A Review on Risk Factors in IT Offshoring Partnerships: Client's Perspective

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Abstract: *In today's era, IT offshoring is a common practice in the global businesses. Firms make a decision to move such type of services to offshore IT service providers for low cost and many other competitive advantages. Simultaneously, identification and handling of risks appears to be critical for IT outsourcing success. The main purpose of this paper is to study the major risk factors related to IT offshoring partnerships from the client perspective. The present study attempted to identify the challenges that could probably a barrier in the development of strategic offshoring partnership with offshore IT service providers. Few of these risk factors work as threats for IT offshoring success and their probable effects on firms core business need to be considered by IT offshoring client firms.*

Key Words: *IT outsourcing, offshoring, risk factors, client, partnership.*

1. INTRODUCTION:

For many years, companies have been advised to spend heavily in information technology to develop and maintain its competitive advantage. There are number of definitions for IT outsourcing but the one that is ideal from the "Handbook of Outsourcing and Off-shoring written by Ilan Oshri, as stated: "IT outsourcing is contracting IT vendor for the management and completion of a certain amount of IT work, for a particular period of time, price and level of service".

Outsourcing is comprised of two words – "out" and "sourcing" sourcing alludes to "the act of transferring task, work and decision rights to somebody else" (Power, Desouza, & Bonifazi, 2006). Organizations must source out work in light of the fact that there are other people who can do it less expensive, speedier and better. Outsourcing in itself is an umbrella-kind of word which covers varied sorts of engagements, to be specific outsourcing, offshore outsourcing, captive offshoring, nearshoring and onshoring (Oshri I. , 2009).

IT offshoring is a type of business process outsourcing in which IT function is exported from U.S and other developed nations, to regions of the world where there are lower labor costs. There is large number of factors that firms must think about when deciding whether to use this strategy, and when choosing where to move this work. Those considerations consist of the political stability of the offshore nation, labor costs and size of the labor pool compare to other competitive offshore nations and the business environment and tax advantages of a particular nation.

Many large firms have outsourced some or all of their IT work. Benefits gained by firms who are outsourcing their IT functions to offshore countries, are like lower costs, improved productivity, higher quality, higher customer satisfaction, time to market and ability to focus on core areas. However, there are many challenges and risks related to IT offshoring.

Whenever an outsourcing decision is to be taken, an inherent risk is associated with it. Further, in any outsourcing arrangement, there are some hidden costs, unexpected outcomes and diminishing service levels.

The major aspect of the proposed research is summarized by the following question:

- What are the major factors that contribute to risk to IT offshoring clients in global offshore IT outsourcing?

2. RISK FACTORS FROM CLIENT'S PERSPECTIVE:

Many researchers have analysed the risk factors that are common in IT outsourcing for client firms (Earl, 1996). Their work on risk factors is summarized in this paper. The effects of risk factors are like geographical location, political, cultural, quality standards, legal contracts and intellectual property, etc. The important risk factors for the study are discussed below:

Provider staff qualification. IT outsourcing facilitates the access to the technical knowledge and expertise of IT specialists, it very often happens that the outsourcing company is supported by the same staff as previous because that staff has been moved from the client company to the IT service vendor. (Lacity & Hirschheim, 1993) warn that many of the firms which decide to outsource, feel that they have lost their business knowledge and experience, because after signing a contract, vendors move their most highly qualified workers to achieve new clients in other companies within the sector.

Lack of agreement with the contract by the provider. When a vendor performs a task for a client, the client always faces the risk that the vendor might not carry out the task as expected or that the vendor might pay less attention and monitor the process less closely than the client would have done (Clark et al., 1995). Additionally, in the case of IT outsourcing, client needs may not be properly met, or priorities may be wrongly established, because the IT vendor does not quite understand what the business is all about (Martinsons, 1993).

This is why Lacity and Hirschheim (1993) claim that external providers are not strategic partners, since the interest in benefits is not a shared one – when clients' costs grow, so do providers' benefits.

Loss of Control. *T*o pass responsibility and blame to vendors is loss of control over outsourced operations. The most common view of outsourcing appears to be that the concerns generated by giving up control override any sense of relief at not having the day to- day operational responsibilities. However, this may be somewhat offset by greater formality, as embodied in explicit service level agreements (SLAs), which almost always exist in arms-length relationships between customers and providers, and are seldom seen between internal departments or divisions.

Loss of technical knowledge. When a service is outsourced, clients slowly lose their understanding of the service over time. Even if the vendor delivers innovative services to the client firm, a large proportion of the new knowledge required remains in the hands of the vendor and cannot be transferred to the client. What is more serious, the firm may lose its capacity to stay up to date with the technological breakthroughs (Clark et al., 1995). Furthermore, the innovation capability of the client firm itself can be decreased, since every innovation requires a sufficient availability of technical and economic resources, something that is not precisely favoured by outsourcing (Earl, 1996).

Another risk is the IT vendor's incapability to adapt to the new technologies. It was mentioned above that one of the major advantage came from outsourcing is the possibility to access state-of-the-art technology, but this is not always the situation. If IT vendors do not identify clear benefits in the incorporation of new technologies, they may be reluctant to adopt them, their main concern being to exploit to the full the service that they already offer.

Hidden costs. Among these stand out the following (Willcocks et al., 1995; Barthelemy, 2001; Whitten and Wakefield, 2006):

- Search for vendors and hiring.
- Transition costs – the time that employees of the firm spend helping the outsourcing IT provider is a transition cost. The costs resulting from the interruptions and from the lack of skill on the part of the IT provider to react in a fast, appropriate way, as the IT internal department of the firm did at the beginning of the contract term, are transition costs as well.
- Costs linked to IT provider control and coordination.
- Transition costs after outsourcing – when the outsourcing contract of client expires and the firm decides to perform its IT activities internally again or change its IT provider.

Unclear cost-benefit relationship. Taking into consideration all the related outsourcing factors and trying to translate them into monetary terms is not an easy task – for instance, how to measure the potentially better service delivered by the IT provider or how to value the cost derived from a poor quality service on the part of the IT provider (Gupta and Gupta, 1992). Numerous client firms faced with these difficulties and admit that they rely their decision to outsource exclusively on the explicit costs generated, leaving aside both the tacit costs and the profits (Clark et al., 1995).

Possible security problems deserve to be mentioned. It is very important when IT provider is trading with several direct competitors of client firm, which is why the confidentiality for the information related to all of them must be strictly kept. Security in the IT externalised services depends on the provider firm and, therefore, a negotiation must take place within the framework of the IT outsourcing contract, for the purpose of establishing policies and procedures to ensure that IT security aims, should continue to be achieved (Fink, 1994).

Taft. (2005) in the study focused on the risk assessment in IT outsourcing for client firm. The study states that risk associated with IT outsourcing that client firm face are contract, privacy and security, technical returns, loss of IT expertise, hidden costs, outsourcing scope and decision process.

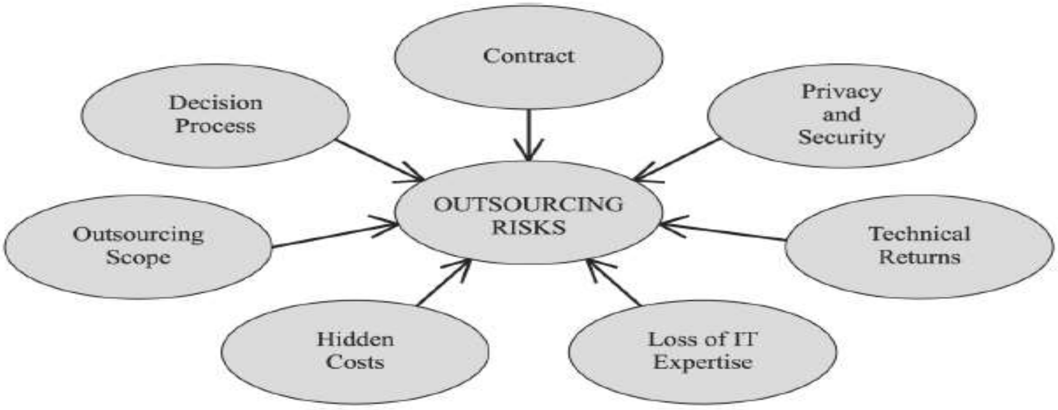

Figure 1. A framework for IT outsourcing risk assessment for client firms. Adapted from (Taft, 2005)

3. CONCLUSION:

Many client firms are engaged in offshoring of their IT functions or services in various degrees and also for many reasons including cost reduction, shortage of IT talents, quality, and tax incentives among others. Without a detail evaluation of various risks involved in offshoring of IT activities, however, any benefits from IT offshoring may be offset by considerable losses due to various risk factors and missed opportunities. This paper has provided a framework for analysis of the major risk factors that are involved during contracting of IT offshoring partnerships with vendor firms.

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