Relationship, contract and IT outsourcing success: Evidence from two descriptive case studies

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ABSTRACT

In spite of the continuous increase in IT outsourcing activities globally, a significant percentage of outsourcing deals are considered either a failure or suffered from serious problems. In China where IT outsourcing practice is still at its initial stage, the situation is more serious. There lacks systematic guidance in terms of how to negotiate decent contracts and how to develop sound relationships. In view of this, an emerging trend of research has explored either the contract or relationship issues in successful IT outsourcing. However, few efforts have been paid to investigate the effects of both relationship and contract on IT outsourcing success with an integrated view. The current research develops a research framework based on the theories in Economics, Management and Marketing fields to investigate the effects of both relationship and contract on IT outsourcing success. To support the propositions, evidence was collected from two descriptive case studies conducted in Hong Kong and Mainland China respectively. The case analysis implies the dimensionalities of relationship and contract. What is more, IT outsourcing success is mainly evaluated from the technological benefits instead of the strategic or economic benefits the client company could gain from an IT outsourcing relationship. A significant contribution of this study to theory is to look into IT outsourcing phenomenon with a balanced view and through an integrated theoretical lens. For practitioners, this research helps clear executives' doubts about simultaneously employing both relationship and contract as a governance mechanism in managing IT outsourcing deals.

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1. Introduction

IT outsourcing has witnessed continuous growth since its prominent adoption by Kodak 20 years ago. According to a recent report by Gartner Group [36], the global IT outsourcing market would rise from US$268 billion in 2009 to US$325 billion by 2013 at a compound annual growth rate of around 5%. Asia-Pacific region is one of the growth leaders compared to other regions. In China alone, the IT outsourcing services market has maintained an extremely rapid growth since 2004 (with a 29.7% compound annual growth rate) and will reach to US$3 billion by 2011 [42]. Clearly, IT outsourcing trend is developing worldwide with a remarkable speed and into various forms [11].

Despite its steep growth trend, IT outsourcing is, however, fraught with difficulties and high rates of failure. Computerworld [14] reported that a low percentage of outsourcing relationships was considered successful and at least 50% of outsourcing relationships were terminated early. Recent examples could be found from the unsuccessful relationship between JP Morgan Chase and IBM [25] and Barclays and Accenture [15]. In China where the IT outsourcing situation is considered quite

different from those of western countries [59], problems also exist. In China, IT outsourcing decision makers are usually short of experience to select and evaluate service providers and immature in negotiating contracts, managing contracts and maintaining good relationships with the providers.

In view of the problems occurred at the implementation stage of IT outsourcing, researchers suggest that the research focus of IT outsourcing should be shifted to two major aspects [53]: the contract - the formal control mechanism of a sound relationship [10,31]; and the relationship - the informal control mechanism [5,70] in IT outsourcing. That is, how to manage the IT outsourcing process formally and informally to protect the benefits for both parties are key to a successful IT outsourcing project. To further shed light on the relationship and contract issues of IT outsourcing and their impact on IT outsourcing success, the present study takes an investigation at these phenomena through two descriptive case studies. Evidences are found to support the propositions that contract is a foundation of relationship, and both contract and relationship are essential and influential factors in IT outsourcing success.

The rest of the paper is organized as follows. First, we review the literature on relationship and contract issues of IT outsourcing. We then provide the theoretical foundations and the research framework of the current research. This is followed by a description of research methodology and a section on the details of case studies,

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including case introduction, analysis and discussion. The paper concludes with the contributions and limitations of the study and future research directions.

2. Literature review

2.1. Literature on relationship issues

The main stream of relationship issues of IT outsourcing focuses on the determinants and attributes of relationships that form partnership-style cooperation. For instance, Klepper [47] considered the development of IT outsourcing relationship as a partnership and developed a conceptual model based on the theory of contract and social exchange. Grover et al. [32] explored the effects of service quality and partnership on the success of IT outsourcing. Partnership in their research was measured by using indicators (communication, trust, cooperation, and satisfaction) derived from Anderson and Narus's [2] study in the Marketing literature. Kern [43] developed an IT outsourcing relationship model involving the operationalization of contract and the emergence of exchange behaviors external to the contract. Through case studies, a strong emphasis of his study was that the success of outsourcing depended not only on the service level but also on the satisfactory relationship between each other. Lee and Kim's [52] work is among the first to distinguish among determinants of relationship, quality of relationship and overall success of outsourcing. The results showed that partnership was a significant determinant of IT outsourcing success. However, they also hinted a potential problem on the unclear distinction between the determinants and components of relationship quality. Goles' [28] and Goles and Chin's [27] studies were based on relational exchange theory. The relational norms were discussed and classified into two categories of relationship: attributes and process. Their work suggests a pattern where attributes and processes of relationship interact with each other in a cyclical fashion and their combination determines the quality of outsourcing project and outsourcing success. Based on Goles and Chin [27], Blumenberg et al. [9] distinguished relationship quality from its determinant in a conceptual model. Their study is probably the most comprehensive collection of relationship quality constructs and its determinants to date; however, the conceptual framework has yet been empirically tested.

2.2. Literature on contract issues

Literature on contract issues can be broadly divided into two categories: the research addressing the contract itself and that examining contract management. First, Barthélemy's [4,5] studies provided the example of a good contract. In his 2003a's work, Barthélemy indicated that writing a poor contract is one of the seven deadly sins of outsourcing, and a good contract should be precise, complete, incentive based, balanced and flexible. In his 2003b's study, contract was regarded as the "hard side" of IT outsourcing management, and a contract is considered good only when it shows preciseness, completeness and balance. Gainey and Klaas [26] highlighted the importance of contractual specificity in the satisfactory outsourcing. They believed when incomplete contracting is minimized through incorporating high level of contractual detail and specificity, it is likely to be more difficult for vendors to engage in opportunistic behavior. In another study, Ariño and Reuer [3] introduced the dilemma IT executives need to face when choosing a complex contract associated with an alliance. Their study is also among the first to bring the concept of contractual complexity into the studies of interorganizational alliance. Barthélemy and Quélin [6] further conducted research on the issue of contractual complexity. Based on transaction cost theory, they gave the rationale for the existence of contractual complexity: when asset specificity increases, contracts need to become increasingly complex. More recently, Chen and Bharadwaj [11] believed that a good contract structure should include

four major dimensions: monitoring, dispute resolution, property rights protection and contingency provisions.

In terms of contract management, Klepper and Jones [48] recognized that managing a contract is crucial and complex, especially at the post-contract stage [1]. Currie and Willcocks [17] summarized that beyond having the ability to build and manage relationships, clients should also have the appropriate contract management ability. Lacity and Willcocks [50] suggested building up a centralized team consisting of members from both client and provider companies to deal with contract facilitation and monitoring problems. Similarly, Feeny and Willcocks [22] identified contract facilitation and contract monitoring as two core IS capabilities in an interorganizational relationship. Shi et al. [73] adopted Feeny and Willcocks' [22] concept about contract facilitation and contract monitoring and developed a new construct – contract management. This construct is adopted in the current study.

2.3. Literature on relationship between contract and relationship

The arguments of the relationship between contract and relationship tend to fall into two categories: (1) formal contract is the base for relationship development; and (2) a good relationship is needed since contract is not flexible in the implementation stage. As an example of the first category, Fitzgerald and Willcocks [23] found that contract to be a critical foundation for all subsequent relationships. Saunders et al. [71] emphasized that contract is the key to any outsourcing relationship, since contract lays the ground rules for governance and structure that guide the interaction between the parties [19]. Goo et al. [31], based on relational governance theory, found that the specific characteristics of service-level agreement are antecedents of trust and commitment (typical attributes of relationship), and trust and commitment lead to the success of IT outsourcing. Studies in the latter category mainly emphasize the importance of relationship in the outsourcing success. For instance, Fitzgerald and Willcocks [23] believed that relationship is necessary since it "overcomes the nasty legal contractual wrangles associated with contracts" (p.93). Clark et al. [13], from a relationship governance point of view, advocated two mechanisms of vendor governance (pure relationship and formal contract). Any IT outsourcing governance structure should be located in between these two extremes. They further mentioned that relationship exists since contract tends to be an inflexible mechanism for governing exchange. Lastly, Willcocks and Kern [77] suggested that "getting the contractual level right is central to success but falls into the necessary but not sufficient category" (p.43). From the relational governance perspective, Poppo and Zenger [65] found that formal contracts and relational governance function as complements instead of substitutes in IT outsourcing relationships. In line with Poppo and Zenger [65], Goo et al. [31] further examined a dynamic complementary relationship between a formal contract and relational governance.

Despite a large proportion of the literature has addressed relationship and contract issues toward IT outsourcing success, only a few of them have put both aspects into one single theoretical framework and explored their relationship in the IT outsourcing context. Though recent studies (e.g., [31]) have explored the relationships between some specific characteristics of contract and relationship governance and have detected a complementary relationship between the two governance mechanisms, the dimensionality of such broad constructs (IT outsourcing relationship, contract dimensions and IT outsourcing) has yet been explored, and the relationships between these constructs still need to be further understood. On the relationship dimension, there is no consistency in the formation of relationship dimension. On the contract aspect, little research has mentioned the concept of contract management at the post-contract stage. For IT outsourcing success, although the literature has suggested a multi-dimensional criterion to evaluate it, the possible components or contributing factors of IT outsourcing success have not been further discussed in the literature.

In view of the above, this research uses three broad constructs to summarize the three dimensions we are interested in the IT outsourcing