

Outsourcing partnerships – a literature study

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Track: Interorganizational Relations

Abstract. Research on interorganisational relationships is highly fragmented. It can be found in, for example, sociology, economics, anthropology, psychology, marketing, organisational behaviour, strategic management, and entrepreneurship. It is unsurprising that the terminology and units of analysis vary notably, as does the theoretical basis of the research. The forms of interorganisational relationships researched also vary, including among others networking, outsourcing, strategic alliances, joint ventures, and partnering. The focus of this research is on outsourcing partnerships.

Outsourcing and partnering have been researched from many different viewpoints, depending on the domain. However, some common topics of interest can be found. In this paper the current situation in outsourcing partnership research is presented from the information systems point of view. Current research gaps are discussed as well.

1. Introduction

Networking of companies is an important current trend. Companies tend to focus their operations on those competencies that add most value and prefer to network with other companies and buy the services that do not add value. Developing a collaboration strategy has become an important part of the business strategy. It is generally seen that this trend is the result of ever-increasing competition that forces companies to find new ways to be more productive and competitive (Pralahad & Hamel, 1990; Quinn & Hilmer, 1994).

Interest in closer relationships has grown as the need for having a portfolio of relationships has been understood – different kind of relationships are required for different type of needs (Bensaou, 1999). This can be seen in the existing variations in outsourcing relationships. Some of them are nothing more than simple subcontracting or buyer-supplier relationships, which have been common especially earlier. However, as the need for different type of relationships has been noticed, the amount of partnership type outsourcing relationships has grown rapidly. Especially in the software industry partnering has become an extremely important tool to simultaneously both sustain and manage the growth of the company and at the same time (Hoch et al, 2000).

Many of those relationships, at least initially, are based on the need for cost savings but another important reason to enter into a partnering relationship is the possibility to tap into the knowledge of new technologies beyond the firm's boundaries (Alner, 2001; Baldwing et al., 2001; Gupta & Gupta, 1992; Lacity & Hirschheim, 1996; Kakabadse & Kakabadse, 2000). Other reasons include flexibility in allocating human resources, access to new markets, possibility to concentrate on company's core competences, focus on strategic issues, increasing product or service quality, shortened time to-market, transferring fixed costs into variable costs, and enhancing competitive advantage (e.g. Tuten & Urban, 2001; Embleton & Wright, 1998; Kakabadse & Kakabadse, 2000; Gonzalez et al., 2005). However, outsourcing is not only “contracting for skills, assets and resources, but contracting for results, where

the quality of both parties' respective skills and resources is highly important to the final outcome" (Peisch, 1995). Very important difference between partnering type relationships compared to more simple and distant relationships (e.g. subcontracting or buyer-supplier relationships) is that partnering relationships are seen as deep, long-term relationships in which many traditional boundaries between companies are broken (Tuten & Urban, 2001; Kakabadse & Kakabadse, 2000).

For the purpose of my research on software outsourcing partnership process and factors affecting success of the relationship I made a literature search to find out what the current situation in outsourcing partnership research is.

2. Topics of interest in outsourcing and partnering research

Research on interorganizational relationships is highly fragmented. It can be found from, for example, sociology, economics, anthropology, psychology, marketing, organizational behaviour, strategic management, and entrepreneurship (Smith et al., 1995). It's no wonder that terminology and units of analysis vary notably, as well as the theoretical basis of research (Dibbern et al., 2004). The forms of interorganizational relationships researched also vary from e.g. networking, outsourcing, strategic alliances, joint ventures, and partnering. The references used in this literature study come mainly from the fields of the (general) management literature on outsourcing, specifically information systems and information technology outsourcing literature, strategic sourcing literature, strategic partnering literature, and marketing and management research on interorganizational relationships. Both American and European mainstream journals related to these themes have been reviewed.

2.1. Relationship attributes and outsourcing partnership process

Outsourcing and partnering have been researched from many different viewpoints, depending on the domain. However, some common topics of interest can also be found:

Many researchers have wanted to identify what are the **relevant dimensions of interorganizational relationships**, and **develop typologies for the relationships**. This includes classifying the relationships in different ways according to various variables, e.g. "how the exchange parties are connected to another in relation to the value chain", "are the relationships mandatory or voluntary", "do the relationships involve equity investments", how organizationally dependent the exchange parties are, how close or distant the relationships is, etc. (Yli-Renko, 1999). **Variables and motivations to enter an interorganizational relationship** have also attracted some researchers (e.g. Buchowicz, 1991; Buck-Lew, 1992; Dibbern et al., 2004) as well as **scope of the relationship** (e.g. Benko, 1992; Gupta & Gupta, 1992), **performance of the parties** (e.g. Arnett & Jones, 1994; Loh & Venkatraman, 1993), and **an agreement between the parties** (e.g. Fitzgerald & Willcocks, 1994; Richmond & Seidmann, 1992; Warsta, 2001; Barthélemy, 2003).

Especially relationship marketing and strategic purchasing researchers have complemented widely the **relationship implementation, development, and management** research (e.g. Dwyer et al. 1987; Anderson & Narus, 1990; Ellram, 1991; Sheth & Pavatiyar, 1992; Morgan & Hunt, 1994; Ring & Van de Ven, 1994; Ellram & Edis, 1996; Kern & Willcocks, 2000). The question they try to answer is 'what are the elements and activities in a contractual relationship'.

Sourcing strategy selection has attracted many researchers. Origins of it can be found from the "Make or buy? Insource or outsource?" discussion which in manufacturing business has started already on 1950's (Tayles and Drury, 2001) and continued e.g. in information systems outsourcing research till the mid-1990's (e.g. Buchowicz, 1991; Buck-Lew, 1992; Reponen, 1993; Meyer, 1994; Lacity &

Hirschheim, 1995 & 1996). In the recent literature, however, as the economic situation and the world around us have changed, the question has transformed into a more complicated one, “what would be the best sourcing strategy for the situation in case?” This is the viewpoint in the more recent frameworks (Yang & Huang, 2000; Tayles & Drury, 2001; Chiesa et al., 2000; McIvor, 2000; King, 2001). DiRomualdo and Gurbaxani (1998) name three strategic intents that outsourcing is used for in companies: strategic improvement (cost and effort optimization), strategic business impact (improving contribution to companies’ performance, within existing lines of business), and strategic commercial exploitation. Various authors comment that the sourcing strategy should reflect the company’s technology and management strategies (DiRomualdo & Gurbaxani, 1998; Domberger, 1998; Tayles & Drury, 2001; Zhu et al., 2001). In relation to the sourcing strategy, there has been much discussion about what a company should outsource and what not. Especially Prahalad and Hamel’s (1990) work on core competencies and later Quinn and Hilmer’s (1994) ideas of strategic outsourcing have given basis for that discussion. Core competence thinking nowadays is a backbone of technology and outsourcing strategies. It has affected also the ideas of how a company should integrate its knowledge strategies with its outsourcing strategies (Quinn, 1999).

Supplier or partner selection is an unquestionably important step and it’s no wonder it has interested many researchers. Partner selection criteria are closely tied to the relationship type and the goals set for the relationship; the future partner should be able to fulfill the expectations. Selection criteria mentioned include e.g. *strategic fit between companies* (Lasserre, 1984; Ellram, 1990), *technical competences* the supplier has (Lasserre, 1984; Ellram, 1990; Dacin et al., 1997; Levina & Ross, 2003), *financial capability and reliability* of the supplier (Lasserre, 1984; Ellram, 1990; Cavusgil et al., 1995; Dacin et al., 1997; Cavusgil and Evirgen, 1997), and other supplier related criteria such as *motivation, commitment, general reliability* etc. (Lasserre, 1984; Cavusgil et al., 1995; Cavusgil and Evirgen, 1997). The selection criteria can also be divided into four: *business criteria* (e.g. the candidate company’s financial situation), *marketing criteria* (e.g. the marketing capabilities of the company), *partner-potential criteria* (what kind of potential the candidate company has for the intended relationship) and *technical criteria* (the needed technical skills) (Varis, 2004).

Michell and Fitzgerald (1997) present a model for selecting and evaluating suppliers for different kinds of needs. Embleton and Wright (1998) stress the importance of similarities in corporate culture in ensuring the success of the relationship.

Problematics of finding the best suited supplier or partner for the company needs have also been viewed from the selection process point of view by e.g. Snir and Hitt (2002). They maintain that having a two-stage contract where first a piloting phase is conducted and after that the project is either continued or cancelled based on the supplier performance, helps in evaluating if the supplier selection was successful.

The central finding seems to be that supplier or partner selection criteria need to be based on the goals and needs of the relationship. If the customer company has a clear strategy and understands its’ own needs, the supplier or partner selection process has better chances for success.

Information security and the **risks of outsourcing** have typically been studied in connection with information systems and information technology outsourcing (e.g. Earl, 1996; Aubert et al., 1998; Willcocks et al., 1999; Bahli & Rivard, 2003; Khalfan, 2004). An outsourcing contract is seen as an important tool for convincing both parties that security issues have been dealt with sufficiently. The requirements for information security as well as the actions needed in the event of termination of the relationship need to be defined in the contract. (Kajava & Jurvelin, 1998.) Information security issues are listed high among the risks of an outsourcing relationship (e.g. Martinsons, 1993; Khalfan, 2004; Wright, 2004). Other risks listed high include legal consequences (Wright, 2004), compromises in management control, and potential hidden costs (Martinsons, 1993). Bahli and Rivard (2003) present a

framework of four risk dimensions (risk factors, scenarios, their consequences, and risk mitigation mechanisms) to help the analysis of risks related to the relationship.

2.2. Successful relationship

Understanding of what factors affect the success of the relationship is crucial for getting the best out of the collaboration and for avoiding possible difficulties. Answers to the question “**What makes an outsourcing relationship successful?**” have come in different formats. What is common to most of the answers is that they draw data from empiria, by trying to understand and model the real-life cases. Researchers have tried to find the answers by posing other questions like “What partnership success means?”, “What are the reasons behind involving in an outsourcing relationship?”, “What were the factors that caused partnerships to fail?”, “What kind of a process leads into a successful relationship?”, or “How the outsourcing strategy affects the successful outcome of the relationship?” (e.g. Ellram, 1991; Morgan & Hunt, 1994; Mohr & Spekman, 1994; Ellram, 1995; Lee & Kim, 1999; Tuten & Urban, 2001; Lee et al., 2004). The results have been rather unified (Table 1) and it seems that the most successful relationships are based on immaterial things like trust between the parties, communication, and commitment, rather than material, such as good contract or good personnel; even though those are, of course, substantial as well. Immaterial things are often hard to measure and they can also be more easily violated and lost.

However, factors of success are heavily dependent of what is defined as to be an outcome of a successful relationship. Dibbern et al. (2004) have identified from the information systems outsourcing literature three typical outcomes that are used when explaining success of a relationship, i.e. satisfaction, expectations set to the relationship and realization of them, and performance of the partner company. The success factors discussed in the next chapter clearly relate to those.

2.2.1. Factors of success

Importance of *communication* in a successful relationship cannot be emphasized enough (Ellram, 1995). It includes communication between the partners, as well as internal customers, users and all affected parties. It also includes ongoing measurement and communication of the results. (Ellram & Edis, 1996.) Communication can be used as a proactive way to avoid problematic situations – when communication strategies include frequent and accurate communication, information is shared willingly, and visions and goals are developed jointly, it helps in preventing possible future conflicts and in sending the message of trust and esteem (Tuten & Urban, 2001; Ellram, 1995; Mohr & Spekman, 1994). Early communication to the partner of specification changes and new products is one part of good communication strategies as well (Ellram, 1995).

Commitment is one of the factors that are often used to describe a good partnership relationship (Mohr & Spekman, 1994; Ellram, 1995). Commitment means that both of the parties have been committed to the relationship, its needs and requirements, and are ready to do their best to fulfill them. It can be shown in different ways but maybe one of the clearest signals to the other party is willingness to invest in the relationship, be the investment time, knowledge or resources (Kern & Willcocks, 2000).

Other factors mentioned include e.g. *reliability* (Tuten & Urban, 2001), *honesty* (Tuten & Urban, 2001), *fairness* (Tuten & Urban, 2001), *constructive conflict resolution techniques* – e.g. taking the other party’s perspective (Mohr & Spekman, 1994), *interdependence* between partners (Anderson et Narus, 1990; Mohr & Spekman, 1994), *interaction processes* (Ring & Van de Ven, 1994), *similarities across organizational cultures* (Mohr & Spekman, 1994; Embleton and Wright, 1998), *support from top management* in both companies (Ellram, 1995; Zhu et al., 2001), *win-win mentality* (Ellram & Edis,

1996; Tuten & Urban, 2001; Zhu et al., 2001), *synergy between two businesses* (Tuten & Urban, 2001), using a *joint, multi-level relationship management* approach (Zhu et al., 2001)

However, the general agreement is that, to be successful, the whole relationship has to be based on *trust*. Trust is built in different ways and all the above-mentioned factors affect in it. It can be given, based on earlier experiences or references but it also has to be earned. It is not easy to rebuild trust once it has been lost. Increased personal contact, such as regular meetings of the key persons of both companies, helps in creating trust. (Domberger, 1998; Spekman et al., 1999; Dietz, 2004)

Table 1. Factors of success in a relationship

Factors of success	References
Trust	Anderson & Narus, 1990; Mohr & Spekman, 1994; Ellram & Edis, 1996; Domberger, 1998; Spekman et al., 1999; Tuten & Urban, 2001; Dietz, 2004
Communication	Mohr & Spekman, 1994; Ellram, 1995; Ellram & Edis, 1996; Tuten & Urban, 2001
Commitment	Mohr & Spekman, 1994; Ellram, 1995; Kern & Willcocks, 2000
Honesty	Tuten & Urban, 2001
Reliability	Tuten & Urban, 2001
Fairness	Tuten & Urban, 2001
A joint, multi-level relationship management approach	Zhu et al., 2001
Synergy between two businesses	Tuten & Urban, 2001
Win-win mentality	Ellram & Edis, 1996; Tuten & Urban, 2001; Zhu et al., 2001
Support from top management in both companies	Ellram, 1995; Ellram & Edis, 1996; Zhu et al., 2001
Similarities across organizational cultures	Mohr & Spekman, 1994; Embleton & Wright, 1998
Interaction processes	Ring & Van de Ven, 1994
Interdependence between partners	Anderson & Narus, 1990; Mohr & Spekman, 1994
Constructive conflict resolution techniques	Mohr & Spekman, 1994
Economic expectations are met	Ellram, 1995; Tuten & Urban, 2001
Long-term perspective	Ellram & Edis, 1996
Satisfactory performance	Tuten & Urban, 2001

The factors above, as mentioned before, are not always easy to measure, though finding some kind of measuring techniques for them is beneficial. There are, however, ones that can be measured more easily, that is performance indicators of the partner: sales, market share, and profitability, in relation to the original goals and expectations (Ellram, 1995; Tuten & Urban, 2001). These are the other group of indicators that are often mentioned when discussing factors for a successful relationship. If the relationship fulfills the *economic expectations* set to it, it usually is considered successful.

2.2.2. Problems in outsourcing

Why do partnerships fail then? The reasons are, naturally, connected to the factors of success: poor communication, lack of trust, poor up-front planning, lack of shared goals, poor relationship management, and unsatisfactory performance indicators are the failure reasons given by Ellram (1995) and Tuten and Urban (2001). Some other reasons mentioned are changes in the broader network of partners and business reasons of one or both parties (Tähtinen, 2001).

Outsourcing arrangements do not always turn out to be successful (List 1). The outsourcing company may become too dependent on the supplier, it may fail to realise any savings from the outsourcing contract (or the outsourcing arrangement may even cost more than making the things internally), it may lose control over critical functions, the outsourcing relationship may be very problematic, and the morale of permanent employees may lower. Outsourcing can also generate new risks like losing the critical skills or developing the wrong ones, it may cause the loss of cross-functional skills or innovative capacity, and also loss of control over suppliers. Even loss of corporate memory has been reported. (Domberger, 1998; Embleton & Wright, 1998; Kakabadse & Kakabadse, 2000; Lacity & Hirschheim, 1996; Quinn & Hilmer, 1994.)

List 1. Problems in outsourcings from the customer point of view

Problem
Outsourcing contract does not bring savings it was intended to bring
Dependence on supplier – loss of control over supplier
Loss of control over critical function
Problematic relationship
Morale of permanent employees lowers
Losing of critical skills – developing of wrong skills
Loss of cross-functional skills
Loss of innovative capacity
Loss of corporate memory

McIvor (2000) found out in his study of outsourcing that some of the problems companies encounter are caused by not understanding the importance of strategic perspective in outsourcing decisions (List 2). Companies are primarily motivated by short-term cost reductions. However, by integrating outsourcing strategy into the company overall strategy the benefits would probably be much greater (Quinn & Hilmer, 1994; DiRomualdo & Gurbaxani, 1998; Domberger, 1998; Quinn, 1999.)

According to McIvor (2000) other reasons for the problems in making effective outsourcing decisions are lack of a formal outsourcing process within the company, too limited cost analysis, and difficulties with core business definition. The decisions to outsource or not are primarily made on the basis of reducing headcount and costs, rather than assessing what makes most sense business-wise in long-term. Cost analysis techniques in many companies are outdated and may give misleading results when analysing which one is the better alternative – perform internally or outsource. Some companies have problems in defining what their core competencies are and even misuse the term “core”. By defining core competencies to be “those things that we do best” (Lonsdale & Cox, 1997) companies unknowingly relinquish their core competencies by outsourcing them. That may lead to a more competitive product but on the long run the company may notice that the former supplier is a new competitor.

List 2. Reasons behind problems in outsourcing relationships (McIvor, 2000)

Reasons behind the problems

Not understanding the importance of strategic perspective in outsourcing decisions
Lack of a formal outsourcing process within the company
Too limited cost analysis
Difficulties with core business definition

The results are, in a way, rather obvious: successful relationships between companies relate closely to the ones between human beings since human beings are, in the end of the day, the ones who do the work. When both parties know what they expect from each other, when there is commitment, coordination, interdependence and trust in place, problems are solved together, information is shared, quality of the work is valued, and both parties are satisfied with the relationship and its results – then the relationship has the ingredients to be a successful one.

3. Research gaps

Referring to the problems found in outsourcing relationships, several research gaps can be found from the outsourcing research area (Table 2.). Lee et al. (2000) in their paper maintain that it’s time to move on in outsourcing research. They posit that outsourcing partnership and issues around that are the next important research field. Lee et al. (2000) propose five areas of research: partnership motivation (differences between contractual relationship and partnering relationship, drivers behind partnership contracts, benefits and risks, etc.), partnership scope (total or selective, long-term or short-term, service or asset, etc.), partnership performance (evaluating, verifying, and improving the performance, etc.), partnership or not (decision-making frameworks etc.), and partnership contract (process and management issues, contract making, procedures for building and sustaining outsourcing partnership).

Much on the same line are Kakabadse and Kakabadse (2000) when discussing outsourcing. They argue that outsourcing has been considerably explored in relation to the elements of economy, quality, and innovation, and there’s need for better understanding in relation to knowledge transfer, behaviour, business risk, and customer satisfaction.

Dibbern et al. (2004) argue that outsourcing success, its definition and operationalization still need more research as success of a relationship is highly dependent on many variables. Another gap is in the outsourcing relationship analysis: there’s crucial need for the analyses based on both the client’s and

service provider's view. Most of the research in outsourcing field is *either* from client's *or* service provider's point of view. Few researchers have looked the relationship from both viewpoints. (Ellram 1995; Lee et al., 2000; Tuten & Urban, 2001; Dibbern et al., 2004). Service provider's view to the relationship should also be studied more extensively (Dibbern et al., 2004). Using the viewpoint of some other stakeholders as well (e.g. IT and business managers or staff) would provide some new ideas (Dibbern et al., 2004). Also, the outsourcing research is mostly snapshots taken at a given point in time and would benefit from longitudinal studies. This is true with outsourcing process as well, as research of changes in outsourcing arrangements over time is needed (Dibbern et al., 2004). Dibbern et al. (2004) also argue that there is a need for comparative studies of outsourcing, including cross-cultural, cross-functional, and cross-industry comparisons.

Table 2. Summary of the gaps in the outsourcing research

Reference	Research gap
Lee et al., 2000	Partnership motivation; Partnership scope; Partnership performance; Partnership or not; Partnership contract
Kakabadse & Kakabadse, 2000	Knowledge transfer, Behaviour, Business risk, Customer satisfaction
Ellram 1995; Lee et al., 2000; Tuten & Urban, 2001; Dibbern et al, 2004	Research from the viewpoint of both parties
Dibbern et al, 2004	Outsourcing success; Research from the viewpoint of various stakeholders, including service providers; Lack of longitudinal studies; Outsourcing process and changes in the outsourcing arrangements over time; Comparative cross-cultural, cross-functional, and cross-industry research
Willcocks, 1995	Need for more empirical studies
Author's own notice	Lack of software R&D outsourcing partnership research, lack of a comprehensive outsourcing partnership model

Many models found from the literature are theoretical, even though lately the amount of empirical documentation has increased. Willcocks (1995) noted that empirical work is needed in assessing the validity of the conceptual frameworks, and I argue that it is still a valid statement. The combination of both conceptual models and empirical testing of them should give a comprehensive understanding of the outsourcing partnership phenomenon to both researchers and managers who cope with the everyday problems.

Also, most of the models and frameworks focus on a certain phase of the relationship life cycle and only some of them have a broader view of the life cycle as a whole. Software research and development outsourcing or partnering has attracted interest of very few researchers.

4. Conclusion

Even though the amount of outsourcing research is already rather high and is still growing the field of research seems not to be very mature yet. Terminology and units of analysis vary, and very small amount of the research works at building for cumulative tradition (Dibbern et al, 2004). Most of the research seems to be of information systems outsourcing and usually from the customer point of view.

Not very much has been written of the outsourcing process and most of that research focuses on single phases of the process. I argue that, from the process point of view, the big picture is missing. Also, factors affecting the success of the relationship still need more studying. Thus, my research on the software outsourcing partnership process and its success factors seem to be relevant subjects on the field of outsourcing research.

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