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2010

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### Recommended Citation

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<http://aisel.aisnet.org/pacis2010/15>

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# RELATIONSHIP AND CONTRACT ISSUES OF IT OUTSOURCING – DESCRIPTIVE CASE STUDIES IN CHINA REGIONS

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## Abstract

*In spite of the continuous increase in IT outsourcing activities globally, a major percentage of outsourcing deals failed or suffered from serious problems. In China regions where IT outsourcing practice is still at its initial stage, the situation is even serious: there lacks systematic guidance in terms of how to negotiate decent contracts and how to develop sound relationships. In view of this, the current research develops a research framework based on the theories in Economics, Management and Marketing fields, and investigates the effects of both relationship and contract on IT outsourcing success. To support the research framework, evidence was collected from two descriptive case studies conducted in Hong Kong and Mainland China. The case analysis implies the dimensionalities of relationship and contract. What is more, IT outsourcing success is mainly evaluated from the technological benefits client company could gain. 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 removes executives' doubts about simultaneously employing both relationship (soft side) and contract (hard side) as governance mechanisms in managing IT outsourcing deals.*

*Keywords: Relationship, Contract, IT outsourcing success.*

# 1 INTRODUCTION

In recent years, IT outsourcing has experienced substantial growth worldwide. According to the prediction of Gartner Group, the global IT outsourcing market has grown from a US\$180.5 billion revenue in 2003 to US\$253.1 billion in 2008 at a compound annual growth rate of 7.2%, and it will keep on increasing with the same speed through 2010 (Gartner, 2006). The Asia-Pacific region is one of the growth leaders compared to other regions, and is forecasted to see IT outsourcing revenue reach US\$16 billion in 2010 (IDC, 2006). In China, the IT outsourcing services market reached US\$806.1 million in 2006, and will maintain rapid growth over the next five years, with a 29.7% compound annual growth rate (IDC, 2007). No matter whether outsourcing is done domestically or globally, the IT outsourcing trend is irreversible.

Despite its steep growth trend, IT outsourcing is, however, not without problems. Computerworld (2007) reported that a lower percentage of outsourcing relationships are considered successful and at least 50% of outsourcing relationships are terminated early. Some even have to bring outsourced functions back in-house, or switch to other providers to avoid further loss/risk. In China where the IT outsourcing situation is quite different from those of western countries (Mchinsey, 2005), problems also exist. China's IT outsourcing market is still at the beginning or learning stage though having experienced a fast growth. Most companies in China are just about to get a basic understanding of IT outsourcing, and are still in the phase of asking "Why" and "What" issues (Dibbern et al., 2004). From the client's perspective, 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.

IT outsourcing problems usually happen at the contract and post-contract stages (Alborz et al.'s 2003), where how to negotiate and come out with a sound contract, how to manage the contract, and how to build up and maintain a good relationship become the most critical issues IT executives need to face. Therefore, IT outsourcing practice has implied that the two important factors that are influential to the final success of IT outsourcing are contract and relationship related issues. In academia, corresponding to the evolution of IT outsourcing practices, the research focus of IT outsourcing has also been shifted to two major aspects (Lee et al., 2003): the contract — the formal control mechanism of a sound relationship (Cellings, 2007; Goo & Nam, 2007); and the relationship — the informal control mechanism (Barthélemy, 2003; Sabherwal, 1999) in IT outsourcing. That is, how to manage IT outsourcing process formally and informally to protect the benefits for both parties in successful IT outsourcing deals.

In view of the trend of business practice and IT outsourcing research, the current research conducted in China regions aims to address the contract and relationship issues at the contract and post-contract stages of an IT outsourcing arrangement.

## 2 SUMMARY OF PREVIOUS RESEARCH

According to Dibbern et al. (2004), IT outsourcing literature mainly addressed the issues of "why to outsource", "what functions should be outsourced" and "how they should be outsourced". While the "why" and "what" issues exist primarily at the pre-contract stage, the "how" issue usually happens at the contract and post-contract stage. At these stages, the major problems aroused are related with relationship and contract.

For relationship, there are two streams of studies in the literature to address IT outsourcing relationship issues. One is strongly practitioner-oriented, which has stressed the importance of relationship management in general. The other, focuses on the determinants and attributes of relationships that form partnership-style cooperation (Dibbern, et al. 2004). Unlike relationship issues, the literature regarding contract issues is mainly based on descriptive studies. The contract literature can be roughly divided into three categories: the research addressing the contract itself, contract management, and the relationship between contract and relationship.

Despite a large proportion of the literature has addressed relationship and contract issues toward IT outsourcing success, few of them have put both aspects into one single theoretical framework and tested their relationship in the IT outsourcing context. On the relationship dimension, there is no consistency in the formation of relationship dimension. On the contract aspect, though numerous studies have addressed the significance of contract, little research has mentioned the concept of contract management at the post-contract stage. There are even fewer studies that made a clear differentiation of contract itself and contract management. For IT outsourcing success, the “why” issues discussed in the literature have suggested a multi-dimensional criterion to measure this construct, however the dimensionality of this construct has neither been confirmed in the literature nor tested in regions where IT outsourcing practice is at the initial stage .

In view of these, this research uses two descriptive case studies to understand the components of both relationship and contract in successful IT outsourcing and the possible relationship between the two seemingly opposite relationship governance mechanisms. It also tries to investigate the effects of relationship and contract dimensions on IT outsourcing success. In short, this paper tries to address the following research questions: (1) what are the possible elements in relationship and contract dimensions at the contract and post-contract stages of successful IT outsourcing? (2) What kind of role do relationship and contract play in the success of IT outsourcing? (3) What is the relationship between contract and relationship in successful IT outsourcing? (4) How is IT outsourcing success evaluated within the special context of China regions?

### 3 THEORETICAL FOUNDATIONS AND RESEARCH FRAMEWORK

IT outsourcing relationship is never adequate to be explained by any single theory, thus multiple paradigms are needed (Kern, 1997). The theories used to explain the relationship and contract issues in the current research are Social Exchange Theory (SET), Relational Exchange Theory (RET), Transaction Cost Theory (TCT) and Relational Government Theory (RGT). The first two theories were used frequently in the literature (Kern, 1997) to explore the relationship issues of IT outsourcing; TCT is borrowed from the field of Economics to address the importance of contract; and RGT, starting from the governance perspective, helps to understand the structure and governance aspects of IT outsourcing process. The content of theories and the corresponding constructs and propositions are summarized in Table 1.

Theories	Major arguments	Constructs/Propositions
SET	SET explains dyadic exchange relations as consisting of “voluntary transactions involving transfer of resources between two or more individuals/organizations”. (Blau, 1964; Cook, 1977; Homans, 1961). Trust and commitment are the core elements in SET (Blau, 1964).	Relationship dimension (trust, commitment, knowledge sharing, communication quality) and P1
RET	RET provides a means to analyze the behaviors and norms that are expected in particular types of contractual relations (Macneil, 1980). Trust, commitment, knowledge sharing and communication quality etc. are deemed as norms in RET (Dwyer et al., 1987; Kern & Blois, 2002; Ring & Van de Ven, 1992).	
TCT	TCT maintains that economic efficiency can be achieved through comparative analysis of production costs and transaction costs (Williamson, 1985). When the transaction costs are high, outsourcing contracts need to be highly specific and complex to offset the risk of opportunism.	Contract dimension (contractual complexity and contract management) and P2
RGT	RGT underlines both the economic rationale of transaction cost economics and the behavioral rationale of relational exchange (Holden & O’Toole, 2004). It is used to describe the governance mechanism of inter-organizational relationship (Dyer & Singh, 1998; Zaheer & Venkatraman, 1995).	P1, P2 and P3

Table 1. Theories and corresponding Constructs/Propositions

Notes: The theories suggested are the major theoretical underpinnings of each construct/propositions. There are overlaps in the use of theories to explain the same construct in the proposition development process.

Based on the theories discussed, the research framework of the current research is listed in Figure 1.

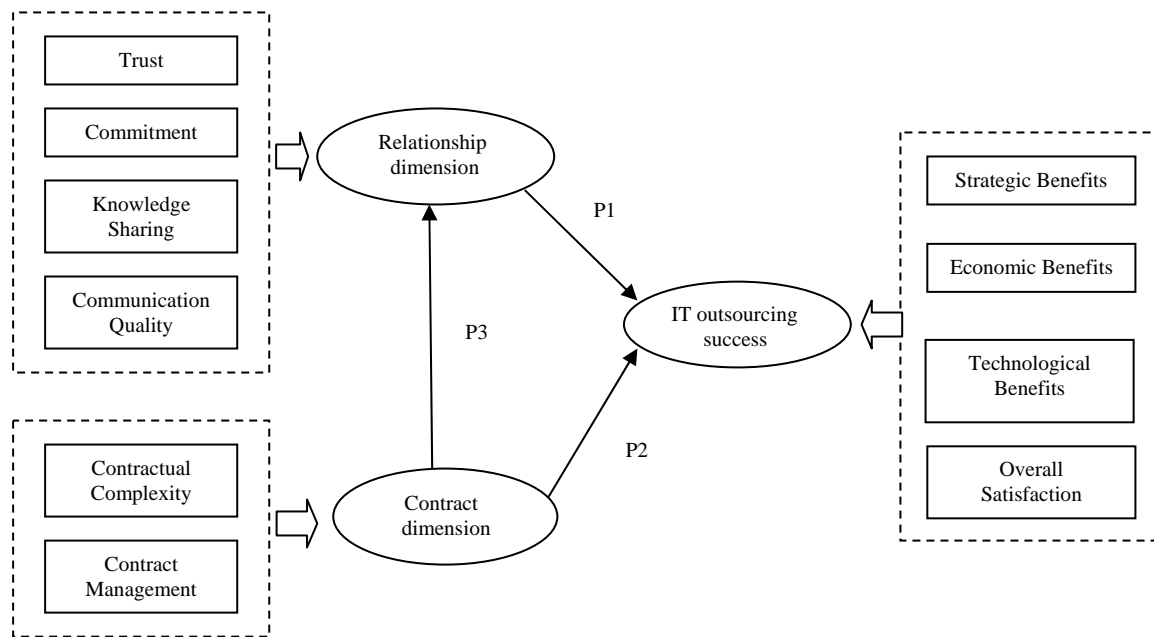


Figure 1. Research Framework

There are totally three major propositions in the research model. The constructs involved are relationship dimension, contract dimension and IT outsourcing success.

**IT outsourcing success** refers to the overall organizational advantage gained from IT outsourcing strategy. From SET and RET's perspective, it is a performance measure of inter-organizational exchange. It is also a criterion to evaluate whether IT outsourcing relationship is satisfactory. Grover et al. (1996) have evaluated IT outsourcing success by the satisfaction of benefits (strategic, technological and economic benefits) client company could achieve through outsourcing activities. Lee and Kim (1999) and Saunders et al. (1997) have further suggested developing another dimension – satisfaction – to measure IT outsourcing success. In line with the above researchers, IT outsourcing success in this research is viewed as a multi-dimensional construct measured from four perspectives – strategic, economic, technological benefits and overall satisfaction.

**Relationship dimension** is broadly defined as the association between IT outsourcing service provider and client company, which involves the characteristics and process of the exchange behaviors. To explore the components of relationship dimension, twelve studies in both IS and Management/Marketing literature addressing interorganizational relationship were investigated. After evaluating the frequency of appearance and the importance level, trust, commitment, communication quality and knowledge sharing were selected as the major components of relationship dimension in this research.

According to SET and RET, the preponderance of literature concerning relationships argues that relationship is a key determinant of exchange success. For example, Halvey and Melby-Murphy (1995) argued that ongoing relationship management forms an integral part of the post-contract management agenda, and its effective handling can make the difference between achieving the outsourcing objective or not. Grover et al. (1996) mentioned that partnership allows two organizations to achieve key organizational objectives and build competitive advantage in their respective industries. Based on this, their empirical results proved that a good partnership with the outsourcing firm is a key to the success in outsourcing strategy. Similarly, McFarlan and Nolan (1995), Kern (1997), Willcocks and Kern (1998), Kern and Willcocks (2002) emphasized the importance of relationship in IT outsourcing by addressing that the success of outsourcing does not depend solely on achieving service levels, but also on the relationship between the two parties and how this helps them to work towards a win-win situation.

From RGT's point of view, the reason why an intermediate mode of governance (relational governance) is needed is that contract alone cannot explain the rich phenomena exist in the interorganizational exchange. Relational governance refers to the role of the enforcement of obligations, promises, and expectations that occur through trust and social identification (Goo & Nam, 2007). It builds on the assertion articulated by Macneil (1980) that contracting is never completely discrete and that even the most fundamental mode of discrete exchange includes some relational elements. A rich body of empirical work has demonstrated that relational governance improves the performance of interorganizational exchanges in general (Heide & Miner, 1992; Poppo & Zenger, 2002; Zaheer & Venkatraman, 1995) and IT outsourcing in particular (Choudhury & Sabherwal, 2003; Goo & Nam, 2007). Thus, the more effective the relational governance is, the more chances IT outsourcing is successful.

**Proposition 1:** IT outsourcing relationship dimension will be positively related with IT outsourcing success.

**Contract dimension** is broadly defined as the characteristics and process related with drafting the text contract and contract management activities at the contract and post-contract stages. Based on this definition and the suggestions in the literature, IT outsourcing contract dimension is divided into two aspects: contractual complexity and contract management.

**Contractual complexity** is the extent to which outsourcing contracts are composed of elaborate clauses (Barthélemy & Quélin, 2006). It is a criterion to measure the quality of text contract. Based on the literature review and theoretical foundations, a detailed and complex contract is more effective in IT outsourcing deals, since it gives enough space to involve preciseness, completeness, flexibility, balance, and other necessary controls to guide outsourcing behaviors (Barthélemy, 2003; Gainey & Klaas, 2003). From TCT's perspective, contracts represent promises or obligations to perform particular actions in the future (Macneil, 1978). It may detail roles and responsibilities to be performed, specify procedures for monitoring and penalties for noncompliance, and determine outcomes or outputs to be delivered. Contractual control is one of the mechanisms to mitigate risks: as exchange hazards rise, so must contractual safeguards (Williamson, 1985), which act to minimize the costs and performance losses arising from such hazards (Heide, 1994). In IT outsourcing context, Barthélemy and Quélin (2006) believed that when asset specificity increases, contracts need to become increasingly complex because contracts could help to mitigate possible opportunistic behaviors by the provider, could help the client to avoid over-dependence on the vendor, and is flexible enough to respond to changes in the environment. To summarize, a more complex contract leaves less room for opportunistic behavior in the face of unforeseen events, and thus guarantees the success of IT outsourcing.

**Contract management** is an action-oriented competence that provides the necessary performance measurement process and final performance information for the diagnosis of problems and the prescription of solutions in managing the IT outsourcing dyads' behavior (Shi et al., 2005). As shown in the definition, contract management involves more actions at the post-contract stage to ensure the success of IT outsourcing. Prior studies have stressed the importance of well developed contracts to the success of IT outsourcing deals; however, most of them did not differentiate between contract itself and actual behaviors of the parties aimed at enforcing the contractual terms. That is they have no idea whether both parties actually comply with contractual terms or are guided by them in their day-to-day exchanges. Therefore, contract management is equally essential to make sure the execution of existing contracts and future contracts, and the accountability of service provider at the post-contract stage (Shi et al., 2005). Support could be found from the following empirical studies: Klepper and Jones (1997), Alborz et al., (2003); Feeny and Willcocks (1998) and Shi et al. (2005).

In a holistic view, from RGT's aspect, contract dimension is another governance mechanism to ensure the success of IT outsourcing. Compared with the informal or relational governance mechanism, formal contractual governance is traditionally taken as the major governance tool in an inter-organizational relationship, and serves to provide structure, guidance, and control to the implementation of IT outsourcing activities. A well-designed contract or Service Level Agreement

(SLA) and an effective execution of the contract terms are consistent with IT outsourcing dyad's purposes and interests, which will definitely lead to the success of IT outsourcing.

**Proposition 2:** IT outsourcing contract dimension will be positively related with IT outsourcing success.

According to economic theory, formal contract exists and works most effectively in discrete transactions, and “the idea of a discrete transaction is the foundation on which concepts of relationship are built” (Dwyer et al., 1987). Based on this fundamental statement, researchers from RGT's perspective investigated the causal relationship from formal contract to relational governance. For example, Ring and Van de Ven (1994), Poppo and Zenger (2002) believed that relational forms evolve from using contractual safeguards to protect relational specific assets. Zaheer and Venkatraman (1995) also claimed that governance structure (represented as formal contractual control) is the first phase in the development of relational governance. In IT outsourcing literature, Lacity and Hirschheim (1993) argued that a well-developed contract greatly influences the resulting quality of the relationship. Gulati (1995) believed that drafting a good contract helps organize the relationship because it allows partners to set expectations and to commit themselves to short and medium-term goals. Kern and Willcocks (2002) mentioned that contracting needs careful consideration, as it is traditionally seen as the beginning and foundation of the outsourcing relationship. Finally, Goo and Nam (2007) claimed that a well-structured SLA plays an important role in cultivating favorable relationships in the course of outsourcing engagements, which will lead to the success of IT outsourcing. Studies in Marketing or Management literature also emphasize the importance of contract management. They believed that the contractual governance involves not only the text contract but also the implementation of the contract in the established service exchange (Ferguson et al., 2005; Vasylychenko, 2005).

**Proposition 3:** IT outsourcing contract dimension will be positively related with IT outsourcing relationship dimension.

## 4 RESEARCH METHODOLOGY

### 4.1 Case Study Design

A case study is an empirical inquiry that investigates a contemporary phenomenon within its real-life context (Yin, 1994). Generally, there are three kinds of case studies: exploratory, explanatory and descriptive case studies. The reason to use an exploratory case study is to define the questions and hypotheses of a subsequent study or to determine the feasibility of the desired research procedures; an explanatory case study is to test the causal relationships in the hypotheses; and the purpose of a descriptive case study is to present a complete description of a phenomenon within its context (Yin, 1993). Descriptive cases require that the investigator begin with a descriptive theory, or face the possibility that problems will occur during the project. The descriptive theory must cover the depth and scope of the case under study (Tellis, 1997). In the current research, descriptive case studies were used to describe IT outsourcing relationship and contract phenomenon in China regions. The research framework and the corresponding theoretical foundations are the “descriptive theories” in this context, and they are sufficient enough to cover the scope and depth of the object being described.

### 4.2 Case Selection

Number of cases and site selection are important strategies before conducting case studies. For the number of cases, since it is not an extreme or unique case or a critical case inaccessible to scientific research, and the purpose is not to test a well-formulated theory (Yin, 1994), this research used a multiple-case strategy to describe the phenomenon. For site selection, Benbasat et al. (1987) suggested that research on organization-level phenomena would require site selection based on the characteristics of firms; Yin (1993) further mentioned that researchers should select “exemplary” cases that reflect strong, positive examples of the phenomenon of interest; the (multiple) cases should also show replication logic to prove the theoretical generalization of the phenomenon. Following

Benbasat et al.'s (1987) and Yin's (1993) suggestions, the current research selected two cases, one from China Hong Kong and another from China Mainland to represent the geographic diversity of the phenomenon under investigation. Both these companies are leading companies in its own field and have used IT frequently in their daily operations. Though there are differences on the maturity level of IT outsourcing, especially on the client side, the Mainland multinational company<sup>1</sup> is comparable and representative in terms of company size and the maturity of IT outsourcing. Furthermore, both companies are in the manufacturing industry, the one which was frequently reported as the largest sector of IT outsourcing service receivers (Grover et al., 1996; Lee & Kim, 1999).

### 4.3 Research settings

Interview was used as the major source to collect evidence. The on-site interview was conducted with the Group IT Manager in the Hong Kong company; and telephone interview was adopted to communicate with the IT manager in Mainland China's company. Both interviewees have been working in the current position for more than three years, and are highly involved in the IT outsourcing relationships with the service provider. The interviews (30-45 minutes per each) were based on open-ended questions with pre-designed interview protocols. Protocols were used to assert the reliability of case study research (Yin, 1994). It is consisted of an overview of the case study project, field procedures, case study questions, and a guide for case study report. In this research, Yin (1994)'s suggestions were followed, and the case study questions are listed in Table 2.

<b>Related constructs</b>	<b>Major interview questions</b>
General understandings	Where do you use IT in your business operation? How many percent did you outsource? Can you describe the history and development of IT outsourcing projects in your company? Can you explain your role in IT outsourcing? What is the purpose of outsourcing in your company? What's your expectation of the future of IT outsourcing?
Trust	Do you trust your service provider in general? And Why?
Knowledge sharing	Do you and your service provider share knowledge with each other frequently throughout the project? Is that effective?
Commitment	Do you feel commitment in the relationship?
Communication quality	How do you feel the communication quality with your provider?
Contract	What do you feel about the contract between your company and the service provider?
Contract management	Do you have any mechanism to manage the contract with your service provider after signing the contract?
Relationship	Can you say your relationship with the service provider is a successful one? Why and why not?
IT outsourcing success	How do you evaluate the overall benefits/results of this IT outsourcing project.

Table 2. Interview questions

## 5 DESCRIPTIVE CASE STUDIES

### 5.1 Case introduction

#### 5.1.1 Case one – TAL Apparel Limited (Hong Kong)

TAL Apparel is a private, family-owned company headquartered in Hong Kong. It is one of the world's largest clothing manufacturers with networks spreading over the Asia Pacific countries and US. It specializes in producing and delivering high-quality garments for the world's leading brands, such as Polo, Brooks Brothers, Calvin Klein and DKNY. TAL produced 55 million pieces of apparel in 2007 (with total revenue - USD 700 million) and about 90% were exported to the US market. Over the years, TAL has won many awards from the Hong Kong government for its innovative technologies used in cloth design, and the cutting-edge supply chain management which has not only helped TAL itself but also its customers cut costs and control inventory.

1. In Mainland China, most IT outsourcing companies are foreign companies or the branch offices/subsidiaries/joint ventures of multinational companies (51case, 2007), so the selected case is representative to reflect IT outsourcing situations in Mainland China.



Technology is the key for TAL's success. IT has been used almost everywhere in their organization, for example, data warehouse, supply chain management, help desk and data center, etc. In terms of outsourcing, TAL has experienced three kinds of outsourcing/offshoring since early 1990s. First, they developed their own subsidiary in Shanghai China (1993) (mainly) focusing on application developments for their manufacturing systems used in factories. The Shanghai office is a full-functional development team consisted of programming executives, system administrators, programmers and people for quality assurance. Compared with developing systems in Hong Kong, the IT "offshoring" greatly reduced the cost for TAL at that time. Second, since e-business supply chain management is always TAL's emphasis, from 1995, TAL has put every effort in developing a web-based platform convenient for both internal and external usage. Besides cooperating with IBM, the great amount of programming work forced TAL to seek help from local (Hong Kong) service providers. However, since at that time TAL was not quite clear about their future requirements, the application developments were all project-based outsourcing. Third, due to the unsatisfactory results delivered by local providers, in 2007, TAL began the near-shore outsourcing with Freeborders, a US-based Shenzhen outsourcing provider to develop applications for the urgent and flexible needs from the Hong Kong office.

### *5.1.2 Case two – Pepsi Cola Beverage Company Limited (Guangzhou)*

PepsiCo International is one of the first American companies to enter China. Through the subsequent 27 years, it has invested over USD1 billion in setting up 21 bottling plants and 1 concentrate plant in 20 cities all over China. It also has more than 40 jointly or wholly owned ventures in China. Pepsi Cola Beverage (Guangzhou) is one of the joint ventures founded in 1995. Pepsi Cola Beverage (Guangzhou)'s major revenue comes from its bottling plant, which is also one of the exemplary bottling plants in China. With several international-standard product lines, and the operational mode adopted from PepsiCo International, Pepsi Cola Beverage (Guangzhou) has been developing very fast in recent years.

IT is used to automate the product lines in the plant. To get the systems tailored to the company's requirements, they usually buy the standard systems directly from the vendors, and then re-develop them by themselves. They have ever thought of outsourcing the application development to the third-party service provider, but the plan did not work. The reason is that, after evaluation, they found (1) in Mainland China, the cost of outsourcing to a local, professional IT service provider (who may provide offshore outsourcing services) is usually high, they cannot save cost like other Hong Kong or overseas clients do; (2) if they choose to outsource to small or medium-sized local vendors, the cost could be reduced, but the quality, privacy and flexibility cannot be guaranteed (for the needs and standards of a multinational company). Therefore, they decided to hire people to develop the applications in-house. However, though they do not outsource the core applications, they do outsource some non-core tasks to local providers, e.g., telecommunication systems, hardware maintenance and disaster recovery plan. The results are quite satisfactory.

## **5.2 Case summary and analysis**

The two cases from the manufacturing industry provide some preliminary insights of the relationship and contract issues of IT outsourcing in China regions. Though one in Hong Kong and another in Mainland China, the cases selected are exemplary cases that reflect strong positive examples of the phenomenon of interest. TAL's case highlights the diversified forms of IT outsourcing (due to the special geographical and economic position of Hong Kong) and discovers the reason why a company decides to terminate or choose an outsourcing relationship (trust and commitment). Pepsi Cola Beverage (Guangzhou)'s case gives a good example of the IT outsourcing situation most Mainland companies need to face. Due to the policy, cost, and trust/commitment issues, most Mainland companies only outsource some peripheral or non-critical projects to third party service providers. The replication logic (Yin, 1994) of these two cases is that, (1) both cases confirmed that in China regions, cost reduction is not the number one concern for organizations to make outsourcing decisions; instead, achieving necessary technological resources is their top objective; in other words, gaining strategic and economic benefits is not the major criteria to evaluate IT outsourcing success; (2) trust,

commitment, communication quality, and knowledge sharing are important factors at the implementation stage of IT outsourcing; (3) both contract (itself and management) and relationship are essential for the overall success of IT outsourcing, and contract is the base for relationship development.

The specific support for each construct/proposition is listed in Table 3.

Construct/proposition	Gathered information
Relationship dimension	<p><i>“We terminated two contracts with local service providers because they could not provide us committed resources...and our new relationship with Freeborders is based on trust. We share knowledge and communicate effectively with each other. We thus feel trust, commitment, knowledge sharing and communication quality are indispensable elements in the relationship”- TAL</i></p> <p><i>“A serious problem that leads to many failures in IT outsourcing or reluctance to outsource is lack of trust and commitment.” “Only when trust and commitment exist can effective communication and knowledge sharing play a role in the relationship. We agree that these four components are important in any IT outsourcing relationship, especially in China where the level of trust and knowledge sharing between business partners are usually low.”-PCB</i></p>
Contract dimension	<p><i>“Hong Kong is a legal society, so a detailed and complex contract is a must in any business collaboration.” “How to manage the contract effectively is another important issue in the later stage.” – TAL</i></p> <p><i>“We recognized both contract and contract management are essential at the contract and post-contract stages. Therefore, besides designing a detailed, balanced contract, one of the tasks this year is to focus on contract control and management to standardize business process.” - PCB</i></p>
IT outsourcing success	<p><i>“Cost reduction is not the major reason for outsourcing/offshoring; instead, seeking for high-quality and professional deliveries, and gaining necessary IT skills not available internally are the main objectives.”-TAL</i></p> <p><i>“We are quite cautious in outsourcing IT (especially the core IT), since we do not think there is any strategic or economic issues involved yet. We care more about whether we can acquire necessary technical resources and minimize total cost of ownership in the long run.”- PCB</i></p>
P1: Relationship dimension →IT outsourcing success	<p><i>“In a successful IT outsourcing engagement, relationship is definitely more important than contract, because outsourcing is also a people’s business.”-TAL</i></p> <p><i>“In China, relationship is very important. Though we have a well-designed contract, we still believe the role of relationship is more important than contract in IT outsourcing success.”-PCB</i></p>
P2: Contract dimension →IT outsourcing success	<p><i>“A complex text contract is necessary when our relationship goes bad. It is a safeguard of our rights in the engagement. After signing the contract, regular contract management is needed to monitor the progress of the contract. Our unsuccessful experience with the local service providers owes to the poor contract management at that time.”-TAL</i></p> <p><i>“In our company, a decent contract and its follow-up contract management is a must in outsourcing relationship. However, many other Mainland companies do not even have a decent contract since they believe relationship can do anything...this is a dangerous thought/behavior to us.” - PCB</i></p>
P3: Contract dimension → Relationship dimension	<p><i>“Contract is the basis of our relationship with the service provider. When the relationship is not stable, we will usually refer back to contract details.”-TAL</i></p> <p><i>“Basically we trust our service provider, and the good relationship is based on the well-developed contract.”-PCB</i></p>

Table 3. Support for constructs/propositions

Notes: TAL=TAL Apparel Limited (Hong Kong); PCB= Pepsi Cola Beverage Company Limited (Guangzhou)

The gathered information of the case studies supported all the three propositions: Both relationship dimension and contract dimension positively influence IT outsourcing success; and contract dimension is the foundation of relationship. This result is consistent with the literature, e.g. Goo & Nam, 2007; Barthélemy & Quélin, 2006; Poppo and Zenger, 2002. Regarding to the formation of relationship and contract dimensions, both cases supported the original assumptions. However, the measurement of IT outsourcing success is not consistent with the literature: in China regions, gaining

strategic and economic benefits are not the strongest motivation of IT outsourcing, instead, achieving technological resources (technological benefits) is the major criterion to evaluate IT outsourcing success.

## **6 CONTRIBUTIONS AND LIMITATIONS**

### **6.1 Contributions**

The main theoretical contribution of this research lies in the development and use of a “relationship-contract” framework to investigate IT outsourcing governance. That is, it is among the first to put both relationship and contract dimensions in one integrated framework, and to explore the effects of these two governance mechanisms on IT outsourcing success. The second contribution lies in discussing the components of the three constructs. For relationship dimension, trust, commitment, communication quality and knowledge sharing are suggested to be influential; and contract complexity and contract management are important factors in contract dimension. IT outsourcing success is mainly evaluated by the technological benefits gained through outsourcing activities. This result is inconsistent with the literature; however, it may reflect the specific situation of Mainland China, where the current study was conducted. The third contribution comes from the use of theories. Since this study involves the elements of both relationship and contract, multiple theories from different domains are used to explain the complex phenomenon under investigation.

For practice, this research emphasized the importance of both relationship and contract in successful IT outsourcing. Relationship dimension (soft side) is a critical factor in determining IT outsourcing’s fate, no matter whether IT outsourcing occur in eastern culture or western culture; and contract dimension (hard side) also plays a fundamental role in promoting IT outsourcing success. In this dimension, contract itself and contract management take equally important roles: without a precise, complete and well-balanced contract, IT outsourcing relationship could not be effectively governed at its earlier stage; and without a careful execution and management of contract in daily operations, IT outsourcing relationship could not be sustained in the long run. In sum, this research removes executives’ doubts about employing both relationship and contract (traditionally opposite mechanisms) as governance tools in managing IT outsourcing activities. It also provides some insights and interesting findings to the investors who want to enter IT outsourcing market in China.

### **6.2 Limitations**

The first limitation in the current research lies in the research methodology. Descriptive case studies, based on descriptive theory, could provide some introductory or descriptive information regarding the research issues; however it could not facilitate in understanding the causal relationships between constructs or the in-depth explanations of phenomena under investigation. Therefore, an explanatory case study is needed to further test the causal relationship in the research framework. What is more, a quantitative analysis (e.g., large scale survey) is necessary to provide more empirical support and methodological triangulation for the propositions or the formation of constructs in the current research.

The second limitation is also related to the design of the descriptive case studies. Though the reliability of the case studies was guaranteed by the use of case study protocol, the construct validity is yet to be confirmed. Yin (1994) proposed three remedies to ensure construct validity in case studies: using multiple sources of evidence, establishing a chain of evidence and having a draft case study report viewed by key informants. In this research the draft report has been showed to the key informants, however due to the difficulty in contacting other key informants and lack of resources, the rest two criteria have not be satisfied. Therefore, the construct validity still needs to be well-tested in the future research.

Third, since one of the cases was selected from Hong Kong, a special region of China, the situation of IT outsourcing could be different from the pure Chinese companies. It is thus suggested to conduct a repeat study in a pure Chinese-company environment, and compare its results with the current one.

Last, this study was conducted in China regions, where the maturity level of IT outsourcing practice is not as high as that of the developed countries, thereby, cautions need to be paid when interpreting the results to the context of other geographical locations.

## 7 CONCLUSIONS

This research using descriptive case studies filled some gaps in the literature on IT outsourcing. It is among the first to bring theories from Economics, Marketing and Management fields to the IT outsourcing context and investigate the two seemingly opposite dimensions or governance mechanisms on IT outsourcing success. It is also among few studies to discuss the dimensionalities of relationship, contract, and IT outsourcing success and to explore the relationships among them. The descriptive theory consisted of the abovementioned constructs was tested, and the results showed that contract is an important foundation of relationship, and both relationship and contract dimension have a positive impact on IT outsourcing success. Last but not the least, a special focus on China regions has raised some interesting discussions for researchers and practitioners who are paying special attention to China – an emerging market for onshore and offshore IT outsourcing.

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