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# Achieving Customer-Provider Strategic Alignment in IT Outsourcing

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**Abstract:** In IT Outsourcing, strategic alignment between a customer and an IT outsourcing provider is very important. This article uses resource-based theory, social capital theory, and organizational learning theory to analyze the relationship between a customer and a provider in IT services Outsourcing context. Based on the former analysis, this article applies a strategic alignment model for managing the customer-provider relationship in IT service outsourcing contexts and focuses on three dimensions: communications, value measurements and governance. Next, we use case studies of China Development Bank to illustrate how it is managing the customer-provider relationship with its IT service provider to achieve strategic alignment.

Keywords: IT Outsourcing, Relationship, Strategic Alignment, innovation

## 1. THE NEED FOR ACHIEVING CUSTOMER-PROVIDER STRATEGIC IN IT OUTSOURCING

In recent years, outsourcing has developed rapidly and has a certain basis. According to the latest fourth quarter Global Sourcing Market Data and Insights disclosed in TPI Index, the total contract value (TCV) of IT outsourcing deals in 2011 at \$95 billion was 3 per cent higher than 2010 [1]. At present, many enterprises making decision to take the IT Outsourcing expect that IT can promote innovation. The scope of the IT Outsourcing develops from back office to front office, from operation to strategy. The focus of outsourcing changed from cost arbitrage to the cooperation which can creates values, that is, through the staff, technical and cooperation network made by processes, it can provide a competitive advantage. The IT Outsourcing has gradually gained in prominence and has already become an integral part of customers' IT strategy.

Although customers benefit from outsourcing obviously, they still worry what factors can lead to successful outsourcing. The current annual growth rate of the offshore IT Outsourcing is 20%, but the study showed that 65% of the outsourcing is failure and disappointing [2]. The relationship between a customer and a provider plays a very important role in the success and failure of outsourcing [3]. Establishing and maintaining an flexible partnership in IT Outsourcing is one way to produce value in outsourcing [4]. Mehta and Mehta identify the client characteristics that influence their potential to forge a long-term C-V partnership, and identify specific areas in which clients' relational investments will strengthen C-V partnerships [5]. Applying resource-based theory and organizational learning theory, Balaji analyzes the impact of relationship, governance, outsourcing arrangement and learning factors on application development outsourcing performance [6].

According to a survey to chief information officials in the United States, Europe and Asia in 2013, IT and business alignment is top the list of management concerns which the chief information officials care [7]. At present, the research of the IT outsourcing primarily focus on the management of the relationship between the customer and the provider, and lack the research on whether both sides match with each other [8]. Outsourcing relationship model focuses on the impact of the customer and the provider capabilities for outsourcing, but lacks the research on the impact of the joint ability of the customer and the provider required for successful outsourcing. In addition, the extent of value co-production is the basis for competitive advantage from

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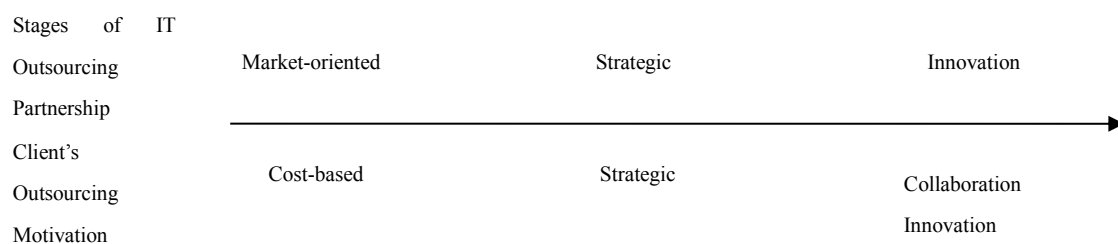
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customer-provider arrangements, but have received little attention.

In order to analyze strategic alignment between the customer and provider in the IT Outsourcing, this article describes strategic alignment for managing the customer-provider relationship in IT Outsourcing based on the three stages of IT Outsourcing partner relationship.

## 2. THREE STAGES OF THE IT OUTSOURCING PARTNER RELATIONSHIP

The critical determinants of successful customer-provider partnerships are client's outsourcing objective and its fit with vendor's capabilities [5]. According to the objective of customer outsourcing, we classify partner relationship between a customer and a provider in IT Outsourcing into three stages, as market-oriented, strategic and innovative (Figure 1).



**Figure 1. Three stages of IT Outsourcing partnership**

### 2.1 Market-oriented partner relationship

In the market-oriented partnership, customers pay attention to the complement of service and business in order to reduce the cost to select providers, but lack long-term plan for outsourcing. This stage of relationship maintains short time, and the conversion cost is low, so the customer can transform freely among many outsourcing providers of high ability. The customer cooperates with providers based on outsourcing contract. The main motivation of the outsourcing customer is to reduce costs, so this stage of the outsourcing produces minimum value, and the degree of the close relationship between customer and suppliers is the lowest.

According to resource-based theory, an enterprise can obtain a sustainable competitive advantage if its resources are valuable, scarce, difficult to imitate and irreplaceable. Whether an organization can maintain its competitive advantage or not directly depends on its own information technology resources and abilities. Through IT Outsourcing, the customer can take advantage of the professional knowledge and rich management experiences of the provider to reduce the cost of enterprise, get high quality service, and enhance enterprise's competitive advantage. For example, Haier not only save operation cost, reduce management risk, but also obtain the high quality IT service of Neusoft by outsourcing IT to Neusoft.

### 2.2 Strategic partner relationship

In the strategic partnership, customers focus on their own core IT skills, and outsource non-core businesses to providers. The goal of customer outsourcing is strategic, and customer forms its core competitiveness through outsourcing. The purpose of outsourcing is not to reduce costs, but to create value through establishing strategic partner relationship. In this stage of outsourcing relationships, the customer create value through establishing long-term cooperation with several providers. In general, the benefits and risks of the long-term outsourcing relationships between the customer and a few providers are high.

In the study of the relationships among the organizations, social capital has become an important theoretical research view. Social capital can be defined as actual or potential resources that exist in individuals or the networks of social organizations. Nahapiet and Ghoshal divided the social capital of enterprises into three dimensions: the structural, relational and the cognitive dimensions of social capital [9]. The strategic partner

relationship has developed the mutual beneficial relationship between the customer and the provider, as a source of social capital to promote the transfer of knowledge between the customer and the provider to form knowledge combination and then create value. Since the cooperation between China Data Group and the Credit card center of Everbright bank in 2005, they have gradually formed a strategic partner relationship in the continuous cooperation and growing <sup>[10]</sup>.

### 2.3 Innovative partner relationship

To improve the strategic benefit of the outsourcing, the customer will invest to their relationships with the provider. The customer and the provider can share knowledge and other resources and solve problems together. In this stage of outsourcing relationships, the degree of the close relationship between the customer and the provider is the highest. This stage of relationship help to improve the customer and the provider's ability, help customers to achieve their long-term strategic IT targets. In the process of outsourcing, customers can learn and accumulate knowledge form providers, and innovate in their own businesses.

Organizational learning theory is a mechanism that the enterprise access and create knowledge and abilities to update its knowledge accumulation. The organizational learning can occur among organizations or in the organization, and plays an important role in continually expanding enterprise knowledge storage, learning and creating knowledge. In this stage of partner relationship, not only the IT outsourcing finishes IT related tasks crossing organization boundary but enterprises improve the potential ability of knowledge creation and organizational learning <sup>[11]</sup>. Through the acquisition and reconstruction of knowledge, enterprises can obtain success of the business operation and realize IT-enabled innovation. Outsourcing has now entered a new field. Outsourcing for low cost has no longer been the mainstream. Outsourcing focuses more on innovation and value-added, and on whether the provider has the creative ability and responsibility to improve the customer's operational ability <sup>[12]</sup>.

## 3. STRATEGIC ALIGNMENT MODEL IN IT SERVICE OUTSOURCING CONTEXTS

### 3.1 Strategic alignment model for managing the customer-provider relationship

Outsourcing has become an integral part of developing strategy for the customer. Outsourcing is no longer to reduce costs of management and business. Customers hope to introduce strategic partners through outsourcing which can help them to realize the transition and make their business more flexible. Most customers would require outsourcing providers to provide improvement and value-added business. In IT Outsourcing, innovation has become a key demand of customers to develop relationship with providers. IT outsourcing has rearranged the IT resources combination between customers and providers. Customers and providers not only improve their cooperation to complete IT services, but also maintain relationship between customers and service providers in outsourcing actively. In IT outsourcing, good rational strategies between customers and providers, such as effective communication, cooperation, value measurement and so on are very important to any of the outsourcing contracts that expect to form long-term relationships between customers and providers.

Based on Luftman's customer-provider strategic alignment maturity model, combining with the former analysis of the IT outsourcing partner relationship, we set up the strategic alignment model for managing the customer-provider relationship in IT outsourcing (Figure 2).

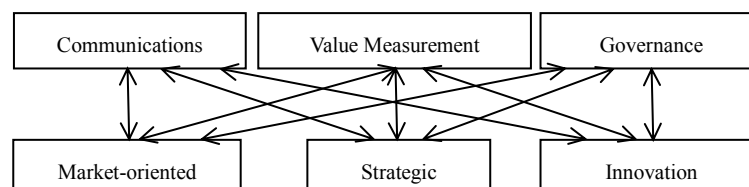


Figure 2. Three dimensions of Customer-Provider Strategic Alignment Model

The nature or extent of the IT offerings outsourced understanding the alignment criteria is critical for both the customer and the provider to realize their benefits from the engagement. The alignment of IT outsourcing partner relationship focuses on three dimensions: communications, governance and value measurement. In IT outsourcing, combining with stages of partnership, we analyze strategic alignment between the customer and the provider from the three dimensions.

### **3.2 The three dimensions of alignment**

#### **3.2.1 Communications**

Communications is a key fact of the success of IT outsourcing. Recent research about the IT outsourcing shows that the extent and quality of communication and knowledge transfer between the customer and the provider relate with the success of the outsourcing and that sharing information and knowledge among partners has a significant influence on outsourcing performance. The customer and the provider need to effectively share information, ideas and knowledge to ensure that goals for both sides can reach a consensus. Especially IT offshore outsourcing, due to the different countries and regions where the customers and provider are, it brings a lot of social border problems, such as the cultural gap, language barrier and domain knowledge gap, which obstruct the communication of both sides, face more risks and challenges than onshore outsourcing.

In IT outsourcing, the knowledge related with the customer need to be shared with providers. Providers also need to share status about reaching customer targets with the customer. In the process of the cooperation and communication, not only can make the provider do better in understanding the needs of the customer, but also can promote the diffusion of technology, knowledge and experiences between the customer and the provider. In the long run, this will greatly improve the quality of the cooperation of both sides. The customer can improve knowledge capital benefits and produce higher outsourcing performance through learning knowledge in outsourcing. In the three stages of the IT outsourcing partner relationship, the customer and the provider need to communicate with each other regularly.

#### **3.2.2 Value measurement**

Value measurement assesses the demonstrable technical and business benefits, which is a kind of method to understand and track the contributions and returns of outsourcing, which is accepted by both the customer and the provider. IT service value includes quality, productivity improvement and continuous innovation. Value measurement includes guidelines, service level agreements, monitoring of the specified results and comparisons of actual and expected results. Value measurement is a part of the outsourcing engagement between the customer and the provider. Outsourcing engagement also lay the foundation of the measurement of outsourcing quality and service level agreements. The structural and cognitive dimensions of social capital have an important impact on knowledge acquisition. The customer can produce value in outsourcing through knowledge learning. The customer and the provider can maintain a long-term close cooperation relationship to produce co-values. And both sides can reach a consensus on the goal, value and the standard. The customer can benefit from the value and knowledge transferred from the provider.

To achieve the expected outsourcing performance, the customer and provider need to pay attention to value measurement of outsourcing strategic alignment. As for market-oriented partner relationship, the operational of customer outsourcing is to reduce cost and get high quality service from provider, and value measurement emphasizes IT service cost and service quality. As for strategic partner relationship, the objective of customer outsourcing is to improve the competitive advantage, and value measurement emphasizes the core ability from the knowledge transfer between customers and providers. As for creative partner relationship, the operational of customer outsourcing is to share the risks with providers and enterprise innovation, and value measurement

emphasizes the customers' business innovation.

### **3.2.3 Governance**

Governance is the mechanism used by customers to coordinate, control and supervise outsourcing. Governance includes the structural aspects of outsourcing, such as building planning strategy, clear lines of authority, meeting schedules, etc. Governance helps to reduce transaction costs and improve the value of the partner relationships between the customer and the provider. In outsourcing, governance generally includes two aspects: formal governance and informal governance. Formal governance is defined as the establishment and management of outsourcing contracts. Informal governance helps to manage the relationships of the customer with providers.

Management and monitoring structures are very important to the success of outsourcing. Contract engagement is necessary, and the relationship between a customer and a provider also play an important role. The customer and the provider need to ensure that their supervision and review mechanism are in place at the level of the appropriate strategy, tactic and operation to gain the maximum benefit from the outsourcing engagement. These mechanisms should include all services of providers and also those that are subcontracted. In the three stages of IT outsourcing, the customer need to manage outsourcing according to outsourcing contracts and coordinate the with relationships with providers.

## **4. CASE STUDIES OF ACHIEVING CUSTOMER-PROVIDER STRATEGIC ALIGNMENT**

### **4.1 China Development Bank**

In China, China Development Bank attempted early to take outsourcing. In 2003, China Development Bank cooperated with Hewlett-Packard and Digital China for outsourcing. In July 2006, China Development Bank signed a three-year strategic IT outsourcing service contract with Provider B. In 2009, China Development Bank signed an agreement of outsourcing framework cooperation again with long-term partners such as China Telecom, China Hewlett-Packard and Zhongke Soft Company.

China Development Bank pays great attention to strengthen the relationship with the main outsourcing service providers and establishes a multi-level and multi-channel communication mechanism to achieve regular businesses and technology communication with the main outsourcing providers in different levels and to improve work efficiency.

China Development Bank firstly introduced outsourcing service to domestic financial industry comprehensively. Outsourcing changed from the comprehensive outsourcing to management outsourcing. Through implementation of the ITIL, providers can complete the key process design of ITIL, and China Development Bank strengthen the supervision of IT outsourcing services in order to improve the outsourcing service level and control the risks of outsourcing <sup>[13]</sup>.

In the IT outsourcing, China Development Bank attempts to import VMO mechanism and improves comprehensively the ability and level of outsourcing management according to principles such as specialization, platformization, unification and standardization <sup>[14]</sup>. That makes Hewlett-Packard China pay more attention to promotion of the value of China Development Bank, and make dispersed and simple contract relationship to a long-term strategic partner relationship.

### **4.2 Discussion**

After the cooperation of IT service outsourcing, China Development Bank and Hewlett-Packard China emphasized on communications, value measurement and governance to achieve their strategic alignment. IT outsourcing makes China Development Bank focus on its own core competitiveness. And at the same time, with

the help of the advanced professional technology, management methods and management tools of Hewlett-Packard China, China Development Bank can improve the the level of management. In the cooperation with China Hewlett-Packard, China Development Bank has learned many advanced ideas. China Development Bank has established a mutual trustful and beneficial strategic partner relationship with Hewlett-Packard China in the process of information construction.

## 5. CONCLUSIONS

Outsourcing has become an important strategy to improve the core competitiveness of enterprises. At present, IT outsourcing has entered into new fields, the customer focused more on added-value of innovation. Based on the analysis of the IT outsourcing partner relationship, this article establishes the strategic alignment model for managing the customer-provider relationship in IT outsourcing and analyses the three dimensions: communication, value measurement and governance. Customers and providers should establish their relationships based on the identity of common values. During the cooperation, both can promote the communication and reduce transaction costs and enhance the diffusion of skills, experiences and knowledge among them. The strategic alignment between customers and providers leads to the cooperation and innovation of both sides and creates more value.

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