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# Exploring The Balance Between Trust And Formal Controls In Information Systems Outsourcing Relationships

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# EXPLORING THE BALANCE BETWEEN TRUST AND FORMAL CONTROLS IN INFORMATION SYSTEMS OUTSOURCING RELATIONSHIPS

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## Abstract

*Trust and formal controls are critical in contemporary information systems outsourcing arrangements. Trust has been recognized as the relationship facilitator, while formal controls have been treated as the governance mechanism. Achieving a balance between trust and formal controls has received much attention in the literature as it leads to better management of inter-organisational relationships and performance results. Although existing research on the balance offers interesting insights, it is largely descriptive and does not establish a sound conceptual base. In contrast, the current studies that investigate the interaction of trust and formal controls have been based on contradictory conceptualisations and conflicting research outcomes, leading to controversial and exhausting debate about trust and formal controls being complements and/or substitutes. In this study, we investigate the dynamics of trust-controls nexus in IS outsourcing arrangements and build a conceptual framework that captures various interplays between trust and formal controls. We argue that different types of balance (antithetical, orthogonal and synergistic) and outsourcing outcomes can mutually influence each other. Based on our framework, we explore the synergistic balance in two case studies and reveal the existence of dynamic patterns of interaction between trust-controls nexus and outcomes, and the changes in the achieved balance. The study provides a new way to explore the balance as the outcome of dynamic interactions between trust and formal controls and its link to the outcomes in IS outsourcing.*

*Keywords: Trust, Formal controls, Balance theory, IS outsourcing.*

# 1 INTRODUCTION

Trust and formal controls are both important in the management of IS outsourcing arrangements, influencing both the quality of service and the quality of working relationships. Outsourcing practices (e.g. business process outsourcing) place a strong emphasis on nurturing trust-building using both formal and relational governing skills within outsourcing arrangements (Goo & Huang 2008). Both trust and formal controls are important strategic assets in managing IS outsourcing relationships between clients and vendors (DiRomualdo & Gurbaxani 1998).

Outsourcing as a means of meeting organisational information systems (IS) needs is now a commonly accepted and growing practice, and one that is continually evolving (Dibbern et al. 2004; Lacity et al. 2010). As a business practice, it consists of an external vendor providing services to a client to supplement or replace internal efforts for an agreed fee over an agreed period (Lacity & Willcocks 2009). Although the development of outsourcing relationships has received growing attention both in industry and in academia, the effective management of IS outsourcing continues to be a challenge for organisations. One of the major issues that both clients and vendors are facing is to demonstrate the value of outsourcing (Lee et al. 2008). Building and sustaining a flexible relationship between two outsourcing parties is one way to create value and achieve business benefits (Willcocks & Kern 1998). Improving the quality of outsourcing relationships is important in meeting the outsourcing challenge (Lee et al. 2003) and influences outsourcing effectiveness (Goo & Nam 2007).

There are two prevailing perspectives in managing inter-organisational relationships which are widely employed: formal controls and relational governance (Poppo & Zenger 2002). Formal controls are represented by a written legal agreement (contract) and formal mechanisms designed to regulate an outsourcing partner's actions to achieve specified objectives (Choudhury & Sabherwal 2003; Goo 2008). Relational governance is driven by unwritten and largely unspoken sets of expectations held by the parties about each other's obligations and prerogatives (Koh et al. 2004; Prifling et al. 2009), and is supported by trust (Sabherwal 1999). Trust is a key factor in managing IS outsourcing and it facilitates the development of outsourcing relationships and encourages both clients and vendors to cooperate (Kern & Willcocks 2000).

The ever-growing complexity of business activities emphasizes the importance of building and maintaining sound business relationships. Many researchers recommend a cooperative partnership between the client and the vendor (e.g. Fitzgerald & Willcocks 1994; Lacity & Willcocks 2009) based on an effective and flexible relationship, in which trust positively influences the success of the outsourcing deal (Cong & Chau 2007; Lee et al. 2008; Sabherwal 1999). Both trust and formal controls should be the centrepieces of a good outsourcing relationship. Overreliance on formal controls may be expensive and complicated (Goo et al. 2009), and may have a detrimental effect on the relationship. A strained relationship can detract significantly from the success of outsourcing. The value, in terms of cost reduction, increased innovation and improved flexibility, of outsourcing is reduced by the greater need for excessive monitoring and reporting. Therefore, trust and formal controls complement each other in managing IS outsourcing arrangements and should serve as two sides of 'the same coin', i.e. as they are in a dialectical relationship (Heiskanen et al. 2008; Möllering 2005).

Trust and formal controls are both essential (Barthélemy 2003; Mao et al. 2008; Sabherwal 1999), and can serve as both complements and substitutes (Goo et al. 2009; Poppo & Zenger 2002; Tiwana 2010), in achieving better quality of service and working relationships. Effective collaboration between outsourcing partners requires alignment of both interests and behavioural actions (Mani et al. 2006). While formal controls attempt to align incentives and interests in providing an administrative architecture (Gulati & Singh 1998) within which an outsourcing partnership proceeds, trust addresses how the information exchange between the client and the vendor promotes a shared understanding of the project requirements and mutual adjustment to align actions to ensure success (Poppo & Zenger

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2002; Ring & Van de Ven 1994; Zaheer & Venkatraman 1995). The benefits of combining trust and formal controls are acknowledged in current outsourcing research. However, scholars have not yet gained a thorough understanding of the nature of these conjoint actions, nor explained the complexity of the combination of trust and formal controls (Huber et al. 2011). In particular, there are a very limited number of studies that consider the appropriate balance between formal controls and trust in IS outsourcing (Sabherwal 1999) and none of a conceptual nature that explain how balance leads to the outcomes achieved. An appropriate balance between trust and formal controls has strategic value, since it helps participating organisations to avoid higher costs, operational disruption, and loss of business opportunities (Goo & Huang 2008). This study explores the research question of how and why does the balance between trust and formal controls influence outcomes in IS outsourcing. In doing so, the study seeks to contribute to the existing IS outsourcing literature in two ways. First, the developed conceptual framework on balance allows for a more detailed examination of the interaction between trust and formal controls. Second, the findings of the study substantiate the view that trust-control nexus has a dynamic nature and depending on the patterns of interplay may influence the outsourcing outcomes differently.

The paper is structured as follows. First, we discuss relevant background literature on trust and formal controls in IS outsourcing, and conceptualise the balance between them. We define three types of balance: synergistic, orthogonal and antithetical and build the conceptual framework. We then describe the details of the chosen research approach. In the following section we describe two case studies conducted for the synergistic balance. The outcomes and insights from the two case studies are then discussed. The concluding section sums up the implications of this study for both researchers and practitioners, outlines limitations and suggests several areas for future research.

# 2 THEORY BACKGROUND

This section provides an overview of the background literature on formal controls, trust and the interaction between them. We highlight the importance of the balance between trust and formal controls and define three types of balance for IS outsourcing arrangements. Also, this section explicates the use of the conceptual framework in capturing the dynamic patterns of trust and formal controls and its effects on outcomes.

## 2.1 Formal Controls

IS outsourcing is a boundary-spanning interorganisational relationship, where a contract (including a service level agreement (SLA)) defines the formal outsourcing arrangement and structures the interactions between clients and vendors. The outsourcing contract provides a legally binding institutional framework in which each party's rights, duties, and responsibilities are codified and the goals, policies, and strategies underlying the arrangement are specified (Gottschalk & Solli-Saether 2005). Clearly, the contract plays a key role in defining the outsourcing relationship and as a result, most research on contractual issues is related to the building and structuring of outsourcing relationships. The SLAs are drafted to efficiently manage outsourcing relationships (Goo et al. 2009) and both parties jointly define goals, responsibilities and service levels. The outsourcing contract is intended to reduce opportunism and facilitate business exchange between two partners. However, contracts often prove to be incomplete (Kern & Willcocks 2000) and many are either too loose or too inflexible (Lacity & Willcocks 1998). Among most common types of outsourcing contracts are fixed-cost, fee-for-service, time-and-materials and strategic partnership (Lacity & Willcocks 1998), where each type depends on the nature of the service that is being outsourced. However, contracts cannot provide solutions to all problems and undue dependence on them may only create additional problems in the relationship. Therefore formal controls based on joint understanding are preferred to complement the regulating role of contracts.

There has been an extensive research done on the role of formal controls in IS outsourcing (Choudhury & Sabherwal 2003; Gopal & Gosain 2009). Formal controls usually include a set of mechanisms that are aimed at either regulating the behavior of individuals (and groups) involved in the project (e.g. development methodology) or outcomes of the project (e.g. target milestones). In this study, formal controls have both an assessment role (assessing project outcomes) and a behaviour role (e.g. coordinating the project team) (Choudhury & Sabherwal 2003). Kirsch (1997) defines 'control' as an attempt to ensure individuals in organisations act in a manner consistent with organisational (and project) goals. This definition has been extended for IS outsourcing, where control is exercised by the client to ensure the vendor's behaviour is appropriate. When successfully implemented, these controls result in the regulation of behaviour and may change throughout the course of the outsourcing project.

Formal controls are defined within the outsourcing contract (including the SLA) as a set of formal mechanisms. Important aspects of the outsourcing contract include completeness in terms of the scope, budget and specified terms (e.g. service levels, benchmarking) and the type of contract (e.g. fixed cost, time-and-materials). Formal controls may include mechanisms for assessing outcomes and coordinating the behaviour of the vendor team and the overall project.

## 2.2 Trust

Trust has been widely recognized as a facilitator of successful relationships between buyers and sellers in many domains from social exchange to economics (Goles & Chin 2005). It is considered one of the most desired qualities in any close relationship and includes common features such as positive expectations, vulnerability and risk-taking behaviour (Mayer et al. 1995). Trusting parties act predictably, fulfill their obligations and behave fairly even when the possibility of opportunism is present (Zaheer et al. 1998). Outsourcing researchers mainly focus on trust at the organisational level (Oza et al. 2006) and define trust as the belief that a promise is reliable and will be fulfilled (Kern & Willcocks 2000). Trust refers to the relational aspects of IS outsourcing, where parties are willing to accept risk for commitments that will result in positive outcomes (Willcocks & Kern 1998). Trust often leads to success in IS outsourcing (Lee & Kim 1999).

In the management of outsourcing relationships, trust has a number of long-term benefits, including enabling parties to focus on long-term objectives and suppressing the risk of opportunism (Zaheer et al. 1998). Trust increases the level of cooperation between the client and the vendor, enabling risk-taking and reducing conflict. While almost all outsourcing relationships are based upon contracts, it is impossible to cover all contingencies in the contracts. Hence there will be reliance to some degree on trust-building between the client and vendor. Many outsourcing relationships are formed among parties who are initially unfamiliar with each other, and under these circumstances, some initial trust-building mechanisms are required, since the parties have not worked together long enough to develop a history of interactions (McKnight et al. 1998). Openness and honesty, good performance, competence and knowledge, predictability, joint understanding and commitment have been acknowledged as trust-building characteristics in outsourcing arrangements (Babar et al. 2007; Oza et al. 2006) and as relationship characteristics overall (Zaheer et al. 1998). Trust may change as the outsourcing arrangement evolves, due to changes in personal, organisational and other conditions of the working environment.

Overall, trust is characterised as the sentiment that prevails in those situations in which outsourcing parties have positive expectations of each other's actions and that each party will fulfil its obligations according to the formal agreement to build satisfying outsourcing relationships. Thus, trust-building is closely associated with the performance function to deliver as per project requirements and behaviour actions to voluntary take corrective actions and acting openly in dealings.

## 2.3        Interaction between Formal Controls and Trust

Ideally, trust and controls are balanced in such a way that both the client and the vendor are confident that the relationship will be so beneficial to them that they are willing to continue the deal and will be satisfied with the outcomes (Heiskanen et al. 2008). While both trust and formal controls affect the achievement of objectives in interorganisational relationships, Long and Sitkin (2006) point out that while "there are numerous examples in the literature where control chases out trust and situations in which trust seems to remove the necessity for control, there are equally as many examples of trust and control being complementary" (p. 91). Others claim that control mechanisms and trust can be pursued simultaneously, and hence are complementary (e.g. Zaheer & Venkatraman 1995) or argue that controls are detrimental to trust (e.g. Gulati 1995), since a reliance on controls will diminish trust-building. Trust and formal controls can be both complements and substitutes (Goo et al. 2009; Poppo & Zenger 2002). The 'complementary' perspective suggests that trust and controls can be mutually reinforcing and can both contribute to the level of cooperation in the relationship, while the 'substitution' perspective suggests that trust and formal controls are inversely related, so that more controls require less trust, and vice versa. Thus, the higher the degree of trust in relationships, the lower the monitoring costs and other control mechanisms (e.g. frequent reporting).

As Cullen et al. (2005) argue there is abundance of options as to how to configure the client-vendor outsourcing relationships. The client is trying to find the optimal kind and level of trust and formal controls to safeguard oneself against any possible risks and opportunistic behaviour of the vendor and vice versa. So trust entails that the client is confident that the vendor will deliver what has been stipulated in the contract, deal with issues, and be upfront in dealings. Control is the other side of the coin (Möllering 2005). Good controls means that the controller can be reasonably confident that no major, unpleasant surprises will occur, while establishing control mechanisms ensures the attainment of desirable outcomes and reduces the level of risk (Das & Teng 1998) in such a contingent environment such as IS outsourcing. Thus, it is reasonable to pursue the notion of balance that tackles with the dynamics of the client-vendor relationship development. Complete reliance on formal controls does not promote the achievement of objectives between two parties and may result in relationship deterioration between the parties (Goo et al. 2009). Similarly, exclusive reliance on trust is also risky (Sabherwal 1999). In essence, we argue that there should be a balance between trust and formal controls since the dominance of either trust or formal controls leads to unnecessary challenges with performance milestones, lack of vision or the risk of opportunism.

Sabherwal (1999) empirically revealed the importance of finding an appropriate balance between trust and formal controls in achieving good IS outsourcing performance. However, he did not provide a theoretical explanation of how trust and formal controls interact with each other and how balance influences the outcomes. This informs the research question that we address in this paper: *How and why does the balance between trust and formal controls influence outcomes in IS outsourcing?*

We deliberately decided to theorise formal controls and trust (as attribute of relational governance). Trust is a trait embedded in every exchange relationship and a necessary condition for relational governance (McKnight et al. 1998; Zaheer et al. 1998). Once exchange partners are granted 'trustworthy' status, they are expected to behave accordingly in the future. We draw on relational contract view (Macneil 1985) and consider formal controls and trust to be independent dimensions (Goo et al. 2009). This posits that apart from the legal role of contracts (and associated controls), the relational attributes of contracts are important since the contract encourages participation and exchange by promoting reciprocity and trust-building. It promotes trust as a relational attribute and views inter-organisational relationships as the deliberate cooperation of both parties to achieve goals.

## 2.4        Theory on Trust-Controls Balance

To explore the concept of balance, we draw on organisational theory on the balance between trust and controls in employer-employee working relationships (Long & Sitkin 2006). From this perspective,

organisations achieve a balance when there is a harmonious integration that facilitates the ongoing development of working relationships and enhances the task outcomes. The integration is determined by the context within which that integration occurs. We adapt Long and Sitkin's concept of balance between trust and formal controls in the context of IS outsourcing. Balance may be understood as something akin to a 'comfort zone'. When it is reached, both clients and vendors agree that the outsourcing arrangement is progressing well. Since we posit that histories of two things (trust and formal controls) are not independent on each other, balance is the outcome of their dynamic interaction and association between them, when one instance in a thing (a particular trust-building strategy) *interacts* with at least one instance in another thing (a particular formal mechanism) (for further details, see Weber 2012).

We argue that the balance between trust and formal controls influences the outcomes in IS outsourcing relationships and in turn, the outcomes may influence the state of the achieved balance (see Figure 1 below). Although we recognise three types of balance (antithetical, orthogonal and synergistic, depending on the interactions between trust and controls) defined by Long and Sitkin (2006) for employee-employer relationships, we only include synergistic balance in this study. We also argue that while balance may appear static for some time in an outsourcing relationship, it is dynamic and may change over time (Long & Sitkin 2006) due to the changing nature of the IS outsourcing environment (e.g. restructure within project teams, changes to IS project requirements) and changes to the size and complexity of the IS outsourcing agreement. Trust and formal controls are also dynamic concepts and may change over time as the outsourcing relationship evolves. Parties in the outsourcing agreement will be continuously seeking an appropriate balance between trust and formal controls to ensure successful outcomes. However, our theory's boundary condition is that the balance is taken from a client's perspective on the change in the balance and the outcomes within the progress of the IS outsourcing arrangement.
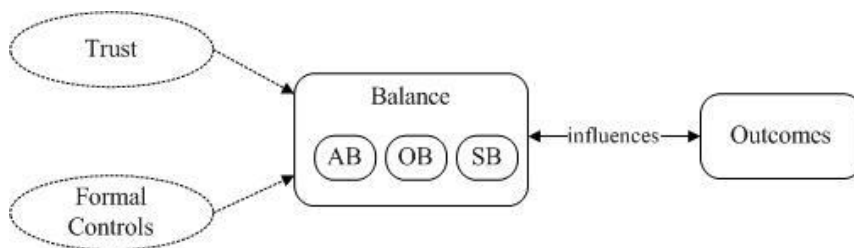


*Figure 1.        Conceptual Framework*

To a great extent the definitions of trust and formal controls are case specific and may involve various control and trust-building initiatives. In essence, the balance is the outcome of dynamic interactions between trust and formal controls. Depending on the integration, trust and controls can act as substitutes (antithetical balance), complements (orthogonal balance) and complements with reciprocal patterns (synergistic balance). Despite our focus on synergistic balance, we provide brief definitions for the remaining types of balance.

Antithetical balance (AB) involves the development of *either* trust *or* formal controls, but not both simultaneously. In antithetical balance, trust and formal controls are viewed as substitutes for each other. Antithetical balance may involve formal controls only, in short-term projects requiring only target deliverables and coordination but not comprehensive relationship development. Stakeholders will often avoid implementing trust in these situations, as it involves more cost and risk (Long & Sitkin 2006). It should be noted that some level of trust will exist (e.g. swift trust among team members in temporary project engagements), but formal controls will have the dominant role. Antithetical trust is also possible in short-term projects between stakeholders who have an existing trusting relationship, and consider formal controls unnecessary.

Orthogonal balance (OB) involves *both* trust *and* formal controls, but they are independent of each other. Usually this type of balance occurs, when both outsourcing parties may have existing trusting relationships, yet they insist on strict project coordination and adherence to the contract. Orthogonal balance is also evident when, despite the presence of trust between the client and vendor, the client may decide to implement new formal controls (e.g. collecting customer feedback to assess interim deliverables). Implementing new formal controls within an outsourcing agreement has little regard for the maintenance, dissolution or augmentation of any trust that may exist between the parties.

Synergistic balance (SB) involves *both* trust *and* formal controls, which are "mutually reinforcing and where each…facilitates and contributes to the effectiveness of the other" (Long & Sitkin 2006, p. 92). Synergistic balance is used to reinforce the strengths of particular types of controls or trust-building. For example, when increasing performance by introducing milestone targets, the level of organisational trust might also be increased when the vendor team consistently in meets performance targets. Furthermore, the use of legalistic control mechanisms during contract negotiations, such as financial rewards for the vendor and contractual safeguards for the client, can increase contractual-based trust between two parties as they are safeguarded against opportunistic actions (Babar et al. 2007; Ring & Van de Ven 1994). With synergistic balance, both trust and formal controls may be viewed as complementary with reciprocal relationships (Pettigrew et al. 2001). In this study, we focus on synergistic balance as the appropriate type of balance since it allows adapting to (contextual) changes by changing configurations of trust and formal controls.

### 2.4.1    The Mutual Influence of Balance and Outcomes

Outcomes from IS outsourcing relationships include satisfaction with working relationships in terms of durability, cooperation and positive information exchange (Goles & Chin 2005; Kern & Willcocks 2000), service quality and performance within the project in terms of costs and timely delivery (Gopal et al. 2002; Goo & Nam 2007; Goo et al. 2009). Some of these outcomes depend mainly of trust (satisfaction with working relationships), while others depend mainly on formal controls (service quality and performance). In particular, the interaction between formal controls and trust has been examined within the context of IS outsourcing projects (Beimborn et al. 2009; Choudhury & Sabherwal 2003; Prifling et al. 2009). Some studies looked at the impact of various formal controls on project outcomes, participant behaviour in the development of trust (Langfield-Smith & Smith 2005), project efficiency (Gopal & Gosain 2009), vendor profitability (Gopal & Koka 2009), and the overall IS outsourcing effectiveness (Balaji & Brown 2010). Other studies looked at the positive role of well-structured SLAs in managing IS outsourcing relationships (Goo et al. 2009) and the positive role of trust in achieving high quality project work (Goo & Nam 2007; Kern & Willcocks 2000; Mao et al. 2008). Overall, the research on the interaction of trust and formal controls has signified the importance on the outsourcing outcomes. However, there is a need to explain how balance affects the outcomes.

While trust and formal controls are each known to positively influence the outcomes from IS outsourcing relationships, we argue their interaction through the concept of balance provides more in-depth understanding. Different interactions between trust and formal controls (three types of balance) may influence the outcomes in IS outsourcing relationships differently. In turn, the outcomes may influence the achieved balance as well. The outcomes are produced by the joint efforts of the client and the vendor. The outcome for the client is continued delivery and performance by the vendor of high quality service work. The outcome for the vendor is remuneration and the possible indirect effects in relation to the built reputation and the continued relationship with the client. Also, both parties learn from their experiences. With time, it seems reasonable to assume that both parties may use their gained status to obtain an 'optimal outcome' from their own points of view (Heiskanen et al. 2008) and thus, may adjust some of the control and/or trust-building activities. As a result, this will lead to the change in the state of the achieved combination (Huber et al. 2011). Furthermore, the type of balance in IS outsourcing relationships may change over time. For example, there may initially be an IS outsourcing relationship that has antithetical balance with formal controls only. As trust develops over time, the type of balance might change to become synergistic. In this way, balance

should be regarded as a dynamic rather than a static phenomenon, whereas the mutual interaction between balance and outcomes is best considered as a 'process model' with states of each construct being important (they will change over time as they interact with each other). This then leads naturally to longitudinal studies of client-vendor IS outsourcing relationships.

# 3 RESEARCH APPROACH

We use an explanatory multiple case study research approach. Case studies are appropriate for the study of contemporary phenomena in the real world context, when boundaries between the phenomenon and its context cannot be clearly delineated, and they are particularly useful in investigating 'why and 'how' questions (Yin 2008). This applies well to IS outsourcing arrangements, due to their socio-technical nature. We used theoretical replication and examined two IS outsourcing arrangements with the synergistic balance achieved differently between trust and formal controls. The current balance in the case studies was identified from initial interviews with key stakeholders and involved such characteristics as instances of trust and formal controls, co-existing and mutually influencing each other at one point of time, several initiatives concerning trust and/or formal controls that changed the working relationship and/or project performance.

Data collection included semi-structured interviews and access to relevant documents. Interviewees were selected using heterogeneity sampling to enable triangulation (Miles and Huberman 1994). We conducted seven interviews with key participants for Case 1 and four interviews for Case 2 (see Table 1 below) over three months (January-March 2009). Each interview lasted about one hour, and all interviews were recorded and transcribed. All interviews were conducted using an interview protocol including questions about demographics, organisational background and context, the use of formal controls, the role of trust, perceptions about the balance between trust and formal controls, and outcomes achieved over the time of the IS outsourcing arrangement. Some participants provided relevant documentation (e.g. SLA details, project requirements).

| Case | Interviewee roles | | Total interviews |
|------|-------------------|--------------------|------|
| | Client organisation | Vendor organisation | |
| 1 | 1. Support Services Leader (one person)<br>2. Midrange Support Leader<br>3. Midrange Support Analyst | 1. Service Delivery Manager (SDM)<br>2. Three Team Leaders (data warehouse, middleware, web applications) | 7 |
| 2 | 1. Support Services Leader (one person)<br>2. Infrastructure Support Leader | 1. Service Delivery Manager (SDM)<br>2. Team Leader for Infrastructure Support | 4 |

*Table 1.        Data collection details*

Case study data was analysed using thematic analysis, a method for identifying, analyzing and reporting patterns (themes) within data (Boyatzis 1998). The researcher identifies the major themes and follows them through various iterations of data analysis. For this study, a hybrid data analysis approach was used, incorporating both deductive and inductive coding. A general coding template was used first to aggregate and classify the data into key categories (e.g. 'trust', 'formal controls'), organised around theoretical constructs. Inductive coding was used for data classified within each of the key concepts to identify sub-categories. In each type of coding, data was analysed based on recurrence and salience rather than frequency (Blatt et al. 2006).

# 4    CASE STUDY DESCRIPTION

Both case studies involved a large client organisation that provided financial solutions for commercial and personal loans, auto loans and leases, and credit insurance (one of four operating divisions, within a US-based multinational corporation, with 130 million customers). The client outsourced 70% of its IT infrastructure to two different vendors that were selected based on their expertise. In Case 1, the vendor is a large Australian ICT company with expertise in strategy and architecture, and application development (with over 1000 staff and A$115 mln revenue p/a) and it was responsible for midrange application support. In Case 2, the vendor is a large Australian ICT company with expertise in systems development and integration (with over 3000 staff and A$504 mln revenue p/a) and it was responsible for infrastructure support. Both outsourcing projects involved initial tender bidding and subsequent contract renewals. In Case 1, the length of the outsourcing project was 6 years and worth of A$2.5 mln p/a, whereas in Case 2 - 5 years and A$5 mln p/a. Both cases involved the synergistic balance, however it was achieved differently with various combinations of trust and formal controls.

## 4.1    Case 1

In 2004, both parties signed the fixed fee contract on the midrange application work, comprising the 24/7 support of the client's three types of IT systems, i.e. data warehouse, middleware and web applications, provided by the vendor. Along with the contract, both parties also defined service targets and performance measures in the SLA (e.g. standard delivery reports, internal KPIs, VOC-based feedback). The synergistic balance was achieved soon after the contract sign-off, between initial trust-building and greater formal controls focused around the scope of the project. In fact, despite the early team-building efforts and positive information exchange, both parties felt that the project required a closer attention around the project scope. By arranging additional reviews initiated by the vendor to finalise the number of supported applications, both parties amended the contract and implemented service guidelines to add more rigour to prevent further misunderstandings and mitigate any potential conflicts between two parties. This positively influenced the development of the working relationship between two parties and facilitated the growth of client's trust towards the vendor's genuine attitude and commitment to the project.

Later on, when the contract was renewed in 2006, the positive trust-building based on the vendor's strong performance diminished the effect of formal controls. For example, the client's executive talked about the interplay between trust and formal controls by emphasizing the strong performance-based trust towards the vendor:

> "I trust this Vendor around their ability to deliver a good service. We've had a good definition of what they do. We have the right balance, we talk about formal controls every two years when we do the contract. We change them, we do the monthly reviews…that's really around the working processes and trusting relationship." (Support Services Leader)

Further, the synergistic effect between trust and formal controls resulted in strong perceptions of positive outcomes, suggesting that people were satisfied with what they accomplished on both sides:

> "We've got a trusting relationship between us and the client; they know that what we're delivering is good value. We've achieved a good medium between trust and governance." (Service Delivery Manager)

At this stage, formal controls were mainly of the regulating nature to monitor the ongoing progress of the project. Despite the positive outcomes in the service quality and project performance, the vendor voiced some concerns around the operational processes responsible for the handover process between the project team and the client's internal development team:

> "When we're taking over new applications, when working with the team that's developing them…it's better if we could spent time with them earlier so that the transition into support

becomes smoother…That's something that will get better over time but it would be good to have more strict controls around some of the processes we do." (Team Leader, Web applications team)

As a result, the client recognised the need to allocate additional human resources to handle the transition process (including the formation of the change management team), as well as together with the vendor they doubled the support team by allocating people to specifically work on the middleware component (now of total 40 people). Further, both parties described the working relationship as open and positive, and referred to the existing "informal operating rhythm" around project-related communications (e.g. regular feedback meetings, unscheduled catch-ups, tea meetings):

> We're quite frank with each other, it gets rid of all the rubbish. If there's problem we'll talk about it…whether it's painful or not…If we see something wrong, even if it's detrimental to us, we'll raise our hand and say "There's better ways of doing this..." Whereas we could just sit down and quietly just let it happen around us and deliver a service." (Service Delivery Manager)

Such openness and commitment from the vendor side resulted in the growth of client's confidence in vendor's competence, let alone with the growth of mutual trust based on shared understanding and a sense of having a common goal. Subsequently, this resulted even in a stronger effect of the synergistic balance, where despite existing formal controls that both parties abide, they still prefer to work informally based on open communication and knowledge about each other's behaviour (e.g. "Vendor is pretty across three teams in the way they work and we know that", Midrange Support Analyst).

By the time when the contract was renewed for the second time in 2009, both parties acknowledged good quality of service (e.g. "technology stability") and achieved strong relationship quality. With the strong trust based on vendor's performance and gained knowledge about each other's behavioural actions, both parties were able to set balanced negotiations around the contract terms to satisfy each other needs in terms of re-negotiating cost of support (for client) and revisiting scope (for vendor). Neither performance measures were reviewed, nor status delivery reports were modified, suggesting that both parties were happy with the progress of the project and the outsourcing relationship overall.

## 4.2    Case 2

In 2005, the client announced the tender on the infrastructure support work as the result of the previous ad-hoc approach used by the internal team of contractors and the need for a consolidated system that could be supported by the external service provider. The project work was given to the current vendor to ensure availability and reliability of the client's large storage networks and various server platforms. Initially the organisations started operating without a contract due to difficulties in wording the scope given diversity in infrastructure technology components. They started working together based on 'good faith' and with good intentions that led to a verbal agreement about the project scope, service targets and pricing, suggesting initial trust-building between the two parties:

> "We agreed on payment terms, we agreed on the services, but it got down to the level of the wording...For a year we were trying to work out how to write all that up. That's a sign of trust. Now they're moving in the right direction." (Support Services Leader)

In this case the initial type of balance achieved was antithetical. Both parties relied on trust during the first year of operation. At this stage, initial trust-building was largely based on client's growing confidence in vendor's capability to deliver service as per client expectations. While formal controls involved very little documentation around the project (e.g. functional specifications), confused levels of responsibility and communication modes. Despite the apparent absence of project governance, the vendor showed a genuine interest in the project that positively influenced the initial development of the relationship between two parties.

The antithetical balance evolved into the synergistic balance by the time when the contract was first signed in 2006. Along with the contract (based on fixed fee), both parties also formally defined the

SLA documentation and standard formal controls such as performance measures (e.g. status delivery reports, VOC-based feedback), as well as enhanced support documentation and improved rigour around operating procedures:

> "They [Vendor] started to go through this process of sharing knowledge, putting it out on paper…The communication's been improving over time. The reporting has been improving over time, the actual operating rhythm and status reports…" (Infrastructure Support Leader)

It seemed that despite good relationship status and positive knowledge sharing, both parties occasionally had certain misunderstandings with regards to project performance. In particular, occasional disputes over the contract clauses with regards to the delivery of service triggered the client to implement formal controls around project scope (i.e. service catalogue) and project interim assessment (i.e. periodic follow-up reviews) throughout 2007 and 2008. This negatively influenced the growth of trust between the parties. For example, the client's executive highlighted the vendor's attitude in the outsourcing relationship:

> "I like our relationships with this Vendor, it's very open, we talk through issues, they are flexible in how they deal with us…We still have conversations "Should you be doing that?", "Is that in your contract?" and this drives down the trust level." (Support Services Leader)

Both parties were satisfied with the progress of the project following the introduction of formal mechanisms to improve the quality of service.

> "It has improved over time, we are achieving a level of stability that we haven't had before." (Infrastructure Support Leader)

Despite occasional disruptions in service provision, both parties were getting mature on service delivery and continued building an open rapport through regular meetings both formal and informal (e.g. monthly, weekly). However, the synergistic balance remained on the same state between trust and formal controls, where formal controls had a greater presence. Besides, the recent changes in the client and vendor teams (i.e. new project manager in client team and new service delivery manager in vendor team) had brought both teams to restore confidence levels towards each other's actions and focus on building a common goal:

> "If there's no trust - there'll be all sorts of controls: defined, very strict. At the moment, it's not that strict. So I guess there's still that trust there." (Team Leader for Infrastructure Support)

The parties renewed the outsourcing contract at the end of 2008. A good level of relationship quality was achieved, suggesting that both parties were satisfied working with each other and the success was linked to the renewed outsourcing deal.

# 5    DISCUSSION

The study explores the nature of finding the appropriate balance between trust and formal controls in IS outsourcing arrangements. A number of insights related to the synergistic balance are evident from the case studies. Building the framework on trust-controls balance revealed some interesting patterns of interaction, which describe mutually reinforcing and bi-directional impacts between trust-controls nexus and outsourcing outcomes. In particular, theorising trust and formal controls as separate dimensions that contribute to achieving a balance state will eventually establish a certain path towards the outsourcing outcomes (see Figure 2 below). For example, in both case studies, finding the right combination of trust and formal controls prevented the outsourcing arrangements from falling apart through a well-structured SLA (Goo 2008) and implemented formal controls with the assessment and regulating roles (e.g. standard delivery reports, change management team), and thus facilitating the growth of trust and commitment in the relationship development (Goo & Huang 2008). Within the balance (state 1), the dynamics of trust and formal controls enables the success of the collaboration by reducing the level of resistance and bringing harmony to the client-vendor relationship (Das & Teng

1998). Both parties achieved desired outcomes without questioning the motives and competence of each other (Case 1) and accepting controls in relation to outcome measurements and behaviour actions (Case 2).
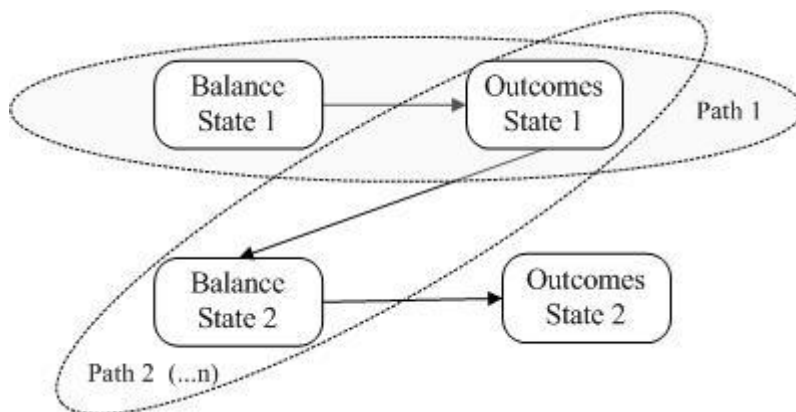


*Figure 2.        Generic sequences of interaction patterns between balance and outcomes*

Also, synergistic balance enables adaptation to changes, either in the outsourcing project or to the organisations involved. It is a flexible type of balance that can work in dynamic contexts, with different interplays between trust and formal controls. For example, in Case 1, a synergistic balance was established between trust and formal controls, reinforced by ongoing good performance of the vendor. In Case 2, additional controls were implemented (e.g. periodic follow-up reviews) to regulate the vendor's performance. In other words, this combination can be referred to the 'comfort zone' between trust and formal controls, or what Long and Sitkin (2006) commonly defined as a "harmonious integration" (p. 46). There is a synergy between trust and formal controls that leads to desirable outcomes for both service quality and relationship development. It is appropriate balance, where trust and formal controls act as complements within the outsourcing relationship (Goo et al. 2009) and with the reinforcing force. If both parties are aware of synergistic balance, they can understand that a decrease in either trust or formal controls can lead to rational actions. In other words, the synergistic balance acts as a survival mechanism against the odds of IS outsourcing, allowing to adapt to the changes in the outsourcing project or behavioural actions of the project teams.

Moreover, it seems that in the case studies, there was a strong relationship between performance-based trust (Sabherwal 1999) and outcome-based controls (Choudhury & Sabherwal 2003). This is consistent with Sabherwal's recommendation (1999) to balance structural controls and trust to improve performance in outsourced IS development projects in light of the observation that excessive focus on either structure or trust may hurt performance. So this study finds that in well-structured outsourcing arrangements, building strong performance-based trust between two parties may reduce the pressure of assessment controls (outcome-based controls) and thereby, the combination of and positive interaction between the two modes (formal controls and trust), can be a powerful mechanism for managing IS outsourcing relationships.

Further, the outcomes (state 1) may also influence the state of the balance (state 2), either by influencing the interactions between trust and formal controls or changing the state of the balance, and thereby, creating a new pattern for interaction (Path 2). For example, in Case 2, the balance has been observed to be a dynamic and emergent concept that can change over time, as the context of the outsourcing relationship changes (e.g. Case 2 when both parties signed the contract and formally defined all the service targets, thereby shifted from antithetical to synergistic balance). However, such transformation may likely to happen at later stages of the outsourcing arrangement, when the situation involved sudden changes in the course of the project (e.g. deterioration in working relationships, change in project requirements), and when the working relationship deepens over time with ever growing sophistication of enacting trust-building strategies (Lim et al. 2011). These dynamic patterns

between the balance and the outcomes resemble the principles of the Newman-Robey social process model (Newman & Robey 1992) that shows the relationship between users (in our case - the client) and developers (in our case – the vendor) to shape the process. So IS outsourcing arrangements progress through time as a series of longer episodes, punctuated by brief (but not necessary present) encounters (Heiskanen et al. 2008). In our case, these episodes mark the dynamic interaction between balance and outcomes, whereas the state of the achieved outcomes may require implementing new initiatives that will transform the operating state of the balance.

Overall, the key contribution of our framework is that it defines the relationship between trust and formal controls as far more complex than it has been indicated by the extant literature (e.g. Goo et al. 2009; Poppo & Zenger 2002). The higher degree of complexity manifests in two ways. First, the relationship between trust and formal controls may change over time, by taking forms of substitution (antithetical balance), complementarity (orthogonal balance) or mutual reinforcing complementarity (synergistic balance). Second, the bi-directional interaction between the formed balance and the outcomes suggests that the time factor is also important since it allows to explore the development of balance and its effects towards achieving interim outcomes first and then to track those changes with regard to the progress made at various stages of the outsourcing arrangement.

# 6    CONCLUSION

The study advances a new lens on the complexity of the relationship between trust and formal controls through the investigation of the balance in two different outsourcing arrangements. The active level of balance achieved within the outsourcing environment dynamically changes between trust and formal controls accumulated by the outsourcing parties. The case study findings have been discussed with the use of the conceptual framework explaining the mutual interaction between the balance and outcomes achieved. It proposes a certain sequence of paths of dynamic interaction between the balance achieved and the outsourcing outcomes. Although only two case studies were presented to explore the behaviour of the synergistic balance, they have revealed a number of insights in relation to the nature of the synergistic balance as being appropriate combination between trust and formal controls, that is capable to tackle with dynamic changes emerged during the outsourcing arrangement.

Also, the study has introduced the concept of balance in IS outsourcing relationships and defined three types of balance. We argue that understanding the type of balance in outsourcing relations and how it evolves over time is significant in achieving success with IS outsourcing. Balance in outsourcing relationships is significant for both practitioners and researchers. For practitioners it provides a useful lens with which to understand and diagnose outsourcing relationships and should prove useful in strategic decision-making by outsourcing managers. For researchers, balance provides a useful new way of explaining outsourcing relationships and outcomes developed over time.

We recognise that this study is subject to limitations, but some of them may be mitigated within our future research. First, we use only two case studies to explore a single type of the balance (synergistic balance). Although we outlined the explanatory purpose of the multiple case study approach, we certainly aim for further replication studies to compare current findings with other studies conducted on the orthogonal and antithetical balances, let alone with use of different industry sectors and increasing number of case participants for stronger generalisation. This research topic can be further pursued with longitudinal case studies that examine the evolution of the balance, with transitions from one type of balance to another. Also, adding granularity to the balance topic by building various portfolios of trust types and types of formal controls will certainly enrich the study.

## Acknowlegements

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