study the data collection and analysis occur concurrently," (p. 554); however, there is no prescribed process for analyzing case study data. Eisenhardt (1989), indicates that the cross-case data analysis identifies

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## How Hidden Costs Affect Operational Management of IT Outsourcing

patterns, by using an assortment of analysis methods to go beyond superficial impressions.

Eisenhardt (1989) suggests three tactics “:

Select categories and look for within-group similarities coupled with inter-group differences, select pairs of cases and list the similarities and differences between each pair, and divide the data-by-data source to exploit unique insights possible from different types of data collection.” (p. 540).

Yin (2009) and Stake (2006) outline different approaches to multicase data analysis. Yin (2009) explains five techniques for data analysis: Linking-Linking data to propositions, pattern matching, time-series analysis, explanation-building, cross-case synthesis, and logic models. In contrast, Stake (2006) demonstrates an approach that begins with making assertions, which will require rating discoveries, a matrix for generating theme-based assertions from merged discoveries rated important, multicase assertions for final report, and a multicase final report.

“The analysis of case study evidence is one of the least developed aspects of doing case studies,” (Yin, 2008, p. 127). Taking this into consideration, an approach to case study data analysis has been developed for this research that synthesizes elements of Yin (2008) and Stake (2006) (see Figure 1).

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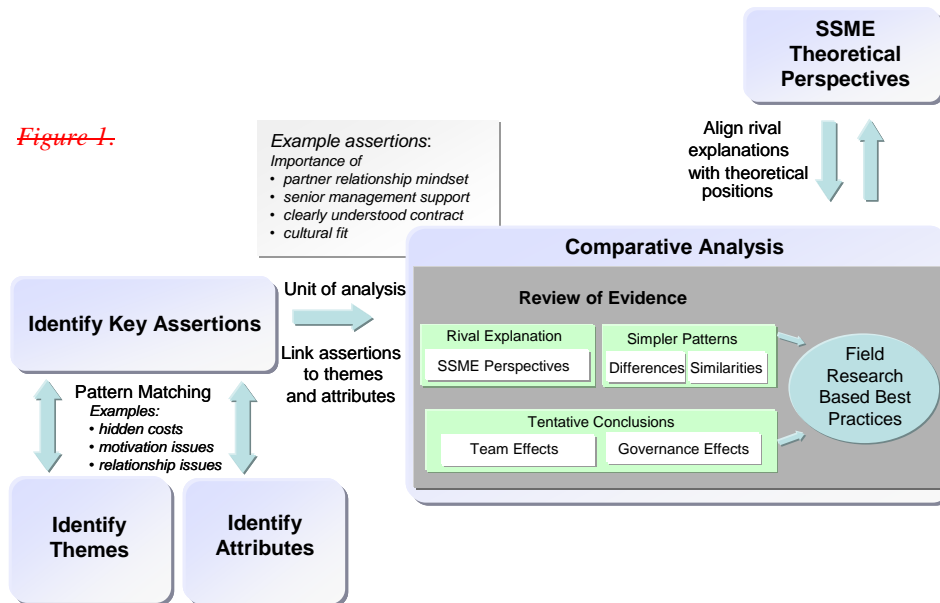
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## How Hidden Costs Affect Operational Management of IT Outsourcing

Figure 1.



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Figure 1. Data analysis model for the comparative analysis of multicase data.

The three rectangles on the left in Fig. 1 denote the analytical technique for initially categorizing the data and identifying the unit of analysis. Interlinks between assertions, themes, and attributes will be documented in a matrix (see Appendix D). Yin (2008) describes pattern-matching as the most desirable technique in case study analysis (p. 136), and an iterative process step, the outcome of which feeds the next step—comparative analysis. This represents the combination of cognitive processes postulated by Yin (2008), rival explanations and simpler patterns, and with

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Stake (2006) drawing tentative conclusions from assertions. The ~~top~~-rectangle on the top denotes the iterative ~~analyses~~-analysis step of reviewing the evidence against SSME perspectives for interpretation of the findings. A design concept that Yin (2008) argues is an essential step as it determines the strategy for analyzing the data (p. 36). The outcomes of the comparative analysis process are field-based best practices. Synthesized from approaches to multicase study analysis found in Yin, R., 2008, *Case Study Research: Design and Methods* (4th ed), p. 136-140, and Stake, R. E., 2006, *Multiple case study analysis*, p. 60-76.

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### Summary

The research will adopt a qualitative approach. ~~this~~-This method is appropriate ~~to~~-for showing how and why events happen as they do. This research is descriptive and according to Cooper, ~~&~~ and Schindler (2008), a qualitative method is appropriate for studies of this nature. The research design will be a multicase ~~case~~-study design, involving IT outsourcing knowledgeable participants from ~~10~~-ten cases. Yin (2008), describes the choice of using a case study as, “an empirical enquiry that investigates contemporary phenomenon within real-life context when the boundaries between phenomenon and context are not clearly evident and in which multiple sources are used,” (p. 18). According to Yin (2008), the holistic design is beneficial when the case study’s underpinning theory is holistic. This study will use the inclusive theory of SSME to corroborate analysis and discoveries.

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A diagrammatical representation of the data analysis method proposed for this study is ~~at~~ available in Appendix A and indicates the analytic strategy for each of the steps. The approach combines features from Yin (2008) and Stake’s (2006) together with the NVivo8 capabilities,

## How Hidden Costs Affect Operational Management of IT Outsourcing

conducting cross-case analysis by using content analysis techniques to understand similarities and differences in the cases. The advantage over single case analysis is that cross-case analysis provides a comparison of the multiple cases in numerous dimensions. Bruns (1998) suggests that the outcome of multiple case study research is often illustrative of best practices on the topic under investigation. Fortunately, IT outsourcing is particularly suited to field-study with standardized and repeatable processes that can be comparatively ~~are examinable~~ ~~comparatively~~ between different organizations. This presents an opportunity for the development of field research-based best practices.

Chapter 4-Four presents the results of the qualitative multicase research. The ~~chapter~~ Chapter discusses discoveries from ~~the~~ data analysis, specifically the attributes, themes, and assertions and their ~~corollary~~ corollaries of the ~~40-ten~~ cases in comparative analysis.

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## How Hidden Costs Affect Operational Management of IT Outsourcing

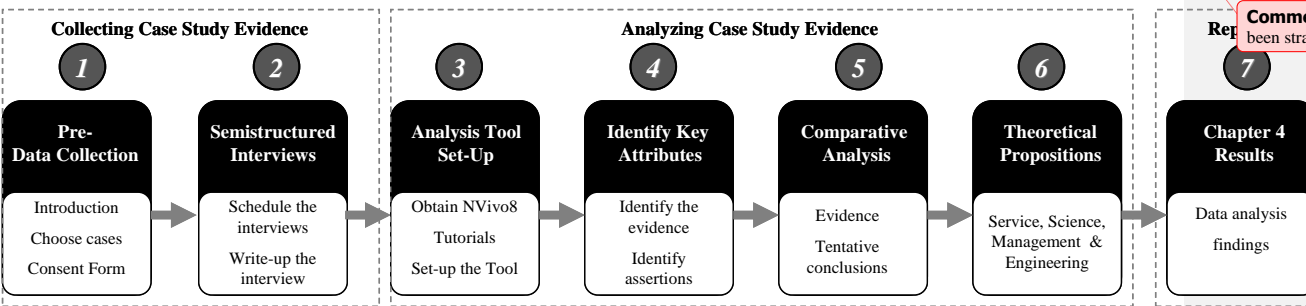
### Appendix A: Multicase Study Analysis Road Map

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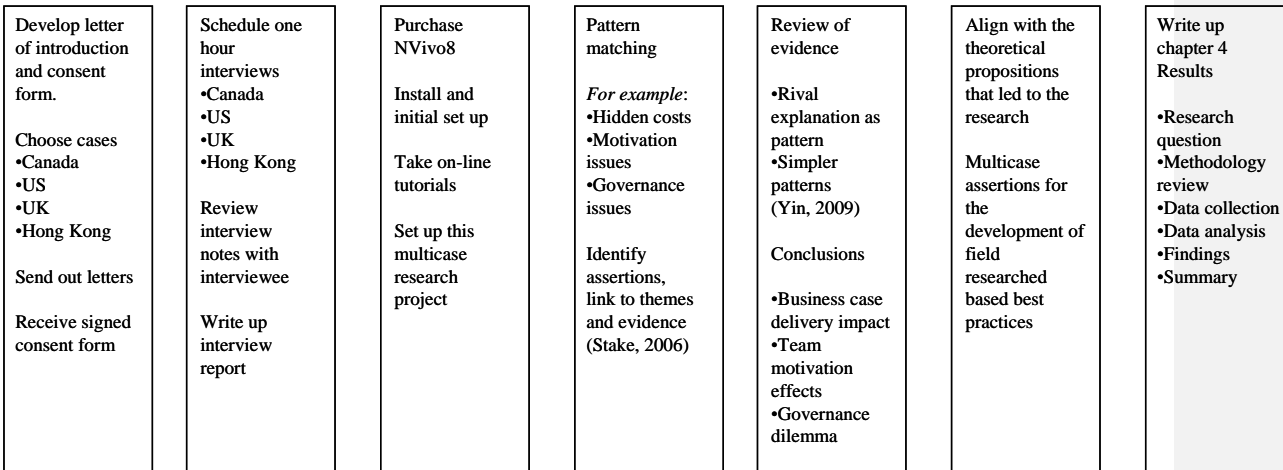
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### Analytic Strategy



## How Hidden Costs Affect Operational Management of IT Outsourcing

### **Appendix B: Signed Informed Consent: Introductory Communication and Informed Consent for Participants Over 18 Years of Age**

Date: \_\_\_\_\_

Dear Study Participant,

I am a doctoral student at the University of Phoenix working on a Doctorate of Management in Organizational Leadership and conducting a research study on the IT outsourcing operational management experience.

Your participation will involve participation in semi-structured interviews that focus on obtaining information on how hidden costs ~~effect-affect~~ operational management of IT outsourcing processes. The questions will take three tracks: ~~understanding~~ Understanding the benefits expectations and hidden costs, understanding the management of the ~~Service-service~~ provider's team and the local team, and understanding the dynamic of contract management and partner relationship-management.

The interview should last no more than ~~4-one~~ hour. The interview will be scheduled at your convenience, and be conducted either over the telephone or face-to-face at a location convenient ~~for to you or by phone~~. A toll-free number will be provided to you for this purpose.

#### **Communications with Researcher**

You can contact me at (001) 1 250 661 5692 or by e-mail [ianswift@email.phoenix.edu](mailto:ianswift@email.phoenix.edu) at any time before, during, and after the study. I will respond to any questions you have related to the study, the ~~informed-Informed eonsent-Consent~~ form, and your confidentiality.

#### **Confidentiality**

Your participation in this study is voluntary. If you choose not to participate or to withdraw from the study at any time, you can do so with no further obligation. The results of the research study may be published, but no personally identifying information will be collected and your results will be maintained in confidence.

All collected data, including electronic signature of the ~~informed-Informed eonsent-Consent~~ form will be stored on a secure hard drive in a secure and locked area. Three years after the completion of the research, I will delete the database of collected data, including all informed Informed eonsent-Consent acknowledgement.

#### **Potential Risks and Benefits**

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## How Hidden Costs Affect Operational Management of IT Outsourcing

In this research, there are no foreseeable risks to you. Please be assured that all participants and their respective organizations will remain anonymous.

Although there may be no direct benefit to you, there are possible benefits in providing aggregate data on the effects of hidden costs on the operational management of IT outsourcing that could potentially facilitate improvements in the IT governance processes thereby helping employees, managers, and organizational leaders.

**Instructions ~~for~~ on how to return the signed Informed Consent to the researcher.**

Signature of the interviewee \_\_\_\_\_ Date \_\_\_\_\_

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## How Hidden Costs Affect Operational Management of IT Outsourcing

### Appendix C: Interview Protocol

#### Understanding the ~~benefits~~ Benefits, ~~expectations~~ Expectations and ~~hidden~~ Hidden costs

##### Costs

1. What was your benefit expectation prior to outsourcing?
2. How important were each of the benefits to your outsourcing decision?
3. Were the actual benefits less, same -as, more -than expected?
  - Reducing operational costs
  - Improve quality of service
  - Access to skills and technology
  - Allowing increased flexibility and focus
  - Innovation
4. How important were consideration of these costs to your outsourcing decision?
5. What were your cost expectations prior to outsourcing?
6. Were the actual costs less, same -as, more -than expected?
  - Vendor selection
  - Transition
  - Layoffs
  - Cultural
  - Ramping up
  - Managing the contract;

#### Understanding the ~~management~~ Management of the ~~Service~~ Service provider's Provider's ~~team~~ Team and the ~~local~~ Local team Team

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## How Hidden Costs Affect Operational Management of IT Outsourcing

1. Executing the outsourcing contract carries a cost in of itself, ~~how~~ How would you describe this cost?
2. What different management approaches have you adopted over the course of the contract to manage the virtual global resources?
3. Have the roles and responsibilities changed ~~in~~ the local team as a result and if so, how?
4. Have the roles and responsibilities changed ~~in~~ the transnational or expatriate teams as a result and if so, how?
5. What team technology do you use to support your arrangement, same time, e-mail, conference calls, other?
6. How do you manage time zone challenges, ~~?~~ ~~does~~ Does the outsourcing provider participate in ~~say~~ conference calls for example, even though it may be the middle of the night for them?
7. How have you adapted to cross cultural business practice challenges? For example conducting business in India is based on relationships and beginning meetings with small talk is an important part of all business discussions, but this can give North American's the impression that they are unfocused.
8. Have you observed any motivation or performance issues with the local team as a result of outsourcing?

## Understanding the ~~dynamic~~ Dynamic of ~~contract~~ Contract ~~management~~ Management and ~~partner~~ Partner ~~relationship~~ Relationship ~~management~~ Management

1. Have you or your local team leads had any training, such as cultural intelligence training to help manage the new partnership?

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**Comment [M159]:** How about transnational or expat teams here as well?

**Comment [M160]:** How about transnational or expat teams here as well?

**Comment [M161]:** You might also want to include cross-cultural business practice challenges as well.

## How Hidden Costs Affect Operational Management of IT Outsourcing

2. Is there a cultural fit between your department and the ~~outsourcer~~ outsourcing service provider?
3. How do you reconcile contractual management and adherence to Service Level Agreements (SLAs) with acting with a “partner” mindset?
4. How does the governance model support the day-to-day operations of the contract?
5. How do you meet to discuss contract performance—formally, in a steering committee setting?
6. Do you have senior management commitment to making the contract work?
7. Will the arrangement be extended to other areas such as business process outsourcing or strategic outsourcing?

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**Comment [M162]:** I like the breadth and operational savvy of your questions.

How Hidden Costs Affect Operational Management of IT Outsourcing

Appendix D: Multicase Assertions for the Development of Field Research  
Best Practices

Assertion	Related to <del>Which</del> <u>which</u> Theme or Factor?	Evidence, Persuasions Reference in which Case

Adapted from Worksheet ~~six~~Six: Multicase assertions for the final report (Stake, 2006, p. 73).

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**Comment [Editor163]:** Please rephrase this as 'Theme or Factors related to'

**Comment [Editor164]:** Please rephrase this as 'Evidence, Persuasions and Reference in the Case'

How Hidden Costs Affect Operational Management of IT Outsourcing

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