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MANAGING VENDOR-CLIENT EXPECTATIONS IN IT OUTSOURCING: A PSYCHOLOGICAL CONTRACT PERSPECTIVE

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Abstract

Managing the outsourcing relationship remains a major challenge today. This study applies the psychological contract perspective to identify vendor and client expectations in IT outsourcing contracts in a two-staged mixed method design. First, we interview IT clients and vendors, and content-analyze interview transcripts to determine mutual obligations expected by both parties. Then, we conduct a quantitative survey of IT clients and vendors to determine how well these obligations are being fulfilled. Preliminary analysis shows that expectations differentiate successful from failed projects, supporting the applicability of psychological contract to IT outsourcing.

1. INTRODUCTION

IT outsourcing has been around since the 1960s, but escalated after Eastman Kodak's 1989 landmark outsourcing (Loh and Venkatraman 1992). The market remains buoyant today and still boasts of continued growth. The Outsourcing Institute estimated that U.S. organizations spent $40 billion on IT outsourcing in 1996 alone, and this is predicted to increase to $282 billion by the year 2000 (Sharpe 1997). As outsourcing matures, we need to understand what differentiates success from failure (Ang and Toh 1998). Prior research has identified advantages and disadvantages, and factors influencing outsourcing decisions (Ang and Straub 1998; Ang and Cummings 1997; Slaughter and Ang 1996), but few studies have dealt with managing the outsourcing contract in detail (Willcocks and Lacity 1998). Companies still find their expectations not being met; Lacity and Willcocks (1998), for example, found that only 56% of sourcing decisions achieved expected cost savings.

This study attempts to understand and manage IT outsourcing by adopting a *psychological contract perspective*, looking at mutual obligations between two contractual parties. We employ a mixed method design (Creswell 1994), comprising both qualitative and quantitative approaches. Our objectives are to determine the nature of client and vendor obligations and explore which of these obligations differentiate successful from failed projects. In the next section, we discuss the theoretical foundation of our study, drawing on relevant prior literature.

2. PSYCHOLOGICAL CONTRACT IN IT OUTSOURCING

IT outsourcing is based on a social exchange relationship involving cooperation of the parties for mutual benefits. Mutual obligations are the essence of the IT contract: the vendor agrees to make specific contributions to the client in return for certain benefits from the client. These obligations extend beyond mere expectations and are based on the perceived promises of a reciprocal exchange.

The nature and impact of these mutual obligations can be best explained using a psychological contract perspective that uniquely focuses on both parties to the contract. A psychological contract refers to *people's mental beliefs and expectations about their mutual obligations in a contractual relation* (Rousseau 1995). The concept of a psychological contract was introduced as early as the 1960s, but empirical work only took off in late 1980s, using the employment relation as the context of study (Robinson and Rousseau 1994). Prior research on the concept of psychological contract has focused mainly on surfacing the underlying mutual obligations between employer and employee, how these are formed and the unique and distinct employer-employee obligations (Rousseau 1990, 1995). Similarly, applying the concept in the context of IT outsourcing, we have the following research questions:

> *RQ₁:* **What mutual obligations do clients and vendors have in IT outsourcing contracts?**
>
> *RQ₂:* **Are there distinct patterns of vendor and client obligations?**

If either party to a contract perceives that these obligations have not been adequately fulfilled, a psychological contract breach occurs. This has various negative impacts on the organization, including organizational citizenship behavior, satisfaction, performance, and intentions to remain (Robinson 1996; Robinson and Morrison 1995; Robinson and Rousseau 1994). Recent work has attempted to apply psychological contract beyond the employment relationship (for an example of faculty-doctoral relationships, see Wade-Benzoni and Rousseau 1998). Ho and Ang (1998) in particular showed that in an IT outsourcing situation where a firm's employees are transferred to a service provider, the outsourcing firm (client) still retained the old mental schemas and continued to treat the outsourced employees in the same way. This persistence of expectations affected the degree of fulfillment of the contract. Ho and Ang represented the first attempt to apply the psychological contract perspective to IT outsourcing; however, it still focused on the mutual obligations from a traditional employment relation. We extend the application of psychological contract in IT outsourcing and argue that failure to meet obligations is likely to lead to erosion of the trust and relationship between the client and vendor, and this will impact the success of the outsourcing project. We expect the contractual parties' perceived violation of expectations to have a negative impact on outsourcing project outcomes. This gives rise to our hypothesis that the *degree of fulfillment of obligations differentiate successful from unsuccessful projects*.

To address our research questions, we conducted a qualitative study to understand the psychological contract elements in IT outsourcing. We discuss our results in the next section.

3. STUDY 1: IDENTIFYING OUTSOURCING PSYCHOLOGICAL CONTRACT ELEMENTS

Since little is known about the nature of psychological contract elements in IT outsourcing, we used a grounded qualitative approach. We conducted in-depth interviews with participants from vendor and client organizations to obtain a rich and "thick" description of what vendors and clients expect of each other.

3.1 Method

We identified client and vendor organizations with experiences in IT contracting. We selected client organizations from members of the Information Technology Management Association of Singapore, since these are senior IT executives who are likely to contract for IT services. For vendor organizations, we targeted members of the Singapore Federation of Computer Industries, representing IT service providers. Altogether, we interviewed 19 client and vendor representatives, including CEOs, CIOs, and IT/project managers. All interviews were guided by an interview protocol sent to participants prior to the session, focusing on their expectations based on actual experience. We independently read the transcribed interview notes for mind saturation, then content analyzed and classified key phrases or sentences into client or vendor expectations. We discussed, reviewed, modified, and reconciled the coding before arriving at the final set of expectations. Cohen's Kappa was 0.89 for both client and vendor expectations, indicating almost perfect agreement (Landis and Koch 1977).

3.2 Results

We identified 11 client expectations and 10 vendor expectations. Clients expect their vendors to (1) estimate project scope accurately and accept changes in scope (project scoping), (2) define clearly the roles and responsibilities of each party (role clarity), (3) charge a fair and competitive price (project pricing), (4) assign high quality vendor staff with experience, requisite skills and good work attitude (vendor staffing), (5) maintain minimal staff turnover during the project (vendor staff turnover), (6) transfer best industry practices and know-how to client (knowledge transfer), (7) complete the job and solve problems independently with minimal client involvement (vendor initiative), (8) respond promptly and beyond call of duty to client requests (vendor responsiveness), (9) conduct regular project meetings to provide feedback (project feedback), (10) work well and build good working relationship with client (relationship building), and (11) deliver a total solution including training, documentation, communication and implementation plans (soft deliverables).

Vendors, on the other hand, expect clients to (1) define requirements and specifications clearly (project specifications), (2) pay competitive prices instead of accepting lowest bid (fair compensation), (3) make payments promptly at predefined milestones (prompt payment), (4) assign high quality staff with experience, requisite skills and good work attitude (client staffing), (5) maintain minimal staff turnover during the project (client staff turnover), (6) provide necessary information and transfer business know-how to vendor (knowledge transfer), (7) own the project and provide strong leadership, support and commitment (client leadership), (8) work as a team and build a good relationship with vendor (relationship building), (9) respond promptly and beyond call of duty to vendor requests (client responsiveness), and (10) attend project meetings and discussions regularly (project monitoring). This list of client and vendor expectations derived from the interviews is validated in Study 2.

4. STUDY 2: DETERMINING IMPACT OF PSYCHOLOGICAL CONTRACT VIOLATION OUTCOMES

In Study 2, we conducted a large-scale quantitative survey to validate the psychological contract elements from Study 1. Additionally, as discussed earlier, we expect clients' and vendors' perceived violation of expectations to have a negative impact on the project outcomes. We thus set out to determine how well these expectations are being fulfilled and which expectations differentiate successful from failed projects.

4.1 Method

Psychological contract elements are crafted and developed from vendor and client expectations culled from Study 1. Project outcome is operationalized as a composite measure tapping psychological contract breach (Rousseau and Tijoriwala 1998), satisfaction (Robinson and Rosseau 1994), and discretionary collaborative behavior (Heckman 1999, adapted). In completing the questionnaires, respondents are asked to think of a recent IT contract in which they were involved and indicate how well their contractual partner has fulfilled each expectation (on a scale of 1 to 5: 1 = not fulfilled at all, 5 = fulfilled to a very large extent).

Survey participants are project and contract managers from client organizations and IT service providers. We targeted the same population as Study 1 (excluding those individuals we interviewed), since this represents the most comprehensive source of IT clients and service providers. We established initial contact via telephone calls with all members of both associations to explain the purpose of the study and invite their participation. A total of 262 client questionnaires and 341 vendor questionnaires were sent out.

4.2 Preliminary Results

We performed preliminary tests based on 44 clients and 65 vendors. The variables' Cronbach's alphas were good (0.73 to 0.97). All of the variables (except for two client expectations—project scoping and project pricing) have significant correlation with project outcomes. To test the impact of the expectations, we first classified projects into success versus failure. A project is considered successful if the outcome measure is 4 or higher, and failure if lower than 4 (on a scale of 1 to 7: 1 = very dissatisfied,

not at all fulfilled; 4 = neither; 7 = very satisfied, very well fulfilled). We then ran a one-way MANOVA followed by subsequent univariate analysis of variance on each of the constructs. The multivariate analysis of variance was significant for both vendor expectations and client expectations, showing support for our hypothesis.

Table 1(a) presents the overall MANOVA of vendor expectations in successful and failed outsourcing projects. Successful projects have more fulfilled expectations than failed projects (Hotelling's T = 0.83, F = 4.47, p < .001). Subsequent univariate analysis on the dimensions of vendor expectations suggests that successful projects are more fulfilled than failed projects on client staffing (F = 1.72, p < .05), client staff turnover (F = 1.89, p < .05), knowledge transfer (F = 2.16, p < .05), client leadership (F = 5.14; p < .001), relationship building (F = 4.70, p < .001), client responsiveness (F = 3.35, p < .001), and project monitoring (F = 5.02, p < .001). There are no significant differences on the remaining dimensions of project specifications (F = 1.53, ns), fair compensation (F = 0.80, ns), and prompt payment (F = 1.30, ns).

Table 1(b) presents the overall MANOVA of client expectations in successful and failed outsourcing projects. Successful projects have more fulfilled expectations than failed projects (Hotelling's T = 1.03, F = 2.99, p < .01). Subsequent univariate analysis on the dimensions of client expectations suggests that successful projects are more fulfilled than failed projects on: role clarity (F = 2.00, p < .05), vendor staffing (F = 3.29, p < .01), vendor staff turnover (F = 2.23, p < .05), knowledge transfer (F = 3.24, p < .01), vendor initiative (F = 3.19, p < .01), relationship building (F = 4.56; p < .001), vendor responsiveness (F = 2.73, p < .01), and soft deliverables (F = 1.86, p < .05). There are no significant differences on the dimensions of project scoping (F = 1.38, ns), project pricing (F = -0.41, ns), and project feedback (F = 1.54, ns).

Table 1. Univariate Analysis of Expectation
(Success: Outcomes ≥ 4; Failure: Outcomes <4)

	Mean – Success	Mean – Failure	F
(a) Vendor Expectations (N = 65)			
1. project specifications	3.39	2.88	1.53 ns
2. fair compensation	2.95	2.55	0.80 ns
3. prompt payment	3.39	2.86	1.30 ns
4. client staffing	3.30	2.68	1.72*
5. client staff turnover	3.24	2.55	1.89*
6. knowledge transfer	3.37	2.60	2.16*
7. client leadership	3.56	2.30	5.14***
8. relationship building	3.63	2.37	4.70***
9. client responsiveness	3.49	2.55	3.35***
10. project monitoring	3.96	2.70	5.02***
(b) Client Expectations (N = 44)			
1. project scoping	2.58	1.92	1.38 ns
2. role clarity	3.61	3.08	2.00*
3. project pricing	3.43	3.58	-0.41 ns
4. vendor staffing	3.31	2.38	3.29**
5. vendor staff turnover	3.34	2.33	2.23*
6. knowledge transfer	3.03	1.58	3.24**
7. vendor initiative	3.38	2.46	3.19**
8. relationship building	3.68	2.42	4.56***
9. project feedback	2.89	2.13	1.54 ns
10. vendor responsiveness	3.24	2.38	2.73**
11. soft deliverables	3.03	2.17	1.86*

ns = not significant   * p < .05   ** p < .01   *** p < .001

The preliminary results suggest that distinct patterns of client-vendor expectations do exist and they differentiate successful from unsuccessful projects. The model has significant explanatory power, providing support of the applicability of the psychological contract perspective to IT outsourcing.

5. EXPECTED CONTRIBUTIONS

This study adds value in two ways. First, it contributes to theory by providing a new theoretical perspective to study IT outsourcing. It uses the psychological contract concept to develop a better understanding of the nature of mutual client-vendor obligations, and their impact on project outcomes. Unlike earlier research that tends to focus on clients' perspectives, this study looks at both client and vendor, reflecting the mutuality of the outsourcing relationship. Second, it contributes to practice by identifying expectations that differentiate successful from failed IT outsourcing projects. This highlights major areas that clients and vendors must focus on, negotiate, discuss, and manage in the contract.

6. WHAT WE PLAN TO PRESENT

Despite the small sample size, the preliminary results show interesting differences in psychological contract elements between vendor and client. At the conference, we intend to present in greater depth our mixed method design, the processes, and detailed results based on complete analysis of the two studies. Additionally, we will analyze psychological contract elements along the transactional-relational dimension, as well as the role of related psychological contract concepts of trust and strength of ties.

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