EXTENDING THE GOVERNANCE-PERFORMANCE MODEL: THE IMPACT OF GOVERNANCE MECHANISM ON OUTSOURCING OPERATIONS IN CHINA

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Abstract

A conceptual model based on the resource-based view (RBV) of the client firm is proposed that integrates IT capability and IT outsourcing governance to explain their relationships with strategic alignment as well as IT outsourcing success. With a growing interest in doing business in China, researchers and practitioners have paid more attention to this vibrant market. Yet, little has been done to model the effectiveness of IT capability and IT outsourcing governance in China. By extending the governance-performance model, this study attempts to uncover the underlying mechanisms through which the IT outsourcing governance and client IT capability influence IT outsourcing success. Both expected academic and managerial contributions are provided.

Keywords: IT Outsourcing Success, Strategic Alignment, IT capability, Resource-Based View (RBV), Outsourcing governance
1 INTRODUCTION

Today, China is asserting its position in the global outsourcing market. According to TechNavio's analysts, the IT outsourcing market in China is forecasted to grow at a Compound Annual Growth Rate (CAGR) of 25.01 percent over the period 2013-2018, while the global IT outsourcing market to grow at a CAGR of 5.84% over the period 2014-2019 (TechNavio 2015). In 2013, the IT outsourcing industry had an estimated market size of around 288 billion U.S. dollars, and the global spending for IT outsourcing services was expected to reach 442 billion U.S. dollars in 2015 (Statista 2016). In that China’s IT outsourcing growth far outpaces other countries in the world, the vital role that China plays in impacting the global IT outsourcing market share should not be neglected. With a growing interest in doing business in China, researchers and practitioners have indeed paid more attention to this marketplace. Yet little has been done with respect to the effectiveness of the governance mechanisms in IT outsourcing.

IT outsourcing success has long been studied by IT scholars. Since IT outsourcing (ITO) became widespread in the 1980s, the use of IT outsourcing has grown dramatically. ITO has been considered an important tool for enabling organizations to reduce the IT cost, improve the service quality and access scarce resources (Seddon et al. 2007). Despite the widespread use of IT outsourcing by organizations, however, the IT outsourcing performance has been reported unsuccessful or often lower than expected in previous research (e.g., Lacity et al. 2010; Lacity et al. 2011; Lacity & Willcocks 2012; Levina & Ross 2003; Susarla et al. 2010). Thus, additional academic research on ITO success appears to be particularly important in terms of helping managers develop sound strategies for achieving better and more consistent outcomes.

While a growing body of IT outsourcing literature has focused on managing the client-vendor relationship (e.g., Coles et al. 2005), empirical research to explore the role that IT capabilities plays in IT outsourcing is still lacking. Unfortunately, research on the relationship between client IT capabilities and ITO success has received relatively less attention and so requires more in-depth research, given the importance of client IT-related capability in outsourcing decisions (Feeny & Willcocks 1998; Han et al. 2013; Kern & Willcocks 2001; Liu et al. 2013). Chae et al. (2014) indicate that mixed findings about the effects of IT capabilities on performance have been repeatedly reported in previous empirical studies and thus, we determined that it would be useful to investigate the underlying mechanisms through which client IT capabilities lead to final outcomes. In addition, existing IT outsourcing studies have mostly applied social or contextual perspectives to examine the outsourcing relationships and success (Feeny & Willcocks 1998; Kern & Willcocks 2001) yet ignored the impact of IT capability. While the abilities of a client firm to acquire and leverage IT-related resources are meant to be influential in the firm’s strategic decision making and managerial skills to work with its vendor (Han et al. 2013), we expect a better client IT capability can ensure a better alignment between the client and its vendor. Given the importance of ITO success and the growing influence of China’s market, this research aims to uncover the role that client IT capability plays in affecting the relationships between IT outsourcing governance, strategic alignment, and ITO success.

2 THEORETICAL BACKGROUND & HYPOTHESES DEVELOPMENT

We adopt the Resource Based View (RBV) as the theoretical basis to explain the relationship between IT capabilities, IT outsourcing governance, strategic alignment and IT outsourcing success. According to RBV, firm resources are the main predictors of performance (Barney 1991). The greater the value generated by the resources, the better the outcome quality perceived by the clients (Saunders et al. 1997). In IT outsourcing literature, client IT capabilities, which are combinations of valuable, rare, inimitable, and organizationally supported resources (VRIOS) (Barney & Clifford 2010), are critical for outsourcing success (Lee et al. 1995; Han et al. 2013). However, client IT capabilities alone are not sufficient to warrant a sustained outsourcing success because IT outsourcing involves both the client and the vendor...
sides. As suggested by RBV, the combination of a unique collection of resources will create synergies leading to sources of sustained competitive advantage (Barney 1991). In other words, the impact of IT capabilities is realized mainly in combination with other organizational factors such as business strategies, strategic alignment, and so on (Barua & Mukhopadhyay 2000; Brynjolfsson & Hitt 2000; Milgrom & Roberts 1995). Thus, we integrate IT outsourcing governance as another organizational resource and strategic alignment as a mediator to the research model. We provide theoretical arguments for the hypothesized relationships in the following section.

2.1 Strategic Alignment and IT Outsourcing Success

In this research, we define IT outsourcing success to be a successful melding of client business needs and outsourcing outcomes (Lee & Kim 1999), the latter of which can be assessed by three benefits: strategic, economic and technological benefits (Grover et al. 1996). We define strategic alignment to be “the degree to which the vendor’s IT capabilities support the client’s business strategic motivations”. This definition is aligned with the conceptualization of Chan et al. (1997), in which they refer strategic alignment to the fit between business strategic orientation and the support that information systems provide to fulfill the need for such orientation. The client’s business motivations to outsource IT functions were adapted from Seddon et al. (2007). This approach works well in terms of assessing how well business strategic alignment is enhanced by client IT capability (measured by technology and managerial capability), and in turn, contributes to different aspects of IT outsourcing success.

The causal link between strategic alignment and performance has been well established in previous literature (Tallon & Pinsonneault 2011; Wu et al. 2015). Past studies have shown the importance of strategic alignment in improving business performance. For example, Chan et al (1997) found that alignment was a better predictor of performance than other antecedents of strategy and thereby leads to a positive relationship between strategic alignment and business performance. Applying to the IT outsourcing context specified in this research, performance outcome refers to the outsourced IT project’s strategic, economic and technological benefits achieved by the vendor company. As argued by Keating et al. (2013), ITO success requires the external alignment between the IT services provided by the supplier and the needs of the customers. When the client’s outsourcing motivations (i.e., their strategic needs) are well supported by the vendor’s IT capabilities, the success of the outsourcing project can thus be assured. Therefore, we propose:

H1: Strategic alignment is positively related to IT outsourcing success.

2.2 IT Capabilities, Strategic Alignment, and IT Outsourcing Success

Client IT capabilities are the abilities of a client firm to acquire, distribute, and leverage IT-related resources or assets (Han et al. 2013). They consist of IT resources or assets and management skills, such as human IT resources and IT-enabled intangibles (Bharadwaj 2000). From a resource complementarity perspective, IT capabilities are the routines or practices/skills that complement IT in delivering its value to firms (Melville et al. 2004; Ravichandran & Lertwongsatien 2005) by leading organizational integration and process reengineering activities effectively (Lee et al. 1995). The conceptualization of IT capabilities in the outsourcing literature is reflected in the technology management capability (Lee et al 1995; Han et al. 2008; Han et al. 2013), which captures the human IT resources of RBV (Feeny & Wilcock 1998) to enhance outsourcing performance. As these capabilities to manage IT are intangible and organization-specific (i.e., they only pertain to the client firm), they are not easily imitable and are valuable resources to ensure sustained competitive advantage (Santhanam & Hartono 2003) and hence IT outsourcing success. As a result, we propose that:

H2: IT capabilities are positively related to IT outsourcing success.

The IT capabilities that client firms possess can help them identify their own IT requirements and focus on their strategic competencies (Koh et al. 2004), hence they can work more effectively and coordinate IT activities with the supports of the vendor firms. Furthermore, managerial capabilities in client firms
to identify the IT trends can encourage vendors to share relevant information and work together toward the same goals (Basselli et al. 2004; Feeny & Willcocks 1998). In other words, client capabilities to manage IT can help the vendors’ IT services to be well aligned with their customers’ business needs, and in turn generate outsourcing benefits. In addition, client IT capabilities can be effective in monitoring a vendor’s work (Han et al. 2008), which in turn ensures that their business objectives can be well supported by the vendor. Thus, we propose the following hypothesis:

\[ H3: \text{IT capabilities are positively related to the strategic alignment of client and vendor.} \]

2.3 IT Outsourcing Governance, Strategic Alignment, and IT Outsourcing Success

The failure to achieve desirable outsourcing effectiveness can be attributed to the selection of inappropriate governance mechanisms (Dibbern et al. 2008) and the lack of governance capabilities in the client organization (Balaji & Brown 2010). In the strategic alliance literature, control has been identified as an essential approach to ensure the achievement of performance (Geringer & Hebert 1989). Formal control can be realized through governance structures and contractual specifications to regulate and monitor performance while informal control such as relational mechanisms can also help to encourage desirable behaviors and outcome (Das & Teng 2001; Eisenhardt 1985). As the IT outsourcing relationship between the client and the vendor shares many of the same characteristics with strategic alliances (Willcocks & Choi 1995), we argue that when outsourcing governance (i.e., the structural, contractual and relational mechanisms) is in place to prevent opportunistic behaviours and reward desirable ones, final outsourcing success is more likely to be attained. Therefore, we propose:

\[ H4: \text{IT outsourcing governance is positively related to IT outsourcing success.} \]

While governance (as a control approach) helps to monitor and ensure outsourcing performance, it can also reduce goal incongruence among different organizational members (Das & Teng 2001). More specifically, when the client firm implements well-established governance structures and well defined guidelines/specifications in the outsourcing contract and has frequent social interactions with their vendor, outcome standards become clearer to follow for the vendor and, at the same time, help the vendor to better appreciate client requirements. This, in turn, means that they can provide services that are more closely aligned to client business needs. Willcocks et al. (2006) also suggest that active governance mechanisms are essential for improving the ability to manage IT strategically. Therefore, we hypothesize that:

\[ H5: \text{IT outsourcing governance is positively related to the strategic alignment of client and vendor.} \]

3 RESEARCH METHODOLOGY

3.1 Approach and Instrument Development

In order to empirically validate our research model, we developed and evaluated a set of research questionnaires and conducted a field study. Our research instrument measuring the four key constructs adapted pre-existing, validated questions wherever possible. Past literature was reviewed to specify a set of items that ensured content validity and to achieve minimal overlap between constructs (Kerlinger 1986; Straub et al. 2004). Items associated with these constructs were assessed using a five-point Likert type scale.

Semi-structured interviews with firm-matched CIOs and project managers of ITO were conducted to evaluate the appropriateness of language and contents of the measurement items. In addition, three expert panels with an average of 25 years practitioner experience helped us to modify the contents before being finalized by three experienced IS scholars.

All items were further refined using a small-scale pre-test of the questionnaire conducted with paired survey answered by CIOs/CTOs and ITO project managers from 34 companies. The purpose of this exercise was to assess logical consistency, ease of understanding, sequencing of items, and contextual
relevance. By so doing, we believe that measurement error was reduced and the construct validity of the study improved. The final operationalization of each construct is summarized as in Table 1 below.

<table>
<thead>
<tr>
<th>Construct</th>
<th>Definition</th>
<th>Source</th>
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<tbody>
<tr>
<td>IT Capability</td>
<td>Consisting of technical IT (technical knowledge and skills for IT development and applications) and managerial IT capability (knowledge as to how IT can be deployed effectively for business strategic needs).</td>
<td>Han et al. (2008); Han et al. (2013)</td>
</tr>
<tr>
<td>IT Outsourcing Governance</td>
<td>The degree to which the client organization governs the IT outsourcing arrangements through structural, contractual, and relational mechanisms.</td>
<td>Balaji &amp; Brown (2007)</td>
</tr>
<tr>
<td>Strategic Alignment</td>
<td>The degree to which vendor’s IT support aligns with client company’s strategic needs.</td>
<td>Byron et al. (2013); Seddon et al. (2007)</td>
</tr>
<tr>
<td>IT Outsourcing Success</td>
<td>The effectiveness achieved by the outsourced IT project, measured by economic benefits, strategic benefits and technological benefits.</td>
<td>Lee et al. (2004); Seddon et al. (2007)</td>
</tr>
</tbody>
</table>

Table 1. Definitions of constructs.

3.2 Data Collection

The research instrument targeted high level/senior IT managers, IT project managers, CIOs and CTOs who have participated in IT outsourcing projects. We collected essential data via online questionnaires distributed to members of the panel base provided by a professional marketing firm over a four month period. The sampling frame was 1347 (i.e., those with qualified job positions and IT outsourcing experiences) and from this, a total of 301 were complete responses without any missing values, resulting in a response rate of 22.4%. Due to the accessible features of the online survey, we had to exclude those duplicated responses that could possibly be answered by the same respondents by detecting the duplicate IP addresses. In addition, responses with gibberish text entries, straight line answers, and speedy checkers were excluded for poor quality. After examining and double-checking for the data quality, a total of 240 usable data will be included in the final data analysis. We will use SmartPLS 3.0 (Ringle et al., 2015) for our data analysis.

4 EXPECTED CONTRIBUTIONS

The primary objective of this study is to shed light on the question of whether client firm’s IT capability actually matters when it comes to outsourcing operations in China. By extending and adapting Wu et al.’s (2015) governance-alignment-performance model, we attempt to explore the underlying mechanisms through which IT outsourcing governance and client IT capability influence IT outsourcing success. We believe that this study can contribute to our understanding of the resource perspective on IT outsourcing success and provide useful managerial guidelines to achieve better alignment between IT outsourcing strategic partners.

References


