Chapter XVI
The Governance Implications When it is Outsourced

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ABSTRACT

This chapter considers the governance issues raised by the increasing use of external parties to supply IT resources (including packaged enterprise software). The chapter briefly reviews existing formal governance frameworks and their treatment of IT outsourcing, then introduces an analytical model for considering outsourcing benefits and risks. The chapter then goes on to highlight some strategic IT governance issues that become critical once a firm outsources a significant proportion of its IT services. The aim of the chapter is to alert decision makers to the fact that outsourcing IT incorporates residual risks even when widely recommended operational controls are implemented. It concludes that effective control processes are necessary, but not sufficient for good corporate governance and suggests that those responsible for corporate governance ensure that both operational and strategic governance issues are considered when IT is substantially outsourced.

INTRODUCTION

Despite ongoing debate about outsourcing's risks and benefits, more and more firms are choosing to outsource significant proportions of their information technology (IT) and information systems. Several general frameworks and principles have been proposed for governing outsourced IT arrangements and, more recently, formal IT governance frameworks have begun addressing issues associated with outsourced IT services. Yet, while these guidelines help address some of the inherent complexity of an outsourcing undertaking, in some ways they can obscure the need to think through the long-term IT governance implications of an IT outsourcing strategy.

This chapter explores the governance issues raised by the increasing use of external parties

to supply IT resources (including packaged enterprise software) and argues that the reliance by firms on external vendors for IT services raises more fundamental governance issues than just operational control of vendors – effective control processes are necessary, but not sufficient for good governance. The chapter briefly reviews existing formal governance frameworks and their treatment of IT outsourcing, then introduces an analytical model for considering outsourcing benefits and risks. The chapter goes on to highlight some strategic IT governance issues that become critical once a firm outsources a substantial proportion of its IT services.

The basis of the chapter is a program of 10 years' study into IT outsourcing beginning with the author's PhD studies and extended by the work of Rouse and Corbitt (2001; 2003; 2007; see reference list). Studies by these authors have included a series of longitudinal IT outsourcing cases (in both the public and private sectors); a number of focus groups (with n=55 informants from vendors and purchasers of IT outsourcing), two case studies of business process outsourcing purchasers, and a survey of large IT outsourcing purchasers in both the pubic and private sectors (n=240).

BACKGROUND

The effective management, control, and alignment (with business needs) of IT resources have been a topic of interest to the information systems discipline for decades (e.g., see Earl, 1988). However, it is generally only since the 1990's (Loh & Venkatranam, 1992) that the term "IT Governance" has been used to describe this responsibility. Typically IT governance is seen as a subset of the corporate governance framework, which defines the institutional structures and processes for directing and controlling the firm in a way that encourages management to maximize the welfare of shareholders and other stakeholders (Tirole, 2001; Weill & Ross, 2004). Governance is understood to encompass authority, accountability, stewardship, leadership, direction, control, and, importantly, management of corporate risks (ASX, 2003; Tirole, 2001).

IT Governance focuses particularly on getting value from the firm's substantial investments in information resources and systems, including their performance, efficiency, and value for money. IT Governance also focuses on identifying, reducing, and managing the significant risks that IT and information systems pose to a firm. IT Governance occurs at different levels within an organization and so is part strategy (enabling value by integrating risk consideration into strategic IT decision making) and part tactical/operational, where it is concerned with effective IT management and minimizing identified risks (including risk of compliance failure).

At the operational level, largely the responsibility of the CIO, governance is characterized by use of specific policies and procedures to improve IT performance, effectiveness and control. Operational IT governance is often reflected in application portfolio, infrastructure portfolio, project portfolio and sourcing portfolio policies and procedures. At a strategic level, governance is the concern of Board members and their delegates (e.g. Board subcommittees). Strategic governance addresses the context of specific IT governance processes and procedures, and the creation of an organizational environment where governance processes can be operated. Strategic governance thus needs to address interdependencies between the various actors, and the allocation of decision rights within the organization (Weill & Ross, 2004). Strategic level governance is also characterized by a substantially longer time frame than operational (or tactical) governance. Strategic governance affects operational governance largely indirectly, by the creation of context and clear goals, and by the allocation of specific responsibilities. Once these are defined at a strategic level, operational processes that might seem problematic can be more easily managed.