RELATIONSHIP GOVERNANCE MECHANISMS OF THE IT OUTSOURCING DEALS: TRANSACTION COST AND RELATIONAL EXCHANGE PERSPECTIVES

Olena Vasylchenko

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ABSTRACT

Relationship Governance Mechanisms of the IT Outsourcing Deals:

Transaction Cost and Relational Exchange Perspectives.

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As companies' budgets devoted to information technology (IT) outsourcing continue to expand, effective IT provider management becomes one of the most critical administrative skills of the 21st century (Heckman, 1999). Yet to this day, there is no agreement among researchers and practitioners with regard to the main research question of this thesis: How IT buyer-supplier relationships should be managed in order to ensure the relationship success?

Adopting an integrative approach to IT outsourcing governance based on both Transaction Cost and Relational Exchange perspectives, a novel IT outsourcing relationship management model is proposed in this thesis with a goal to investigate and explain how formal/contractual and informal/relational governance mechanisms employed by the parties of the IT outsourcing dyads may complement each other in their effect on the overall relationship success. The conceptual model is tested and further developed when applied to five cases of IT outsourcing deals in Canadian insurance and airline industries. The findings not only show support for the integrative approach to IT outsourcing, but also reveal how informal and formal governance mechanisms may complement each other by playing different roles within interorganizational financial, service, and informational exchanges. It appears that in the successful IT outsourcing deals the parties actively practice formal/contractual management of the financial exchanges between them, while resorting to informal/relational governance of interorganizational service exchanges. Well developed both formal and informal information exchanges between organizations seem to be essential to the IT outsourcing relationship success.

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1. Introduction

Efficient information processing is becoming increasingly critical for business success in the Internet age (Ireland, 1999). However, rapid technological advances on many fronts have made it less feasible for firms to internally maintain all the technological expertise they need to compete successfully. To meet this challenge, firms increasingly turn to outsourcing (Heckman, 1999).

Information Technology (IT) outsourcing is the subcontracting of a part or all of the IT function of a company to an external outsourcing vendor. The degree of subcontracting ranges from just one part of IT function (such as equipment maintenance) to the whole sale outsourcing of an entire IT department (Lee, 1996). Data center operations, telecommunications, PC acquisition/maintenance, and system development are all examples of IT functions that can be outsourced individually (McFarlan & Nolan, 1995).

Nowadays, IT represents a significant portion of the outsourcing activity in numerous organizations (Jorgensen, 1996). Moreover, the companies' budgets devoted to the IT outsourcing continue to expand (Heckman, 1999). Among the most advocated advantages of IT outsourcing are cost reduction, service quality improvement, and an increased ability to focus on the "core business" (Quinn & Hilmer, 1994). Yet, many researchers point out that IT outsourcing also may have disadvantages. It may expose firms to the opportunism of vendors and limit their ability to develop valuable competencies (Barthélemy, 2003; Heide & Weiss, 1995; Lonsdale, 2001). Other IT outsourcing risks affecting customers' bottom line are costly contractual amendments, unexpected transition and management costs, fierce resource and time consuming disputes and litigations (Bahli & Rivard, 2003).

For the past few years, IT outsourcing ventures have been termed successful and less successful in achieving their expected objectives. Most of the existing studies of IT outsourcing are inconclusive with respect to the driving factors of such relationship success (Kern & Willcocks, 2000). Such inconclusiveness is greatly due to the fact that IT outsourcing tends to be more complex than most other forms of outsourcing due to several facts: 1) IT is not a homogenous function, but comprises a variety of activities (Kern & Willcocks, 2000); 2) IT capabilities evolve very fast filling the IT outsourcing market with uncertainty (Bahli & Rivard, 2003; Jap & Ganesan, 2000; McFarlan & Nolan, 1995); 3) there are no simple bases of measuring the economics of IT activities and of IT outsourcing (Bahli & Rivard, 2003; McFarlan & Nolan, 1995; Ross & Westerman, 2004); and most importantly, 4) there are high switching costs associated with IT outsourcing decisions (Heide & John, 1990; Heide & Weiss, 1995; Ireland, 1999; Lonsdale, 2001).

Indeed, high switching costs is a commonly stated reason for why the IT outsourcing customers often find themselves in a particularly vulnerable dependency position relative to their suppliers (Ireland, 1999; Lonsdale, 2001). Once a certain IT vendor has been chosen from competitive market through a series of consideration stages and bidding process, IT buyer becomes strongly inclined to choose the same vendor for the next contract. This situation arises due to the high switching costs that buyer incurs as a result of prior commitment (1) to a technology and (2) to a particular vendor (Heide & Weiss, 1995). Information technology market is highly technologically heterogeneous. Technological heterogeneity refers to a lack of a common technological standard. As result of the prior purchases, buyers often have invested in assets that are incompatible with products and services offered by other vendors. For example, computer software is frequently idiosyncratic to a particular system and can not be easily adapted to a new one. Beside technological heterogeneity problems, IT buyers face switching costs due to the specifics of the relationship with existing vendor. Heide and John (1990) point to the commonality of the relationships where buyers have developed routings and procedures for dealing with a specific vendor. For instances, technical support personnel transfers, the training programs for the staff to use the sourced IT systems, or the modification of the structure of organization to fit the software (Heide & John, 1990; Lonsdale, 2001). All of these will need to be modified if a new relationship is established. Thus, while there is still a competitive supply market, both types of switching costs that would be incurrent in finding a new supplier and installing new software are putting buyer in a post-contractual dependency position (Lonsdale, 2001), while creating a disincentive to switch to a new vendor and a motivation to stay in existing relationship to economize on switching costs (Heide & Weiss, 1995). Such customers' dependency, in turn, gives more bargaining power to their suppliers as they realize that their customers are locked-in. Hence, the suppliers may start behaving opportunistically by renegotiating the terms of the contracts during contractual periods, increasing their profit margins, and reducing their performance levels. The outcomes for a customer can be that costs rise, quality falls, or the supplier withholds innovation (Bahli & Rivard, 2003; Lonsdale, 1999).

Unsurprisingly, upon finding themselves in such relationships, IT customers are often extremely dissatisfied with the results of their IT outsourcing deals. According to 700 business-technology professionals in InformationWeek Research's Analyzing the Outsourcers study, thirty percent of IT outsourcing customers say their cost savings fell short of expectations, and 38% complain of unexpected add-on costs after their contracts began (Gareiss & Weston, 2002).

As termination of the unsatisfactory relationship is often not an attractive option, because of the client's locked-in dependency position due to prevalence of switching costs (Heide & Weiss, 1995), there have been numerous calls, in the IT outsourcing literature, for a research that would investigate the efficient ways for the IT buyers to manage their suppliers (Ireland, 1999). In order to maximize the business value of purchased IT products and services and to mitigate supplier's possible opportunistic behaviors, an effective management of the relationship with the vendor is a key to success and becoming a critical component of the information management function (Barthélemy, 2003; Heckman, 1999). Indeed, researchers have identified the effective IT supplier management as one of the most critical IT skills of the 21st century (Heckman, 1999).

Considering the above, this thesis addresses the following primary question which has not yet been answered clearly in the literature:

How should the relationship between IT customers and suppliers be governed in order to ensure the relationship success?

Thus, the general purpose of this study is to investigate and document how the IT outsourcing customers manage their relationships with their IT suppliers in order to ensure the relationship success. The next section will present an overview of the literature concerned with customer-supplier relationships, and identify potential determinants of success of IT outsourcing relationships. It is expected that the initial research question will lead to a number of more detailed questions, which will then be addressed in the study.

2. Existing IT Outsourcing Relationship Approaches

IT outsourcing relationships have already received some attention in the literature (Heckman, 1999; Kern & Willcocks, 2002; Lacity & Willcocks, 2001; McFarlan & Nolan, 1995), yet all of these studies were mostly inconclusive. There has been no agreement among researchers and practitioners with regard to the question: *How should the relationship between IT suppliers and customers be governed in order to ensure the relationship success?* Two opposed perspectives underlying most research into IT outsourcing relationships can be found in the literature. These perspectives are respectively based on two theoretical approaches to contracting: Transaction Cost Theory and Relational Exchange Theory.

Supporters of both perspectives agree that to insure the relationship success parties have to use certain controlling governance mechanisms that either inhibit opportunistic action or promote mutual commitment to the relationship (Stump & Heide, 1996). Control/governance mechanisms are the safeguards that firms put in place to govern interorganizational exchange (Jap & Ganesan, 2000). The necessity of such control mechanisms in the IT outsourcing context arises from the dependency position of IT clients relative to their suppliers, which when combined with high uncertainty of IT markets, exposes clients to the suppliers' potential opportunism and jeopardizes the success of the deals (Heide & Weiss, 1995; Jap & Ganesan, 2000; McFarlan & Nolan, 1995). The control mechanisms can be influenced by both parties and often are mutually negotiated. In the IT outsourcing industry, two types of the control mechanisms are available to the parties that can influence the relationship outcomes: (1) formal/contractual mechanisms and (2) informal/relational mechanisms. The Transaction Cost and Relational Exchange perspectives further differ with regard to which of these control mechanisms are the most successful in safeguarding the interests of the parties and ensuring the relationship success.

2.1. Transaction Cost Theory

The proponents of Transaction Cost Theory (TCT) argue in favor of formal relationship governance based on the development and enforcement of short-term explicit contracts. This position is focusing mainly on the preclusion of the partners' opportunistic behaviors. It argues that the process of supplier management requires discipline, structure, and formalization, and that successful buyer-seller relationships are based on arm's length, rigorously negotiated contractual understandings. Thus, the short-term explicit contracts are the best option buyers have in order to manage their suppliers.

The general problem addressed in TCT is how to conduct exchange between parties that possess only partially overlapping goals (Stump & Heide, 1996). The theory suggests that parties may act opportunistically if given the chance. In the IT outsourcing setting, opportunism poses a transaction hazard for the customer to the extent that a relationship is supported by high switching cots and by informational asymmetry (Stump & Heide, 1996). Therefore, TCT views relationship management as a problem of deploying control mechanisms to manage partner opportunism, with the overall goal of minimizing governance cost (Stump & Heide, 1996). Short-term explicit contracts are viewed, under this perspective, as the most effective relationship governance mechanism for several reasons. First of all, they reduce uncertainty about behaviors and outcomes by providing formal rules and procedures to govern the relationship (Lusch & Brown, 1996). A poorly written contract leads to many misunderstandings and major disruptions during the life of the contract and may result in many costly rewrites of the contract (Jorgensen, 1996). Second, a lack of contractual detail enables a party to exploit loopholes either passively, by evading informally stated obligations, or actively, by engaging in behaviors that unilaterally improve the party's terms of trade (Wathne & Heide, 2000). On the other hand, facing the legal and economic consequences of violating explicit written contracts, IT suppliers can be expected to behave less opportunistically. Finally, shorter rather than longer term outsourcing contracts are preferable in order to ensure the flexibility of the relationships and their adjustment to the swiftly changing IT environment. The study by Lacity et al. (1995) published in *Harvard Business Review* shows that the average total outsourcing contract, among respondents, was for 8.6 years; yet by the third year, most companies complained that the technology provided by supplier was already outdated. In their subsequent study, Lacity and Willcocks (1996) found that customers' expectations were satisfied in 89 percent of short-term explicit IT outsourcing deals while customers were disappointed in 60 percent of long-term relationships. Since IT outsourcing vendors do not share the same profit motives as their outsourcing customers, a short-term explicit contract is often the only mechanism to ensure that expectations of the outsourcing customer are met (Lee, 1996).

Many researchers insist that a well developed contract greatly influences the resulting quality of a relationship (Fitzgerald & Willcocks, 1994; Lacity & Hirschheim, 1993). A good explicit contract and integrated Service Level Agreements (SLAs) specify in detail the exchanges of services and/or products, financial matters, service enforcement and monitoring methods, communication and/or information exchanges, and key personnel and dispute resolution procedures (Halvey & Murphy, 1996). The literature suggests that a good contract must be precise, complete and well balanced between parties (Barthélemy, 2003). Preciseness of the contract shows in clearly specified service costs and performance measurements (Saunders et al., 1997). Completeness of the contract refers to the definition in extensive detail of the services to be provided by outsourcer (Parkhe, 1993).

A well balanced contract should also prescribe substantial penalties for non-compliance as well as rewards for exceptional efforts (Jorgensen, 1996). Moreover, it will include, when needed, detailed "reversibility", "benchmarking", and "risk and reward" clauses (Barthélemy, 2003). Reversibility clauses are necessary when specific human and material assets have been transferred to a vendor as a part of IT outsourcing deal. Only reversibility clauses can guarantee that IT outsourcing clients will keep some control over their specific assets and will get them beck in case relationship dissolution (Barthélemy, 2003). Benchmarking clauses provide an efficient way of evaluating IT vendors. Benchmarking consists of comparing the services and prices offered by a vendor to the similar types of services and their pricings offered by other vendors on the IT market (Aubert et al., 2004). IT outsourcing clients often refer to external consulting companies specializing in benchmarking, which possess large data bases that allow comparing a certain vendor to the rest of the industry. Benchmarking helps to find out whether the services delivered by a vendor are similar to those generally offered by the industry and to determine the areas that could be improved. For instance, if the price asked by a vendor is much higher than the average price in the industry, a client can be entitled to negotiate a better price. Risk/reward clauses are especially effective for high-risk projects with significant business benefits, such as application development projects (Feeny et al., 2003). Because these contracts withhold a significant percentage of the fees until the project is successfully completed, they distribute risk, provide benefits to both sides and align a company's interests with those of its supplier. Under risk/reward clauses, suppliers risk reduced profits if they fail to deliver but are rewarded for superior performance. Therefore, most suppliers undertake risk/reward projects only if they are confident they can succeed.

Thus, parties in formally/ contractually governed IT outsourcing deals will adhere to the rules and procedures spelled out in the outsourcing contract with regard to financial matters, service enforcement and monitoring methods, communication and/or information exchanges, and key personnel and dispute resolution.

2.2. Relational Exchange Theory

The proponents of Relational Exchange Theory (RET) perspective point out that TCT has failed to recognize that economic transactions are frequently imbedded in social relationships that mitigate the risk of opportunism (Macneil, 1980; Wathne & Heide, 2000). Meanwhile many researchers agree with regard to the importance of relationships arising during post-contract management phase to the success of such ventures (Kern & Willcocks, 2000). RET explicitly views the relationships, in which transactions are imbedded, as endogenous safeguards against opportunism (Joshi & Stump, 1999). As Larson (1992) notes, the relational context itself acts as a "moral control" to diminish opportunism in exchange dyads. According to this view, IT buyer-seller relationships are more effective when based on less formal notions such as commitment, trust, and partnership (Heckman, 1999). This type of relationships is expected to produce better marketplace result for both buyers and sellers. It is subsequently expected that operating performance will be improved for both (Heckman, 1999).

Relational exchange supporters maintain that in the swiftly changing conditions of IT industry, complex and tight explicit contracts make the relationship between IT client and supplier dangerously inflexible. Meanwhile, a growing number of the information technology executives agree that, in IT outsourcing, flexibility is the key (Gareiss & Weston, 2002). The lack of such flexibility often creates obstacles for suppliers to reach optimal outcomes, thereby reducing their commitment to relationship (Jap & Ganesan, 2000). Because the complexity of any large IT outsourcing arrangement makes it extremely difficult to specify in advance all possible future contingencies, both customer and supplier are best served when they enter into such relationship expecting to live by the spirit rather than the letter of the contract (Heckman, 1999; McFarlan & Nolan, 1995). The proponents of RET argue in favor of general clause IT outsourcing contracts, also called "gentleman's agreements", where the parties trust each other to adapt to changing circumstances through informal relational techniques (Lonsdale, 2001). In support of the latter view, Heckman (1999), in his survey of IT supplier management practices of 518 large corporations, found that most companies surveyed continue to manage their relationships in a relatively informal way. For instance, only 18% of organizations surveyed used a formal measurement system to evaluate the performance of their current IT suppliers, and dissatisfied customers were more likely to use informal rather than formal methods of communicating their dissatisfaction. Moreover, practitioners admit that, while Service Level Agreements may be useful for ensuring that suppliers meet targets, they fail to address the less tangible issue of value-added benefit from outsourcing. Currie (2000) points out that the suppliers' ability to meet SLAs has deflected attention from the wider issue, namely, the extant to which the supplier can offer a client a competitive differentiation in the market place.

Another down side of short-term explicit contracts is in that they may signal to IT supplier the low level of trust on the part of customer, which can result in lower levels of reciprocal loyalty. Indeed, IT industry reports show that the invoking by customers of the terms of service-level agreements "puts a strain on the relationship" (Gareiss & Weston, 2002). Also, the IT outsourcing providers are typically concerned about their customers having access to the system configuration parameters, which is often stipulated in such contracts, because they feel these settings represent a trade secret and competitive advantage (Jorgensen, 1996).

Researchers supporting informal/relational governance mechanisms admit that IT customers and suppliers will always have differing economic objectives, yet writing detailed contracts can not prevent outsourcers from behaving opportunistically if circumstances fall out of spelled out contractual rules, which often happens in IT industry. However, shared approaches to problem solving, strong interpersonal trust, and managing the relationship less as a contract and more as a strategic alliance are considered by many to be critical determinants of long-term IT outsourcing success (McFarlan & Nolan, 1995). Indeed, there is a current trend in the IT literature which shows that many IT service providers as well as customers are seeking longer-term relationships with their partners (Currie, 2000; Gareiss & Weston, 2002).

2.3. Integrative Approach to IT Outsourcing Management

Recently, some researchers pointed out that both described above perspectives yield inconclusive results when applied separately to the IT outsourcing context. Such inconclusiveness is attributed to failure of either of these approaches to capture all of the specifics of the IT outsourcing environment, which tends to be more complex than some other standard buyer-supplier relationships (Kern & Willcocks, 2002; Klepper, 1995). In particular, the IT outsourcing context is characterized by combination of high switching costs and high market uncertainty. Klepper (1995) conceded that in the future an effort should be made to combine both perspectives to obtain a better understanding of the mechanisms by which IT outsourcing relationships are managed. Meanwhile, researchers elsewhere have already found support for integrative - "plural governance" approach to buyer-supplier relationship management under described above conditions (Cannon, Achrol, & Gundlach, 2000). Following Klepper's advice (1995), Kern (2002) maid initial attempts to incorporate both TCT and RET elements in order to map the exchanges between IT outsourcing parties. He admits that the contract cannot dictate the specific exchanges to be made for a long term into the future, since it lacks the flexibility needed to deal with volatile IT market conditions. Although contract is fundamental for an outsourcing relationship, "it is neither self-enforcing nor self-adjusting" (Goldberg, 1980).

At this point, the RET comes to play, since its core concept is the longitudinal exchange relation between two specific actors (Kern, 2002). Relational governance becomes a necessary complement to the adaptive limits of contracts by promoting both sides' satisfaction with the relationship through fostering continuance and bilateralism when change and conflict arise (Macneil, 1978). In this context, satisfaction with a relationship can be defined as "a positive affective state resulting from the appraisal of all aspects of a firm's working relationship with another firm" (Anderson & Narus, 1990). The satisfaction with the outsourcing relationship comes with the achievement of the client's expectations. The expectations are partly defined by the service level agreements, the contract, and the client's initial outsourcing strategy terms. Yet, the expectations will also depend on how the vendor reacts and responds to demands and changes made by the client. Satisfaction with the outcomes increases the vendor's trustworthiness over time and determines the overall successfulness of the relationship (Kern, 2002). In support of this view, Kern (2002) found that in many cases, although SLAs were met by vendors, this did not ensure the clients' satisfaction with the relationships. In fact, to attain customer satisfaction, vendors needed to show more understanding of their business and more commitment as well as initiate investments beyond the terms stipulated in the agreement. Kern (2002) concludes that outsourcing success 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. In the later view, a "good relationship" between the parties seems to become not only the means to ensure IT outsourcing success, but also a part of the definition of relationship success itself.

Through the survey of 285 top IS executives, Poppo and Zenger (2002) have also found that explicit contracts and relational governance function not as substitutes but as complements in explaining customer satisfaction with IT outsourcing relationship exchange performance. Moreover, the authors attribute such complementarities to the suggestion that contractual and relational governance have different antecedents within IT outsourcing context. IT outsourcing customers may sign up for explicit contracts in order to protect their specific assets, and thus to lower their switching costs; while they may use relational governance to make sure that the relationship will adjust to the high technological uncertainties existing in IT markets.

Barthélemy (2003) has found as well the support for simultaneous use of contract and relational techniques in the IT outsourcing relationships. In his sample of 50 organizations, those that were managing their IT outsourcing deals through both the “hard” (contractual) and the “soft” (relational) sides expressed the highest overall satisfaction as opposed to those using only one or neither of them. In other words, good contract coupled with good relationship seemed to lead to IT outsourcing success.

Although these recent studies revealed the advantages of simultaneous use of contractual and relational approaches to IT outsourcing, they did not document and explain how exactly the formal and the informal relationship governance mechanisms may complement/interplay with each other and in what combination they may be used by the parties to ensure the client's satisfaction and the relationship success. In fact, Barthélemy (2003) used measures of preciseness, completeness and balance of the IT outsourcing contract in order to operationalized the construct of managing the relationship by "hard side". However as it was pointed out earlier the contract is neither self-enforcing nor self-adjusting (Goldberg, 1980). Thus, Barthélemy's measure of hard side of the IT outsourcing relationship fails to capture whether both parties actually comply with contractual terms or are guided by them in their day-to-day exchanges or for dispute resolutions. To correct such measurement oversight and to better capture both processes of managing the relationship by hard and soft sides, the empirical research needs to get closer to the everyday reality of interorganizational governance in the IT outsourcing dyads. A contract usually specifies in detail the exchanges of services and/or products, financial matters, service enforcement and monitoring methods, communication and/or information exchanges, and key personnel and dispute resolution procedures. If the IT outsourcing parties choose to deviate from such formally prescribed behaviors towards more informal techniques, in which area of their relationship would it occur? Neither of the existing studies gives an answer to this question. This leaves practitioners with little to draw on when attempting to follow the latest academic advice. They would have to find the right combination of contractual and relational governance through trial and error. Thus, more empirical exploratory research is needed to investigate a possible interplay of contractual and relational approaches in the IT outsourcing dyads and its effect on the success of such relationships.

The primary research question of this thesis is: *How should the relationship between IT suppliers and customers be governed in order to ensure the relationship success?* In light of the empirical studies reviewed above and in order to address some of their weaknesses, it seems logical to use the integrative approach as a basis for launching an exploratory investigation into client-supplier relationship in IT outsourcing. Therefore, this research focuses on dyadic relationship context and complementary use of formal and informal relationship governance mechanisms by the parties in their attempt to ensure the relationship success. This study attempts to answer the main research question though addressing four more specific research questions:

1. Do IT outsourcing parties manage their relationship by formal/contractual governance mechanisms?
2. Do IT outsourcing parties rely on informal/relational governance mechanisms?
3. How can formal and informal relationship governance complement each other?
4. Does complementary use of formal and informal relationship governance mechanisms lead to the IT outsourcing relationship success?

The next section presents a theoretical model that integrates the notions of relational exchange and transaction cost theories in order to explain the properties of an IT outsourcing relationship and to find the answers to the four specific research questions formulated above. In the following sections, through a field study investigating specific IT outsourcing deals and incorporating opinions and views of both IT supplying and buying parties, this research will allow to shed some light on how exactly different contractual and relational governance mechanisms may be used in order to ensure the success of the IT outsourcing deals.

3. Building an Integrative Model of IT Outsourcing Relationship

Informed by the integrative approach as a guiding framework, the goal of this research is to seek answers to the four specific questions formulated above. Therefore, an integrative relationship success model is proposed that incorporates both formal/contractual and informal/relational governance as factors of the success of the IT outsourcing deals. The model also includes some major contextual variables that have been found by other researchers as influencing significantly the nature of the relationship arising between the parties in the IT outsourcing context. The model is illustrated in Figure 1 and described below. This integrative model served as a basis for launching an explorative study into IT outsourcing relationships, and it was modified and extended as the research progressed. Initially however, the model was comprised of three types of constructs of the client-supplier IT outsourcing relationship:

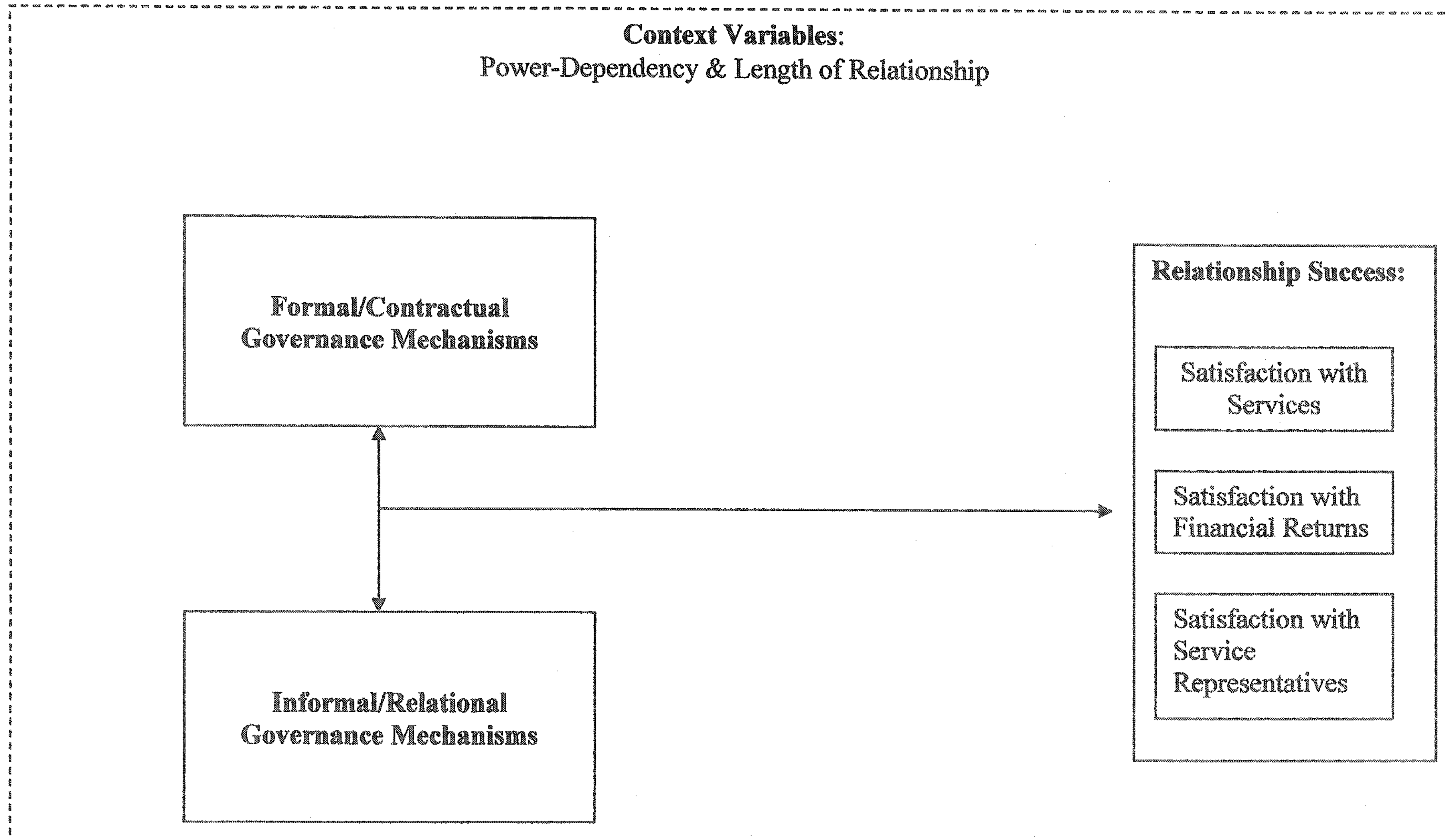

Figure 1. The Integrative Model of IT Outsourcing Relationship Governance

- Construct of Relationship Success as a critical outcome of the model.
- Constructs of Formal and Informal governance mechanisms that can be influenced and employed by both parties in order to attain relationship success.
- Contextual factors: power-dependency situation and length of the relationship, which may influence the nature of interplay between the formal and informal governance constructs of the model.

The following subsections will further explain and develop each of these theoretical constructs.

3.1. Relationship success

The IT outsourcing literature generally defines the relationship success construct through the level of clients' satisfaction with achievement of their different IT outsourcing expectations. The initial expectations differ from client to client and are partly defined by the service level agreements, the contract, and the client's initial outsourcing strategy terms (Kern, 2002). The examples of such expectations are IT cost reduction, improved service quality, access to better competencies, reduction of the risk of technological obsolescence, and reallocation of resources to the "core business" (Barthélemy, 2003). Moreover, since constantly changing IT outsourcing environment demands continuous readjustment of the clients' initial outsourcing strategies, the clients' expectations will also depend on how the vendor reacts and responds to demands and changes made by the client (Kern, 2002). Indeed, satisfaction can be defined as "a positive affective state resulting from the appraisal of all aspects of a firm's working relationship with another firm" (Anderson & Narus, 1990).

Recent IT industry analysis (Gareiss & Weston, 2002) shows that IT customers want their supplier to be reliable and trustworthy, technically skilled, and able to save them money. These findings show support for the adoption in the present research of the three-dimensional definition of satisfaction proposed by Jap and Ganesan (2000). They view satisfaction as a higher-order factor consisting of three composites: satisfaction with financial returns, products/services, and sales representatives. Satisfaction with financial returns will come about when a client has achieved its financial expectations; these may be lower IT operational cots, reallocation of resources to the "core businesses", lower capital investment costs, and conversion of fixed cost to variable. Satisfaction with products/services comes from achievement of client's service delivery expectations such as improved service quality, timely access to skilled resources, and reduction of the risk of technological obsolescence. Last but not least component is satisfaction with service representatives. It arises from the trustful and flexible relationships the representatives of both parties are bale to build as relationship unfolds in time. The satisfaction with service representatives will come as clients and suppliers establish good communication channels, as they show mutual flexibility in adjusting to changing IT environment, and as suppliers show commitment and understanding of clients' business objectives.

Researchers agree that customer satisfaction and therefore overall relationship success depend greatly on the different relationship governance mechanisms employed by the parties, which are aimed at either mitigating partners' opportunistic behaviors or promoting mutual commitment and trust (Heide, J.B. & John, G., 1990; Jap, S.D. & Ganesan, S., 2000; Joshi, A.W. & Stump, R.L., 1999). Therefore, it is important to include governance mechanisms as major relationship success factors of the integrative IT outsourcing relationship model.

3.2. Governance Mechanisms

Following the integrative approach, it is proposed that parties in the IT outsourcing dyads will use both formal/contractual and informal/relational governance mechanisms in order to ensure the success of the relationship. These governance mechanisms can be influenced and mutually negotiated by both parties.

Formal/contractual governance mechanisms are based on precise, complete and well balanced contracts and manifest themselves in the adherence by both parties to the contractually prescribed behaviors with regard to various exchanges between them. The supporters of integrative approach insist on the importance of well negotiated contracts to the success of the IT outsourcing deals as they lay out a foundation of such relationship (Barthélemy, 2003; Kern & Willcocks, 2002). However, these studies did not differentiate between contract itself and actual behaviors of the parties aimed at enforcing the contractual terms. Careful contract enforcement would entail monitoring of service delivery, payments, and implementation of other contract requirements as well as regular revisiting of the contract for updates (Lacity, 2000). Researchers studying other service industries have, in fact, defined the contractual governance construct as the degree of the parties' reliance on the implementation of the formal contract in established service exchanges (Ferguson, Paulin, & Bergeron, 2004). To address such conceptual oversight of the IT research, this study not only assesses the explicitness of the formal IT outsourcing agreements, but also looks into whether IT clients and suppliers indeed rely on the contractually prescribed behaviors in their day-to-day management of the relationships.

Informal/relational governance mechanisms are also used by the parties as they strive for the relationship success. The informal relationship governance arises from the trust embedded in relationships between people on both sides and will aim at promoting flexibility of the relationship, which is so important in the IT outsourcing environment and which cannot be sustained through explicit and rigid contractual terms (McFarlan & Nolan, 1995; Poppo & Zenger, 2002). These informal/relational governance mechanisms will be manifested in positive relationship-building actions by both parties which go beyond contractual requirements (Heckman, 1999) and even against them in the instances where contractual mechanisms are deemed ineffective.

This research endeavored to explore whether indeed the IT outsourcing parties rely simultaneously on both formal and informal governance mechanisms in their day-to-day management of the IT outsourcing deals and whether this governance strategy ultimately leads to the relationship success. Moreover, it was important to investigate how exactly these two seemingly opposite relationship governance mechanisms may complement each other in their effect on the overall relationship success.

3.3. Context Variables

The IT outsourcing management process and complementary nature of contractual and relational governance mechanisms cannot be analyzed in isolation from interorganizational environment. The IT outsourcing literature views the following aspects of interorganizational environment are particularly relevant:

- Power-dependency situation
- Length of the relationship

The IT outsourcing literature insists that the power-dependency imbalance is inherent to the IT outsourcing dyads. The IT outsourcing clients often find themselves in a vulnerable dependency position relative to their suppliers due to significant switching costs and existing informational asymmetries in favor of the latter. Such dependency position locks the client into the relationship and gives more power to its supplier, which in turn opens the client to opportunistic behaviors of the part of supplier. Indeed, the power-dependency imbalance is viewed by researchers as a major reason for the clients to employ formal and informal governance mechanisms in order to mitigate the suppliers' opportunistic behaviors and promote their commitment to the relationship. The clients' ultimate goal of using relationship governance mechanism is to correct the power-dependency imbalance by gaining more control over interorganizational exchanges. Control can be explained as the ability to get what clients want done, when clients want it done, for an agreed price, and with possibility to change their mind at a later stage (Kern & Willcocks, 2002). Given the above, it is important to include the power-dependency construct as a major contextual variable of the integrative IT outsourcing relationship model.

Some researchers also point out that the length of the relationship between the parties may have a direct bearing on their choice of using formal or informal governance mechanisms to manage day-to-day interorganizational exchanges (Heide & John, 1990; Jap & Ganesan, 2000). The IT outsourcing parties often start their relationships by negotiating the contractual terms that would manage the interorganizational exchanges between them. Thus, parties may start by managing their initial exchanges through formal/contractual governance mechanisms. However, as the relationship unfolds and both parties experience higher levels of trust towards each other, they may start deviating from contractually prescribed behaviors and resort to more informal management (Poppo & Zenger, 2002). Considering the above, it seems important to include the relationship length as a contextual variable in the integrative IT relationship governance model.

Overall, the described above conceptual model has a potential of furthering our understanding of the complex processes of managing IT outsourcing deals. By incorporating both TCT and RET perspectives, it brings attention to the complementary nature of formal and informal relationship governance mechanisms as they may be employed by both parties in order to ensure their relationship success. It should be noticed however that the present model provides theoretical answers only to three out of four research question. The third question: "*How can formal and informal relationship governance complement or interplay with each other*?" has not been yet addressed by researchers at all. Therefore, this study will pay especially close attention to the specifics of a possible complementary nature of formal and informal governance within the IT outsourcing dyads.

The following sections of this thesis present explorative qualitative study of several IT outsourcing deals that was conducted in order to verify whether the developed here integrative model reflects the reality of relationship management in the IT outsourcing environment.

4. First Stage of the Research

4.1. Methodology

The present research was carried out following multiple case study strategy advocated by Yin (1994). Consequently, five case studies of the IT outsourcing deals were conducted during two major research stages. The diagram illustrating the order of methodological steps is presented in Figure 2. The first research stage consisted of two case studies of the client-supplier IT outsourcing dyads in the insurance industry. This stage allowed for initial validation and further development of the integrative IT outsourcing relationship model. The second stage of the research was conducted with an aim to address the issue of external validity of the revisited theoretical model and to find some additional support or challenge the findings of the initial case studies. This stage included three case studies of the IT outsourcing dyads in the airline industry.

Case study research is increasingly gaining acceptance as one of the leading research approaches in the information technology field (Dubé & Paré, 2003). Case study research strategy is particularly appropriate for studying IT outsourcing phenomenon for several reasons. First, by documenting present-day IT experiences, case research allows academia to keep up with the rapid changes occurring in the IT world as well as in organizations. Second, highly flexible and multifaceted case research methodology is especially useful for trying to understand the complex and ubiquitous interactions among organizations, technologies and people. Finally, in-depth case investigations have a great potential to spur new ideas and new lines of reasoning that address limitations and challenges of the existing academic views and IT outsourcing practices (Dupé & Paré, 2003).

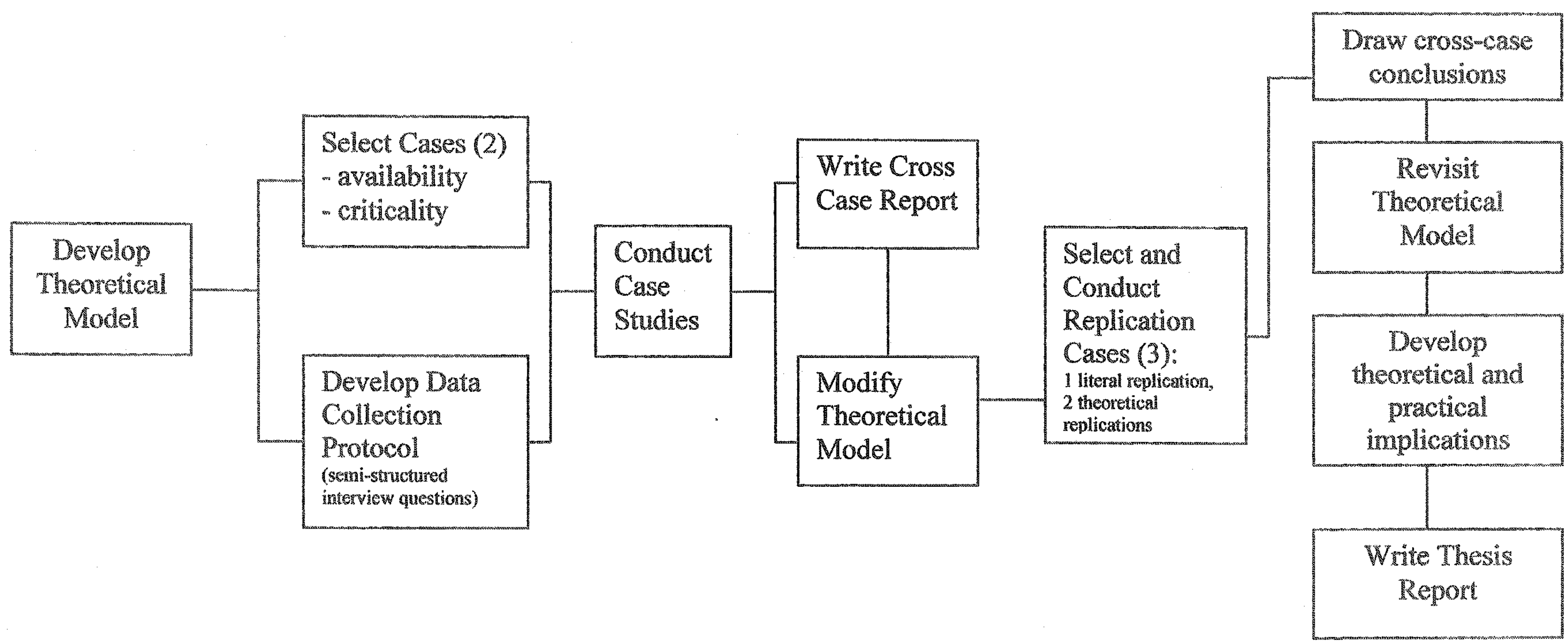

Figure 2. The Multiple Case Study Research Structure

Adapted from Yin (1994).

Given the above and taking into consideration the explanatory nature of the main research question: "*How should the relationship between IT suppliers and customers be governed in order to ensure the relationship success?*", the case study research strategy is the most appropriate for undertaking the investigation into management issues of the IT outsourcing deals (Yin, 1994). Subsequently, the goal undertaken in this case study was to test the developed above integrative IT outsourcing relationship model, to highlight the constructs of contractual and relational governance mechanisms and to show their operation and possible complementarity/interplay in an ongoing social context. The quantitative survey methodology employed by previous researcher (Barthélemy, 2003) did not capture the dynamics and nuances of interplay between the constructs under investigation. By looking deeper into the context and structure of the behaviors unfolding in the IT outsourcing dyads, the multiple case studies approach employed in this research was able to provide a richer description of the constructs as well as interactions between them. The advantage of multiple case study strategy as opposed to a single-case study is that is allows for comparisons across interorganizational contexts (Eisenhardt, 1989). The replication logic of the multiple case studies permitted better development of the initial theoretical model, and provided some preliminary evidence with regard to generalizability of the findings.

Since the relationship success is the ultimate result of managerial efforts and interactions of both parties to a relationship, an IT outsourcing dyad was chosen as a unit of analysis in this research. Besides, qualitative data collection method of multiple respondents covering the perspectives of both parties seemed the most appropriate for exploring relationship practice in IT outsourcing (Kern & Willcock, 2000) because the understanding of the relationship depends on the "knowledge of reality as socially constructed by the individual human actors" (Walsham, 1995). The differing and multiple perspectives provided a rich picture in this otherwise often "messy and iterative process" (Parkhe, 1993).

4.2. Case study sample & Data collection

During the first stage of the research, ten participants were interviewed, including IT directors, contract managers and technical support managers, in the client and its two IT supplier organizations in the early months of 2004. Client A is a Canadian company from the insurance sector, which is very IT intensive. A company from Canadian insurance sector was chosen for the initial case studies for a few reasons. First, a preliminary investigation into prevalence of the IT outsourcing practice identified insurance industry as one of the very IT intensive sectors. Second, case studies were selected on the bases of availability. Finally, the introductory interview with the client's IT director revealed that the company is currently involved in the two successful IT outsourcing relationships, which represent a critical research setting since the goal of the study is to identify the relationship governance of the successful IT outsourcing deals.

From the beginning, it seemed very important to give a closer look to the current economic and IT trends in the insurance sector as the research context might have a direct bearing on the nature and the outcomes of the interorganizational relations within it (Dubé & Paré, 2003). The annual review and outlook on insurance markets, released by Swiss Re (Dec. 2004), indicates that during 2004, the life and non-life industry continued to recover from the difficulties of recent years provoked by the stock market downturn in 2001. The insurers are expected to maintain their return to profitability in 2005 and through 2006. Consequently, the industry's IT spending is expected to increase in 2005 (Forrester Research, Sep. 2004). At the same time, the insurers are shifting from a pure cost-cut mode to a model that emphasizes agility and efficiency. They are removing fixed costs in favor of variable costs. One way to cut fixed costs is to outsource jobs. It is expected that enterprises will decrease their spending on in-house IT labor while outsourcing infrastructure and applications maintenance activities. A renewed interest for IT outsourcing is a recent trend in the insurance industry which has typically deemed IT outsourcing a bit too risky, given that its job is to quantify risk and provide as much financial security as possible for its customers. However, fiercer competition, rapidly evolving technology, deregulation and the resultant spawning of more innovative insurance products, terrorism, and a volatile economic landscape all demand IT business solutions that surpass the capabilities of in-house staff (Outsourcing Journal, Jan. 2003).

The new strict reporting and auditing requirements related to the 2002 Sarbanes-Oxley Act (SOX) is another important factor that increased the IT intensiveness of the insurance sector. The Sarbanes-Oxley Act is the response by the U.S. Congress to a number of major corporate and accounting scandals. The law, which affects all publicly traded companies in the U.S., is intended to improve corporate responsibility, increase public disclosure, improve the quality and transparency of financial reporting and auditing, and strengthen penalties for securities fraud and other violations. The impact of this legislation is spilling over into the Canadian environment as the bar for higher financial reporting standards is raised on a global level. (Price water House Coopers, Insurance Review, Mar. 2003). The insurance industry executives are still coming to grips with the full ramifications of this measure and with possible technological solutions that will keep them in compliance. At present, many insurers recognize the need to upgrade their back-end systems, consider enterprise resource planning tools as well as performance management software which provide financial modeling, budgeting and consolidated reporting across organization (Insurance NetworkingNews, Dec. 8, 2004). Moreover, the companies are now trying to rationalize the technology, consolidate processes and create a standard. From IT perspective, insurers are focusing on integrated financial solutions from single vendors (Insurance &Technology, Sep. 2004).

Another important driver of the trend towards IT outsourcing is the growth of e-insurance (Outsourcing Journal, Jan. 2003). Web-based distribution of insurance products places a heavy burden on IT departments. With the rapid evolution of technology, the pressure on in-house IT personnel to keep certifications up to date becomes excessively high. Therefore, IT outsourcing becomes an obvious solution for insurance companies who want to maintain a competitive advantage. Moreover, outsourcing helps insurance companies add new lines of business quickly (Insurance &Technology, Sep. 2004) and compete with grooving in numbers virtual insurance companies (Outsourcing Journal, Jan. 2003).

Given all of the above, today's business climate projects a robust future for those insurance companies who recognize the benefits and cost effectiveness of outsourcing IT functions to an outside supplier (Insurance & Technology, Sep. 2004; Outsourcing Journal, Jan. 2003). Overall, the reality of today's insurance industry is that the companies have to outsource to remain competitive. As a result, the question of effective IT supplier management is very crucial in this industry context. Therefore, the IT outsourcing dyads in Canadian insurance sector represent a good research setting for studying the issues of IT outsourcing relationship governance.

Consequently, two major IT outsourcing projects undertaken by Client A with different vendors became the focus of the study. The first project concerned outsourcing data center operations and support, the second – telecommunication function. Both IT outsourcing vendors of the client are large reputable Canadian IT Consulting and Telecommunication companies. Tables 1 and 2 present an overview of the client and supplier organizations interviewed, which were disguised to respect their request for confidentiality.

Client A organization is very large in terms of size, structure and turnover. It is the sixth largest life and health insurance company in Canada. It insures over 1.5 million Canadians, employs more than 2,000 people and manages over $17 billion in assets. This likely to have a significant influence on the degree of power the organization has in its inter-organizational relationships, due to its prestige, industry standing and reputation (Kern & Willcocks, 2002). The client company has a quite large internal IT department (240 people) and follows a strategy of selective outsourcing. The client entered the IT

Table 1

Client A Organization and Interviewees

Client company & interviewees	*Industry*	*Origin*	*Outsourced*	*Start of deal*	*Length of deal*	*Size of deal*	*People transfer*	*Customer of vendor company*
Client A • IT Executive Director • Director, Client Services and Operations, Information Systems • Analyst, Technical Support, Project Manager	Insurance & Financial services	Canada, Quebec	Selective: 1.Data centre & software support	2002	5 years	15-20% of an. IT budget	None	Supplier A
			2.Telecoms network	2003	3 years	3-5 % of an. IT budget	None	Supplier B

Table 2

Suppliers A and B Organizations and Interviewees

Supplier company and interviewees	*Origin*
Supplier A • VP Services • Customer Account Manager • Service Strategy Manager • Account manager, Printing Operations	Canadian
Supplier B • VP Business Markets • Customer Support Manager • Customer Satisfaction Analyst	Canadian

outsourcing ventures with main objectives to save costs and refocus on its core business. It is important to notice that the client had prior experience with IT outsourcing; therefore one could anticipate some degree of relationship management expertise when it came to operationalizing the IT outsourcing ventures (Kern & Willcocks, 2002).

The supplier organizations are some of the largest outsourcing service companies in the Canadian market. Supplier A is the largest Canadian independent information technology (IT) services firm and the fifth largest in North America. Supplier A and its affiliated companies employ approximately 25,000 professionals. It provides a full range of IT and management consulting services, including IT strategic planning, business process engineering and systems architecture. Supplier B owns and operates Quebec's second-largest telecommunications network. It has some 2,200 employees.

Supplier B is a subsidiary of one of Canada's leading providers of data, Internet Protocol (IP), voice and wireless communications services. It provides customers throughout Quebec with range of business solutions in IT, telecommunications and e-commerce services.

The in-person and phone semi-structured interviews with representatives of all three organizations were scheduled for 1h, but in many cases lasted anywhere up to 3hrs. All interviewees were assured anonymity, to promote openness. All interviews were tape-recorded and transcribed. Questions addressing the constructs of the proposed integrative relationship management model were posed, with a strong emphasis on what characteristics influenced relationship success (See Table 3).

Table 3

Operationalization of Conceptual Constructs

Construct	Interview questions
General information	• What type of IT activity is being outsourced? • What are your objectives in this relationship? • Does this IT project represent value or cost center for your organization?
Power-Dependency	• What percentage of the company's IT budget is outsourced in this deal? • Number of people transferred to the supplier organization (if any)? • Do you feel like you are being locked-into the relationships with your suppliers? • Did you or do you plan to do official RFP (Request for Proposal) at the end of the contract or you prefer to negotiate informally with the current supplier? • Did you invest in any specific assets as the result of his deal?
Length of relationship	• What is the length of the IT outsourcing deal? When did it start? • Have you had a prior business experience with this supplier?
Formal/contractual governance mechanisms	• Do you see this relationship as contractual or partnering focused? • To what extent the contract precisely defines the expected performance of the relationship? • Does the outsourcing contract preview frequent efficiency reviews and benchmarking by your internal auditors? • What other control methods are available to you? • Does your contract or SLA precisely state the substantial legal penalties for failure to perform a well as rewards for superior performance? Have you had to employ such (dis)incentives on any occasion? • How often do you have to bring up the clauses of the contract in dealing with the IT provider? What is their usual reaction in such cases? • Have the terms of the contact been renegotiated since it begun? In whose favor?

Informal/relational governance mechanisms	• Would you characterize this relationship as based on trust? • Do you see the long-term perspective of this relationship? • How do you handle unforeseen critical situations? • Does the IT supplier dedicate whatever people and resources it takes to meet your needs? • Is it important to you to keep this relationship flexible? If yes, how do you address this issue? • What other then contract means of persuasion available to you when negotiating with this supplier? • How the interpersonal relationships between people on both sides influence the resolutions of conflicts?
Relationship Success	• On the scale from 1 to 5 how successful is this IT outsourcing relationship? • What are you basing your opinion upon?

It is important to notice that due to the semi-structured nature of the interviews, these questions represent only a part of all question answered by respondents, as many follow-up questions were formulated in order to extend the initial answers and to explore the bases of certain opinions.

The interviews presented first-hand exploratory empirical insights into relationship practice. The second source of data was obtained from extensive documentary evidence. The secondary documentation consisted of press releases, newspaper articles, IT system performance reports, customer satisfaction questionnaires used by vendors, and IT outsourcing contracts. Also, informal discussions were held outside the companies as well as on premises with several participants during the contact initiation phases and lunch times. By the end of the data collection phase, the author had gathered about 200 pages of qualitative and quantitative information on two distinct IT outsourcing relationships between one client organization and its two major IT suppliers.

The broad range of documentary evidence and interview data provided alternative views of the relationships between the client and its IT suppliers, and helped provide a critical perspective to the relationships.

4.3. Data Analyses

The responses from all three parties were then collected and analyzed into construct cards (Martin, P.Y. & Turner, B.A., 1986), which in turn represented the areas of commonality or discord in responses with regard to the IT relationship characteristics employed in the integrative model: length of relationship, power-dependency situation, relationship success, and relationship governance mechanisms (formal and informal). Next, the obtained construct cards were analyzed in the theoretical memorandums, which helped to identify the cross-case patterns. As patterns were identified, the author began to look for the logic behind these, for which direct and indirect links could be drown based on the existing theoretical approaches. This, in turn, led to new emerging themes suggested by the data. The resulting process of moving back and forth between the data and the theory allowed to make sense of the large data set and reveal a "deep structure of social behavior" (Light, 1979) within IT outsourcing dyads.

In order to assure construct validity of the findings, following Yin (1994) and Kirk & Miller (1986), triangulation approach was applied to the data collection process, which consisted of using multiple sources of evidence, such as tape recorded interviews, documents, reports, newspaper articles and others. This triangulation of data sources helped develop the converging lines of enquiry and assured the construct validity of the findings. Further, the internal validity of the research was addressed by using such data analysis techniques as cross-case pattern matching and explanation building (Yin, 1994).

Finally, to ensure reliability of the research procedures, a chain of evidence was maintained by carefully recording dates and circumstance surrounding the interviews, as well as the interviewees' names and job titles. Most importantly, a comprehensive case study data base was developed consisting of interview transcripts, notes in form of construct cards, theoretical memorandums, secondary documents, and tabular materials.

5. Cross-Case Exploratory Findings

The following report on the analysis of the research material obtained from the interviews with the participants and the secondary documentation has been structured by the use of the main dimensions and constructs of the model. Each of these constructs is developed below and they are illustrated with a few selected quotes from the case study organizations. These quotes represent only a tiny fraction of the rich data collected and are provided simply to give a flavor of the way the organizations described their approaches to the research themes.

5.1. IT Outsourcing Context

Before proceeding to analyzing the crucial constructs of relationship success and relational governance mechanisms, it was important to take a closer look at the context variables of relationship length and power-dependency situation as they may have significant impact on the nature of possible interplay between formal and informal approaches to the IT relationship governance.

5.1.1. Relationship Length

Of particular interest was the fact that the suppliers had different lengths of relationship experience with the client. Client A's relationship with Supplier A started in 1996 with acquisition by the latter of the wholly owned IT subsidiary of the former. The parties signed a five-year mainframe outsourcing contract, and since then they have signed two other consecutive contracts with addition of some printing services. Client A's relationship with Supplier B is very recent. In the beginning of 2003, Client A switched from its former telecommunications provider to Supplier B. For that matter, an agreement on mutual exchange of the services (IT and insurance services) was developed between the parties. It is thus likely that the suppliers' differences in business history with the Client A may create some differences in their relationship dynamics with the former. However, such possible differences could be minimal due to the fact that both suppliers have a large customer bases in the insurance industry; and therefore they already have understanding the client's major business drivers.

5.1.2. Power-Dependency Situation

In the beginning of the study it was important to gain a clear perspective on power-dependency situation in the IT outsourcing dyads, since both TCT and RET view it as major reason prompting companies to develop relationship governance mechanisms. Supporters of both theoretical perspectives agree that due to specifics of the industry, IT outsourcing customers always find themselves in higher dependency position relative to their suppliers (Heide & John, 1990; Heide & Weiss, 1995; Ireland, 1999; Lonsdale, 2001; Wathne & Heide, 2000). The dependency manifests itself in reluctance of the customers to switch the IT vendors. This gives more power to the suppliers, which could start acting opportunistically, and thus jeopardize success of the relationships. Under such circumstances, the main goal of both contractual and relational governance mechanism is to protect more dependent customers from potential negative aspects of existing power imbalance, namely opportunism.

The analyses of data collected during interviews to some extent confirm the dependency situation described in the literature. On the first glance it looks like Client A is in control of its relationships with the IT suppliers. The client company is quite large and is one of the leaders of Canadian insurance industry. It is also one of the top ten clients for both of its IT supplier. Thus, it can be expected that Client A enjoys a significant degree of power in its inter-organizational IT outsourcing relationships. Indeed in the initial interview, Client A's Principal IT Director expressed the following opinion:

> I feel like we are in control [of the relationships with IT suppliers]. Of course, it is not easy to transfer your business from one supplier to

> another, in some ways it is a waist of time. But if some other provider can cut my costs and cover the transfer expenses, I will not be able to argue with the financial department only because I have a good relationship with this supplier… We will switch to a new one almost in a heart beat.

This statement implies that the customer does not feel being locked-in to the relationship with any of its IT suppliers and believes that there is always a possibility to switch to other providers. However, subsequent interviews with Client A's IT staff and more detail analysis of both relationships revealed a quite different picture.

Client A ⇔ Supplier A

The relationship between Client A and Supplier A started with acquisition by the latter of the Client A's wholly owned IT subsidiary, which involved a transfer to the supplier of the majority of subsidiary's employees. The loss of a significant part of the in-house IT expertise puts Client A into dependency position relative to Supplier B.

During interviews, other Client A's representatives revealed several additional reasons for which they believe switching to another supplier is not a viable option:

> There are not that many providers in that world [IT market] and we know that if we want to change them it will be a big problem because we would have to transfer all the operations to the other company, so we prefer to negotiate. (Director, IT Services and Operations, Client A)
>
> I do not see us moving to someone else…Not only because of our historic relationship, but they really know very well our environment here, and they have maid for us a lot of environment modifications, so it would be pretty hard for us to move somewhere else. (IT Project Manager, Client A)

These opinions confirm the theoretical assumptions regarding dependent position of the customers in the IT outsourcing deals. This particular client does not consider technologically heterogeneous IT market to be perfectly competitive. Moreover, while Supplier A possesses intimate knowledge of Client A's informational environment and has made multiple modifications to it, it would take too long for another supplier to learn Client A's environment. During that time significant costs, time losses and potential operational difficulties would be incurred by Client A. All of the above creates disincentive for Client A to switch to another vendor, thus putting them into relatively dependent position vis-à-vis Supplier A. Indeed, all Client A's representatives seem to believe that, as long as Supplier A keeps delivering good service quality, they will prefer to negotiate with regard to all other possible issues rather then try to switch to another provider.

Client A ⇔ Supplier B

Similarly, Client A is locked-in to the relationship with Supplier B for several reasons. When switching to Supplier B in the beginning of 2003, Client A "burned the bridges" with its former telecommunications supplier, who was the leader in Eastern-Canadian telecom market:

> Supplier B was supposed to pick the line from [Former Supplier] by a specific date, but they [Supplier B] did not do so. On that date our [client's] contract with [Former Supplier] has expired, so they started charging us 43 cents per minute instead of 5 cents per minute…and we said to them [to the Former Supplier] "you can go ahead and charge us this exorbitant rate, but… we will never consider you as a potential IT provider again because it is not fair. (Director, IT Services and Operations, Client A)

Given that these two suppliers account for about 70% of the market, at the moment, there are no viable competitors that Client A could switch to, in case it wants to terminate the relationship with Supplier B. In addition, Client A has sustained significant switching costs during business transfer phase between suppliers. Client A representatives admit that they want to avoid such costs in the future.

Finally, Client A is at the same time a group insurance provider for Supplier B. Such mutual exchanges of services increase dependency position of the client company. If terminating the relationship with the supplier, they will not only incur significant switching costs, but will face a potential loss of revenues from their core business.

To summarize, the initial power-dependence situations in both relationships open up the client company to potential opportunistic behavior on the part of its suppliers. The following sections of the paper will describe what relationship governance mechanisms Client A employs to eliminate such possibilities.

5.2. Assessment of Success of the IT Outsourcing Deals

In order to gain a deeper insight into the construct of relationship success, as related to IT outsourcing deals, and to verify the appropriateness of using the presented in the model three-dimensional measure of relationship satisfaction as the operationalization of success, the representatives of the client organization were asked to give their overall impressions of a relevant relationship and to score the relationship success on the scale from 1 to 5 (1 is being "very unsuccessful" and 5 – "very successful"). Interestingly, both IT outsourcing relationships were assigned a score of 4, which shows that the client considers them to be relatively successful. In addition, one of the client representatives commented that there can always be a room for improvement in any client-vendor relationship; however both of the IT outsourcing relationships, in which the organization is presently involved, are successful and satisfying to them.

Further, the representatives were asked to support their opinion with examples and define characteristics of relationship that they see as very important to success of a particular deal. When analyzing the obtained responses, the author subsequently looked for the themes of customer satisfaction with product/services, financial returns, and suppliers' service representatives.

5.2.1. Satisfaction with Products/Services

With regard to the quality of the services, Client A admitted with satisfaction that most of the time they demand and receive service quality higher that it is stipulated in the service level agreements. The IT Director of the client organization assessed the relationship success based on the technological flexibility they get from suppliers and on how well suppliers comply with their tough service delivery requirements. Client A's IT project manager supported this statement by sighting the instances where they have made some emergency requests to provide them with more processing power for the short periods of business peaks than was agreed upon in the contract. At all the times, Supplier

A was willing and able to help them out. Moreover, they would do it free off charge. This shows to Client A that the supplier values them as a client and cares about their business reliability. Supplier B, on the other hand, had some shortages in service delivery during network transfer phase. Interestingly, Client A did not consider these initial problems when assessing their satisfaction with services; rather they attributed them to switching costs, saying that problems occur in the business transfer phase with any supplier. Overall, Client A expressed satisfaction with the services of both suppliers.

5.2.2. Satisfaction with Financial Returns

In the beginning of the interviews, both client representatives stated that the IT outsourcing projects were undertaken in order to better control the company's IT budget and direct resulting cost savings to increase their concentration on the core business. Both clients expressed satisfaction with financial returns. However, when asked to give an approximate percentage of the achieved cost savings, neither of them was able to come up with a number. Instead, they pointed out that IT technology is very fast changing and the needs of the company have evolved significantly since the beginning of the contracts, which made the objective assessment of possible cost savings very difficult, if not impossible. Overall, their cost savings came from not having to make additional investments to sustain and increase the company's expertise in those IT areas. The difficulty of assessing cost savings and using them as an indicator of IT outsourcing relationship success was already pointed out by other researchers (McFarlan, F.W. and Nolan, R.L., 1995; Ross and Westerman, 2004). Nonetheless, the client has indicated many instances where they received some extra services from their suppliers free of charge. This indicates to some extent that operational cost saving have been attained by the client.

To summarize, although the client was not able to quantify their lower operational costs, they expresses satisfaction with achieving their other financial objectives such as reallocation of resources to the "core businesses", lower capital investment costs, and conversion of fixed cost to variable.

5.2.3. Satisfaction with Service Representatives

According to Client A's IT Director, the important characteristic of the relationship success is in that they get exactly what they ask from suppliers and are not afraid of "punishment" when refusing other marketed to them by the suppliers outsourcing projects. To support this statement, Client A's IT Director recalled the following situations that occurred several months ago:

> Client A was always performing its printing activities in house. However, during their business peak periods they had to use external printing service providers. Since 1996, Supplier A was providing Client A with such ad-hoc emergency printing, while trying to persuade Client A's executives to eventually discard their progressively outdating printers. In early months of 2004, Client A faced a decision of whether buying a new printer and keeping printing as internal IT function or discarding the old printer and outsourcing printing completely to Supplier A. After a serious consideration and several meetings with the supplier representatives that were making case for outsourcing, the client company finally decided to keep printing capability in house. Nonetheless, the IT Director expressed his satisfaction with the fact that although Supplier A's people were disappointed over the loss of business opportunity, they remained "good

players", meaning that they kept Client A's profile in their machine to handle some emergency peaks that may still occur.

Such flexibility and "good playing", in the IT director's opinion, are very important to the relationship success. He believes that former comes from interpersonal links between individuals on both sides.

The client organization considers its both IT outsourcing relationships to be successful, although they acknowledge higher levels of trust and flexibility in their relationship with Supplier A. They attribute such difference to much longer business experience and stronger interpersonal contacts with Supplier A's representatives than with Supplier B. This goes to show that trust is a longitudinal construct (Lacity and Willcocks, 2001) and that "satisfaction with service representatives" construct might be influenced by contextual variable of relationship length.

Both IT outsourcing suppliers consider their relationships with this client to be a successful one. For both of the supplier, Client A is one of their top ten customers by the volume of business revenue coming from the IT outsourcing deals. The suppliers sighted quality of interpersonal relationships and their openness as major drivers of the relationship successes.

Overall, the analysis of the data collected shows a considerable support for using three-dimensional customer satisfaction construct as operationalization of IT outsourcing relationships success. Client A considers both relationships to be successful and expressed significant satisfaction with all three dimensions of the construct. This, in turn, impelled to take a deeper look into the relationship governance mechanisms the client company uses to manage these IT outsourcing deals.

5.3. Formal/Contractual Governance

Outsourcing research and experience emphasizes the importance of the contract (Lacity and Willcocks, 1998, Kern, 1999). Contract is often seen to be an important foundation of the IT outsourcing relationship as it prescribes in details the behaviors of the parties with regard to products and/or services, financial, and informational exchanges between them (Kern & Willcocks, 2002). Therefore, it was imperative to take a closer look at the contracts between Client A and its both suppliers. The clauses used in both contracts are listed in Table 4. It is important to notice that there are no "one-size-fits all" clauses (Barthelemy, 2003). The actual content of a good contract should vary depending on the type of outsourced IT activity and the contractual hazards associated with it (Williamson, 1991). Since Client A is pursuing selective outsourcing strategy which is characterized by lesser contractual hazards than total IT outsourcing

(Barthelemy, 2003; Grover et al., 1996), both contracts may be considered explicit enough for these types of deals. The explicitness of the contracts manifests itself in the fact that service level agreements describe in precise terms the type, scope, and nature of the service required, the times when these services should be available, and the

Table 4

The Content of the two IT Outsourcing Contracts

Contractual Clauses	**Data Center Operations Contract: Client A & Supplier A**	**Telecommunications Contract: Client A & Supplier B**
Contract amount	15-20% of the client's annual IT budget	3-5% of the client's annual IT budget
Transfer of employees	None	None
Contract duration	5 years	3 years
Number of pages of the contract	38	6
Vendor management clauses		
Service level reports with service level measures	X	
Bipartite committees with regular meetings	X	X
End-user surveys	X	X
Cash penalties for nonperformance	X	X
Escalation procedures	X	X
Adaptation to the changing environment		
Adjustment of charges to changes in your business with a guaranteed minimum volume for the vendor		X
Adjustment of charges to changes in your business with a non-guaranteed minimum volume for the vendor	X	
Evolution of technology towards market standards	X	
Price clauses		
"Fixed Price" clause	X	X
"Benchmarking" clause	X	
"Risk and reward" clause		
Contract Termination clauses		
Material reversibility with vendor's assistance at the end of the contract		
Human reversibility with vendor's assistance at the end of the contract		
Material reversibility with vendor's assistance in case of anticipated contract severance on behalf of the client		
Human reversibility with vendor's assistance in case of anticipated contract severance on behalf of the client		
Severance clause in case of gross mistake or negligence from the vendor.	X	X

levels of performance. Both contracts preview substantial financial penalties to the outsourcing vendors if at any time they deliver a level of service which does not meet the requirements of the contracts. In fact, in the two contracts, the vendor management clauses are very much the same, with the exception of "Service level reports with service level measures". These procedures are not outlined in the contract with Supplier B because they are being performed entirely by a third monitoring party. Due to the shorter length of the contract with Supplier B and specifics of the telecommunications market, "Adaptation to changing environment" clause is less explicit. The two contracts use simple "fixed price" clauses, in addition to which the contract with Supplier A uses a complex "benchmarking" clause with attached to it penalties for the supplier for non-compliance. Contract termination clauses do not include reversibility terms, since there were no personnel or material assets transfer from ClientA to supplier in these deals. The length of the contract with Supplier A is five years, which is relatively short term for the data center outsourcing industry where many clients sign 10-year contracts. Similarly, 3-year contract with Supplier B is also relatively short, given that most clients of this telecommunication provider embark on 5-year contracts.

Overall, the IT outsourcing contracts between Client A and its suppliers can be considered explicit and short-term. Indeed, the client and both suppliers agreed with such assessment. This is in compliance with the arguments of TCT supporters. Further, from the TCT perspective, in order to prevent opportunistic behaviors of the vendors, the client would have to manage its IT outsourcing relationships strictly by the "letter of contract".

In his research on governance mechanisms of the IT outsourcing deals, Barthelemy (2003) used explicitness of the contractual document itself as the operational measure of the extent to which customer manages the relationships though "hard side", meaning though contractually prescribed behaviors. However, as it was pointed out by others, the contract is neither self-enforcing nor self-adjusting (Goldberg, 1980). Thus, it was imperative to investigate whether indeed the everyday interactions between the parties are governed through the procedures prescribed in the contracts. However, in order to preserve the structural integrity of the data analyses, the initial integrative framework had to be enriched through introducing a classification of day-to-day interorganizational interactions.

In an IT outsourcing relationship the parties interact with each other through a complex pattern of interorganizational exchanges (Kern & Willcocks, 2002). These interorganizational exchanges are aimed at achieving the parties' mutual objectives and can be grouped in three major categories:

- Product/service exchanges
- Financial exchanges
- Informational exchanges

Product/service exchanges constitute the core of the IT outsourcing relationship. A client undertakes an IT outsourcing project in order to obtain certain IT products and services from an external provider. It can be expected that a client's satisfaction with product/services will depend on the quality of interorganizational exchanges of them.

Financial exchanges between the parties are heavily influences by differing financial objectives of the participants. These exchanges may be comprised of regular payments, mutual investments in the relationship-specific assets, occasional rewards and penalties. Through managing the financial exchanges with the IT suppliers, the clients aim at achieving their financial expectations of the deals. Thus, financial interorganizational exchanges influence greatly clients' satisfaction with financial returns of the deals.

Informational exchanges are directed at facilitating service and financial exchanges between parties. They include different kinds of service delivery and financial reports, user satisfaction surveys, interorganizational meetings, interpersonal interactions between the people on both sides. The parties in the IT outsourcing also use informational exchanges as channels of renegotiations and mutual adjustments. It is through formal and informal informational exchanges between the representatives that interpersonal trust is built over time and mutual commitment is communicated. Consequently, a client's satisfaction with service representatives of its IT supplier depends greatly on the quality of informational exchanges between them.

To summarize, the quality of product/service, financial, and informational exchanges between organizations can be expected to determine the respective components of client's satisfaction with the relationship. Therefore, in order to ensure the relationship success, the IT clients and the suppliers may choose to govern their service, financial and information exchanges through either formal governance mechanisms, which are usually spelled out in the contractual terms, or informal/relational methods. Thus, an important goal of the data analyses was to investigate how exactly and in what combination the formal and the informal governance mechanisms may be employed by the parties with regard to these three interorganizational exchange types.

This section presents the findings with regard to the governance of interorganizational service, financial, and informational exchanges through the contractually prescribed behaviors.

5.3.1. Product/Service Exchanges

The exchanges of IT products/services formed the core interaction in the relationships. This made it essential that service requirements are carefully listed, which the client did in Service Level Agreements of the contracts. Since these deliverables are key to the relationship, several penalties for non-performance were attached to service level items in the contracts. To insure that SLAs are being delivered, TCT prescribes for the customers to focus their management efforts on service delivery measures as well as use actively penalties in order to "punish" low performance of the suppliers. However, the interviews with Client A' representatives revealed a quite different approach to managing service delivery.

Continuous managing of relationship performance by SLAs is considered to be a "waist of time". According to the IT Director, monthly reports would only indicate what happened in the past and would not be of much help to daily performance of the deals. He finds it is easier to deal with problems as they arise than at the end of the month:

> Oh, there are companies that choose to stick to the book, there are some. But, I choose not to do so because it would not work for our company. First of all, it is counterproductive to have four people instead of one dedicated to a relationship in order just to collect statistics. Reports at the end of each month do not do much for me; we depend so much on technology that I can not manage it by reports. If the problem occurs, I have to know about it and deal with it right away, not at the end of the month…We do not want to count how many times glitches occur during the month. We make sure that they do not occur more then once… I have to admit that we are a difficult client to serve. We have high expectations. I do not care whether SLAs guarantees 97, 6% of network availability, I need 100% all the time! (IT Director, Client A)

Although Client A still regularly collects information on some hard and soft supplier performance measures, such reports have little bearing on client-supplier relationships. Indeed, on rare occasions of service delivery failures on the part of suppliers, Client A never applies penalties explicitly prescribed by the contracts. Moreover, some Client A's managers were not even aware of their existence.

Similarly, Supplier A's representatives are not very aware of the SLAs and the penalties attached to them, mainly because they have never been use to govern this relationship, unlike in cases with some other of their clients:

> I am 99% sure that we never paid any penalty to them not because we always provide a topnotch service but because when the problems happen they understand that we have been doing a good business with them for the last 20 years, and because of the trust and partnership thing they never come to us and ask for penalties to be paid; although some other customers may. (VP Services, Supplier A)

All parties, the client and the suppliers, agree that managing relationship with SLAs would create a significant additional cost and deteriorate trust between them trough diminished flexibility. The following to extracts clearly demonstrate the position of both parties:

> We have such long relationship with Supplier A and, as you know by now, Supplier B's and our bosses are very good friends, so it does not make sense for us to get formal with them. May be we have reservations about price sometimes, but these companies give us for free a lot of other additional favors and services that their other clients have to pay for. So I can not be constantly on their back with a contract in my hand, because next time I might need a favor, they could send me back to check with the contract. (IT Director, Client A)

> We want to forget about contract because what a contract says maybe, a year after, already outdated. The needs have changed; the SLAs are not the right ones any more. So a true partnership or a trusted relationship will evolve without rewriting the contract clauses. So what happens with [Client A] is that we put the contract in the drawer and 4 years after we want to negotiate, we take it out and we see that the number of clauses is not valid any more so we renew them. We have been able to work with them without the contract and very positively. (VP Services, Supplier A)

The comments above clearly illustrate that Client A does not manage its day-to-day relationships with the IT suppliers by Service Level Agreements (SLAs) spelled out in their initial contracts. The IT Director indicated that contracts are only brought up when a relationship is going bad and there is not much hope to restore it.

5.3.2. Financial Exchanges

From the beginning, the client indicated that its IT outsourcing projects were the means to financial savings. As a direct result, the financial exchanges received the greatest attention from all parties. Clearly, cost control represents the client's major relationship concern, especially since the driving motivation for the vendors is to increase their margins. In turn, Client A resorts very regularly to contractually prescribed behaviors with regard to financial exchanges.

For instance, Client A pays great attention to and is actively using the contractual clauses related to the price renegotiations and contract termination issues. Their contract with Supplier A allows for benchmarking and competitive price adjustment, while the contract with Supplier B allows for the initiation of price renegotiation by either side. Client A admits to directly reminding Supplier A's people about penalties and contract termination clause attached to refusal on the part of the supplier to adjust their charges to the present market rates. They also brought up the contract in order to remind Supplier B to readjust prices for all the Client A's Canadian subsidiaries that previously had separate contracts with the supplier.

Supplier A's representative acknowledges that Client A is a very cautious client that likes to sign the contracts of minimum length. According to the supplier, the data center outsourcing contracts can range from 3 to 10 years, and many of their large clients sign 10-year contracts, but not Client A. Supplier A admits that Client A indicated to them from the beginning that a longer than 5-year contract is too long for them. Even having signed a 5-year contract, Client A made sure to write in a clause which allows them to exit the relationship and impose significant severance penalty on the supplier in 3 to 4 years if the latter refuses to adjust their prices.

Both Client A's and Supplier A's representatives sighted a situation that occurred during their last contract renegotiation. Client A asked for competitive price readjustment, but Supplier A was not fast to follow up on the request. It came to the point where Client A had to remind the supplier of the existing contract clause that allowed for penalty for a failure on the part of the latter to do so. They were fast to work out another offer, but Client A wanted to make sure that it was a fair one. They used services of a benchmarking company in order to gain access to numbers concerning current market prices. At the end, Client A signed a new five-year deal, but only when it turned out that Supplier A's offer was a fair one.

Supplier A's representative recalls:

> In 2000, he [Client A's It Director] always had this page of the contract in his inner pocket that stated that he had a right to cancel the contract with us. And he would say several times "well do not go too far because I have this contract canceling note here with me that I can always pull out if you are not acting as a true partner. (VP Services, Supplier A)

The telecommunications contract with Supplier B is of 3-year duration, which is also a relatively short time period in this industry. It appears that the client cautiously chooses to sign shorter term contracts that allow for more frequent price renegotiations and reassessment of relationships. Moreover, Client A refers to such contractual terms as "benchmarking" and "severance clause" in order to exercise control and prevent the suppliers' opportunistic behaviors within financial exchanges.

5.3.3. Information Exchanges

Information exchanges involve embedded process occurring via contractually agreed mechanisms such as regular meetings and report exchanges, but also through free and active informal exchanges between parties (Heide & John, 1992; Kern & Willcock, 2002). Meaningful and frequent information exchanges between parties are a necessary antecedent of trust (Kern, 2002) and one of the critical factors of relationship success (Heide & John, 1992).

All parties admitted the importance of information exchanges to the success and longevity of their relationships. Thus, multiple formal communication channels were written in to contractual terms and parties are actively employing them. For instance, Supplier A has a full time employee working on Client A's premises, who is mainly responsible for facilitating communications between the two parties. Formal communication in this context is characterized by hard facts such as technical service delivery reports, IT projects' reports, regular IT personnel meetings, periodic customer satisfaction surveys and others.

Although the relationship with Supplier B is more recent and not all communication channels are yet in place, the organizations make efforts to create them.

Recently assigned contract manager sees his main function in ensuring that everything goes well in a relationship. He meets with the client representatives every month to discuss the quality of the services delivered and customer's satisfaction with them. In addition, to the scheduled periodical meetings he often calls them "just to see if everything is all right."

Another communication and relationship building technique used by Supplier B was organizing a meeting of the client representatives and the supplier technical and sales representatives. The theme of the meeting was "How can we get closer to our customers through the quality of service". It helped a lot to both parties. The large number of questions addressed to the client representatives demonstrated to them that the supplier cares about them and wants to learn from them. It also helped the supplier a lot because the technical people and customer service people rarely meet customer face to face, and so they do not have relationship with them. Having the client explained to everybody the consequences of the service quality made an impression on technical personnel and may increase their attentiveness in the future.

A very interesting point is that with regard to Client A-Supplier A relationship, both parties although acknowledged the role of formal information exchanges, insisted on much higher importance of informal interpersonal connections between their representatives to the relationship success. On the other hand, in the Client A-Supplier B relationship, formal information exchanges occupied much more important position. This difference in approaches to information exchanges could be attributed to the different lengths of business experience Client A has with the two suppliers. Meaningful informal communications arise from the trustful interpersonal relationships that come to exist as mutual business experience growth. It seems that through good formal information exchanges in the beginning of the relationship parties are able to build trust between them, which then is sustained through important informal information exchanges.

5. 4. Informal/Relational Governance

The previous section illustrates that both IT outsourcing relationships started of by the parties developing and signing good explicit contracts. After signing the contracts and as the relationships unfold, the client, indeed, relies to an extent on contractually prescribed mechanisms in order to manage its exchanges with the suppliers. However, further analyses of the research material revealed that the client and the suppliers also deviate from the formal procedures and resort extensively to the informal/relational governance in all three relevant exchange areas.

5.4.1. Product/Service Exchanges

From the first interview with the client's IT director it became evident that the company puts large emphasis on using relational rather than contractual methods of day-to-day technical management of their IT outsourcing deals:

> *Researcher*: How often do you bring up the contractual terms in every day dealing with the supplier?
> *Respondent*: Never. I do not want to open it. In fact if I want to open the contact, they say "well something is going wrong" and this is the start of the end. And I guess on their side is the same thing: if they are beginning to look at the terms, we say oh something is going wrong. (IT Director, Client A)

Both IT suppliers of the organization share similar point of view and they insist that trust and interpersonal relationships between people on both sides are the foundation of relationship success. In fact, managing these IT outsourcing deals through trust and understanding of each others' business goals and constraints rather than sticking to SLAs helps the parties sustain the technological flexibility, which is the key to IT outsourcing relationship success. Indeed to the Client A, technological flexibility is a major operationalization measure of the relationship success.

Technological flexibility of the relationships shows itself in the fact that the parties regularly deviate from prescribed by the contracts behaviors related to service exchanges between them. With regard to Client A-Supplier A relationship, this is illustrated in the comment made by the Supplier A's contract manager:

> Oh, they may ask us to do something for them for a couple of days, like having a little bit more of the service. And we are open to do that. For instance, they asked us to add a little bit of capacity, and we were in the position to do it for the end of February, when it is their REER period. They were really in rush at the end of the month, and we were in the position to help them… we did not charge them. And in another instance, once we made a small error in operations, as the result of that some of their people had to work past business hours. They had to redeploy people internally because we made and error. So, they looked over it too. That is the kind of relationship we have with them. (Contract Manager, Supplier A)

Client A admits of periodically asking added capacity from the supplier, and they are always sure to get it. They trust the provider not to bail out on them during the most critical business periods.

Although the relationship with Supplier B is quite recent (one year), service exchanges between the parties have already started deviating from original contractual terms. Initially, Client A chose to use services of a third external party in order to monitor availability and break downs in telecommunication lines provided by Supplier B. Thus, network management services were not included in the contract. However at the time the interviews were conducted, this situation was changing because Supplier B started providing Client A with such monitoring reports as "value-added" service - free of charge. Client A's IT director expressed his satisfaction with such proactive behavior of the supplier and pointed out that it will contribute to cutting the company's IT costs.

The client admits that although good interpersonal relationships promote flexibility and reduce the occurrence of conflict situations, in some instances they still need to "play tough" while staying true to their commitment not to revoke SLAs and penalties. The following extract of the interview with the client IT Director illustrates well the relational tactics employed by the client in such cases:

> *Researcher*: Without referring to SLAs, how do you deal with technical problems that may occur in the relationship?
> *Respondent*: We contact what ever highest manager they have and make him understand that glitches are not acceptable.
> *Researcher*: And what are your means of persuasion?
> *Respondent*: You mean penalties? They could be implied but never overtly. Suppliers usually know what can do an unsatisfied client. For example, a bad word spreads very quickly. Moreover, suppliers like

> [Supplier A] have a wide range of services, and we are using only a small part of it as of now. So if we do not like their service in this sphere, they will loose opportunity to sell us other services in the future. (IT Director, Client A)

The extract above shows that the client uses the possibility of future business opportunities and its references of the suppliers to other prospective customers as harder relationship management tactics, when softer relational tactics fail to deliver desirable results in service exchanges between them.

5.4.2. Financial Exchanges

Although the financial exchanges between the parties in both relationships are more formally framed, there are still multiple instances of financial flexibility exercised by the participants in order to promote "good spirit" of the relationships and earn each others' trust. For instance, in the episodes illustrating technological flexibility (previous subsection), both suppliers could impose extra fees on the Client A for the services rendered in excess of SLAs, yet they did so free of charge. When interviewed, Supplier A admits that they do so because the Client A is one of their oldest and loyal customers; Supplier B, on the other hand, considers it to be a trust building move on their part. The latter shows that flexibility not only arises from trust, but promotes trust itself. In fact in the Client A-Supplier B relationship, the parties were flexible with each other even before a trustful relationship was established. For example, Client A has experienced some serious downtimes on the fault of Supplier B during the business transferring phase. The contractual terms allowed them to impose a significant penalty on the supplier. However, they chose not to do so. Instead, the supplier agreed to cover the monetary difference between the contractual charges and the actual telecommunication charges the client incurred during that period. This last incident shows that Client A not only promotes interpersonal relationships to insure flexibility, but it is being flexible sometimes to build the relationships.

Another interesting relational strategy on the part of the client with regard to financial exchanges is that they always act as an equal power player. Although, power-dependency analyses show that the Client A is to some extent locked-in these IT outsourcing relationships, they are doing their best to convey to the other parties that they will walk out on a relationship at the first sign of unfair pricing or dishonest behavior on the part of a supplier. This tactic seems to work quite well for them, as Supplier A's Contract Manager made a following remark: "They are really trying to get the best for the money they are spending. So, we know that and we have to work with that in mind. They are not attached… there is a sentimental attachment, but the financial deal will decide." (Contract Manager, Supplier A)

5.4.3. Information Exchanges

One of the most important observations in these IT outsourcing relationships is that all parties put significant efforts into building and sustaining trustful communication channels between the people on all levels. Highly ranked managers of both supplier organizations make it a point to stay in touch with IT administration of the client company:

> We were able to get [Client A's representative] on our side because at the beginning he was not very comfortable with us, he did not know us, and that was ok. I personally said to [Client A's representative], I was going to be meeting with them, and he could call me anytime, so every two-three weeks I send him an e-mail, I will tell him about something that might interest him. And he does the same thing that is why he called me for you. So that is the type of relationship we are trying to build. When you get to a situation where you might have trouble, then if you have a good relationship with other party, they might give you a chance because they know they can trust you. (VP Business Markets, Supplier B)

> It is definitely a part of the culture of [Supplier A] to stay close to our customer through the personal relationships because we believe that people by from people. Most of the people will buy [Supplier A]' services because they trust [Supplier A] capabilities – sure, because [Supplier A] gives them a good price – sure, but also because they trust the person in front of them, they truly believe that this person will help them and will work for them as an extension of their company. So, if there is no good one to one relationship between the people, things will not evolve as well, and problems will start rising. So, yes I like to stay close to our clients: so we invite them to play golf, from time to time have dinner with them, talk with them on the phone…I personally like to ask how the clients spouses do, how many children do they have, what do they like besides work and…Just to get a little bit more intimacy between us because I have a conviction that in our business there will be issues and problems from time to time, and if you are close to the partner or vendor, you will not be as harsh on the person when problems happen, you will be forgiving in a sense because you have close relationship with that person, you are not going to bit him or her and threaten that person… you are going to listen and be lenient in a sense. If you do not have good one to one relationship, you will attack each other at any sight of a problem. (VP Services, Supplier A)

From the extracts above it appears that the suppliers view strong interpersonal relationships as a buffer and facilitating mechanism when a relationship hits hard times and needs to be readjusted.

The IT Director of the client organization fully supports this point of view: "I realize that flexibility comes from individual and interpersonal relationships. We have a very good contact at [Supplier A]. I do know the executive of [Supplier B] quite well. I think the relationship will evolve the same way as it did with [Supplier A]."(IT Director, Client A)

Interestingly, he does not see the acquisition of previously wholly owned Client A's IT subsidiary by Supplier A, in the beginning of their relationship, as "loss of expertise", the term so often appearing among IT outsourcing disadvantages sighted by academics and practitioners (Ireland,1999). On the contrary, the IT director believes that the relationship "have benefited" from this situation because their former employees were assigned as their contract and project managers. Thus, Client A oftentimes gets more flexible and favorable treatment than the new clients of Supplier A. The following extract demonstrates that in managing this relationship the IT director relies greatly on his personal contacts with the former employees: "Sometimes I hear: "Of course, you have such a favorable contract because of him [that individual]" And I can not disagree with them. That individual sometimes is more on our side than on his employer's." (IT Director, Client A)

Client A's project manager fully supports this opinion and insists that trustful informational exchanges between them and Supplier A are the bases of their relationship success:

> Well most of the time the client service team at Supplier A and us, we have a good relationship. We move at the same pace, we see the things in

> the same way, we trust each other... I trust them when they tell me something and I have the impression that they trust me when I tell them something. Do you understand what I mean? (IT Project Manager, Client A)

Interestingly, although in every day management of the IT outsourcing, the Client A was promoting and sustaining both formal and informal information exchanges, as soon as problems aroused, the formal communication channels would be forgone in favor of informal direct communications. Indeed, contacting the highest person on the supplier side seems to be a favorite problem resolution tactic of the client. All Client A's interviewees are persuaded that it is a waist of time to follow escalation procedures prescribed by the contract and go through all the formalities of customer service call centers when reporting a technical problem. They want to talk directly to people in charge and people they have trustful relationships with. Both suppliers have tried to persuade the customer to go first through the formal channels, but the client insisted on having a direct contact. The fact that the contract managers of the supplier organizations get disappointed to find out about the client's problem from their bosses and not from the client himself does not seem to bother the client much. Their reply to such complaints is that this technique works for them and they will stick to it. As of now, the suppliers have accepted such chain of communications.

To summarize, Client A actively uses a number of relational techniques for everyday management of its service, financial and information exchanges with the IT suppliers. These techniques range form promoting trustful interpersonal relationships and flexibility between the parties to establishing reliable and direct communication channels, and even tougher relational tactics of leveraging future business opportunities and references in order to gain upper hand in conflict situations.

5.5. Summary

The aim of the presented above two case studies was to test and further develop the integrative model of IT outsourcing relationship governance (See Figure 2). Overall, this initial exploratory research showed definitive support for the integrative approach to IT outsourcing, as it has been used by the client in both of its successful IT outsourcing deals. Before discussing the resulting conceptual extension of the initial integrative model, a brief summary of the two investigated relationships seems warranted.

Both deals, Client A - Supplier A and Client A- Supplier B, were undertaken by the client following a selective IT outsourcing strategy. However, the contract with Supplier A accounted for much larger proportion of Client A's annual IT budget (15-20%) than the contract with Supplier B did (3-5%). Client A – Supplier A relationship was a successful long-term business rapport comprised of several short-term IT outsourcing contracts (three contracts since 1996), while the relationship between Client A and Supplier B was very recent (first contract since 2003). In spit of the differences in technological nature, size, and length of the relationships, Client A used the same integrative approach to the governance of their deals with both suppliers. The simultaneous exercise of formal and informal governance appeared to work well for the client, since they considered both relationships to be successful and expressed significant levels of satisfaction with the products/services received, financial returns and service representatives of both suppliers. The following section will discuss the specifics of interplay between contractual and relational governance that influenced the success of these two IT outsourcing deals.

6. Revisiting of the Integrative Model

Overall the analyses of the qualitative data collected during this case study reveal an interesting picture. It is evident that the client company simultaneously uses both contractual and relational approaches to the governance of its relationships with the IT suppliers. Some recent IT outsourcing studies have already shown support for the simultaneous use of both TCT and RET perspectives in order to insure success of the IT outsourcing deals (Barthélemy, 2003; Kern & Willcocks, 2002). The theoretical contribution of the present study is in that it reveals the interplay between formal and informal relationship techniques as they applied by the parties to the three major interorganizational exchange areas: product/service, financial, and information exchanges. Indeed, by introducing into the model the structure of interorganizational exchanges, it became possible to investigate the specifics of the interplay between contractual and relational management approaches employed by the parties. This interplay is illustrated in the Figure 3 and discussed below.

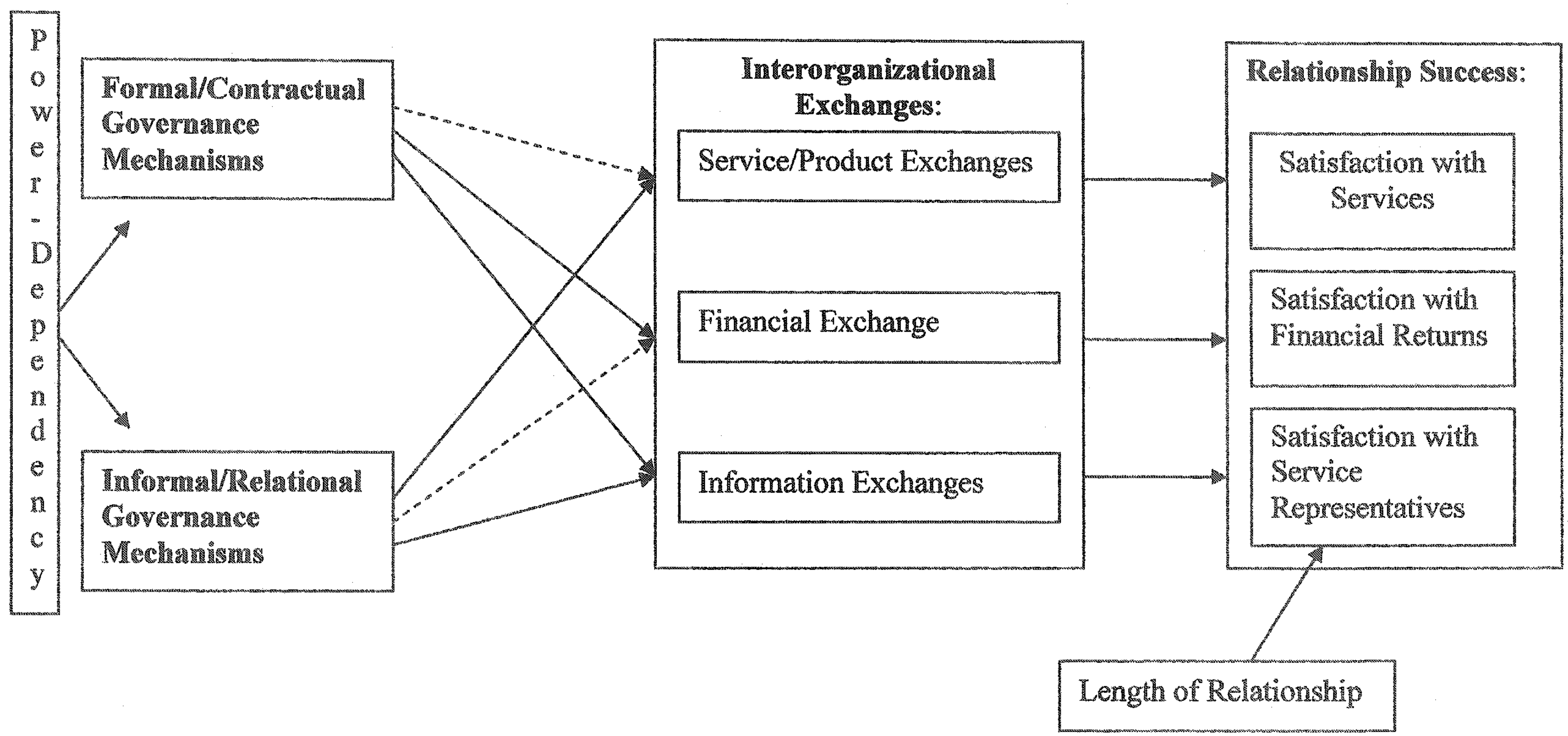

Figure 3. The Revisited Integrative Model of IT Outsourcing Relationship Governance

6.1. The Interplay of Formal and Informal Governance of Interorganizational Financial Exchanges

Given that cost cutting is one of the main goals of the IT outsourcing client, it is very important to the latter to maximally protect themselves from the possible opportunistic behaviors of their IT suppliers. Thus, financial exchanges between the parties of IT outsourcing deals are better managed mostly through formal procedures of short-term explicit contracts. For that matter, the client in the case studies actively enforces such price negotiation clauses as "benchmarking" and competitive price adjustment. Moreover, the client insists on short-term contracts, since they allow for more frequent price renegotiations. These findings indicate that the parties in the IT outsourcing relationship do not rely on concepts of trust and commitment when managing their financial exchanges. Instead, they realize the inherent differences of their financial objectives, and thus resort to arm-length governance in order to safeguard their own interests (Lacity et al, 1995).

Interestingly, the only informal financial exchange governance technique used by the client was to keep an appearance of "equal power player". In fact, although the power- dependency analyses revealed the client's objective dependency position relative to the suppliers, the former makes it a point to regularly communicate to the suppliers that the relationship will be terminated at the first sign of opportunistic behavior on the part of the latter.

To summarize, the findings suggest that the interplay of contractual and relational approaches to management of financial interorganizational exchanges demonstrates itself in the crucial role of the contracts, while some limited informal mechanisms might only be employed by the client in order to reinforce the influence of the formal governance.

6.2. The Interplay of Formal and Informal Governance of Interorganizational Product/Service Exchanges

The data analyses reveal that in order to ensure technological flexibility and longevity of the relationships, parties resort exclusively to informal/relational governance when managing service exchanges between them. Client A's core business depends significantly on the quality of information technology sources. Therefore, facing constantly changing IT market conditions, they do not want to be constrained by explicit contractual SLAs. Consequently, both the client and the suppliers actively promote informal service delivery management. For that matter, Client Adoes not rely on the contractually prescribed regular service delivery monitoring and measurement. Instead, they prefer to deal with the problems as they arise, which allows for faster delivery process improvement. Neither does Client A impose penalties on the supplier for occasional poor performance instances because once punished, a supplier may be less willing to adjust to the fluctuations in the client's technological needs, which will make the relationship dangerously inflexible. As an alternative to monetary penalties, in case of conflict situations, Client A leverages suppliers' reputation and future additional business opportunities with them as "harder" relational management techniques.

Overall, the interplay of formal and informal governance of service exchanges between the IT outsourcing parties appears to be quite different from their interplay with regard to the financial exchanges. While within financial exchanges the parties employ informal governance only in order to enhance and reinforce adherence to the contractually prescribed behaviors, it appears that within service exchanges relational governance mechanisms are put in place by both parties in order to get rid of contractual constraints. The sole reliance on the informal governance when it comes to product/service interorganizational exchanges seems to work very well for the client, as they express satisfaction with outsourced IT services. This particular finding, if supported by further research, has a potential of creating significant savings to the companies, as they move away from time and resource consuming SLA management techniques towards more flexible informal service delivery management.

6.3. The Interplay of Formal and Informal Governance of Interorganizational Information Exchanges

Last but not least, well developed and regular formal and informal communication channels between parties are both present in the successful IT outsourcing relationships as they support and facilitate the service and financial exchanges. Among formal governance mechanisms of information exchange are creation of management positions designated to facilitating communications between the parties, regular technical and financial reports, scheduled interorganizational meetings on all managerial levels directed at resolution of specific issues as well as suppliers' learning of client's business environment and objectives and frequent customer satisfaction surveys. Interestingly, informal information exchanges were found by both parties to be even more important to relationship success than formal communications. Highly ranked client's and suppliers' managers made it a point to invest in trustful interpersonal relationships. This had an impact on that the client would always forgo contractual escalation procedures in favor of direct communications. Such relational technique, in the client's opinion, greatly helped to speed up the problem resolution processes.

IT outsourcing researchers and practitioners often tend to over-focus on the financial and product/service exchanges and fail to address information exchanges between organizations (Kern & Willcocks, 2002). This thesis is highlighting however the importance of both formal and informal communication channels to the overall success of the IT outsourcing deals. Moreover, it seems that informal communications based on trustful interpersonal affiliations play more significant role when problems need to be resolved and conflicts attenuated. At the same time it appears that formal interorganizational communications promote overall stability and structural integrity of the relationships by providing executives of both parties with regular performance reviews, mutually indicating the companies' strategic intentions and allowing the suppliers to learn more about their services' impact on the client's business.

6.4. The Relationship Success

Another interesting finding of this study is that it shows a considerable support for using three-dimensional customer satisfaction construct as operationalization of IT outsourcing relationships success. Although Client A admitted that their initial IT outsourcing expectations were mostly of financial nature (IT cost savings, redeployment of financial assets to concentrate on the "core business"), when asked to explain their understanding of the relationship success, Client A referred to their satisfaction with services, financial returns and service representatives. Indeed, such three-dimensional satisfaction construct is highly compatible with three types of interorganizational exchanges. It seems logical to assume that product/service exchanges between the parties determine a client's satisfactions with service delivery. Similarly, the nature of financial exchanges will influence a client's satisfaction with financial returns as well as the dynamics of informational exchanges will have an impact of a client's satisfaction with service representatives. It seems that the absence of agreement among researchers with regard to the driving factors of the successful IT outsourcing deals is in large part due to the lack of common operational measures of the construct of the relationship success. If so, the three-dimensional satisfaction construct presented in the integrative model has a great potential of providing such common grounds of measurement by integrating client's assessments of their experiences with all three interorganizational exchange types.

6.5. IT Outsourcing Context

6.5.1. Power-Dependency Situation

The research findings show support for the existing academic opinion that power-dependency imbalance is inherent to the IT outsourcing environment (Heide & Weiss, 1995; Lonsdale, 2001; Ireland, 1999). The nature of IT outsourcing is such that clients become locked-into relationships for a variety of reasons, including high switching costs (Heide & John, 1990), loss of expertise (Lonsdale, 2001; Ireland, 1999), lack of competition on the IT market (Heide & Weiss, 1995) due to prevalent technological heterogeneity, and other. It is this unfavorable to the clients power-dependency imbalance that creates necessity of employing formal and informal relationship governance mechanisms in order to mitigate the suppliers' opportunistic behaviors and ensure the IT outsourcing relationship success.

6.5.2. Relationship Length

Some researchers maintain that the length of the relationship between the parties has a direct bearing on their choice of using formal or informal governance mechanisms to manage day-to-day interorganizational exchanges (Heide and John, 1990; Jap and Ganesan, 2000). They suggest that the IT outsourcing parties often start their relationships by managing their initial exchanges through formal/contractual governance mechanisms. Afterward, as the relationship unfolds and both parties experience higher levels of trust towards each other, they may start deviating from contractually prescribed behaviors and resort to more informal governance (Poppo & Zenger, 2002). The results of the present study do not support this relatively popular point of view. Client A has much longer relationship experience with Supplier A than with Supplier B. Nonetheless, it pursues identical relationship governance strategies with both of them. In fact, the client's representatives expressed an opinion that it is important to introduce some informal/relational governance right from the beginning of a relationship as it shows "good will" of the parties and promotes flexibility. Overall, it seems that the length of the relationship does not influence the client's decision to resort rather to formal or to informal governance of its exchanges with the suppliers. In fact, both governance modes appear to be employed from the beginning of the deals. This suggests that the informal governance may not be a product of interorganizational trust, but rather its antecedent. However, this finding should be treated with caution as its validity may be compromised by the fact that Supplier B was an insurance customer of Client A for some time before they entered into the IT outsourcing relationship. Thus, they were not complete strangers to each other right at the beginning of the relationship, and they may have already had a certain level of trust for each other. Considering the above, more research might be needed in order to clarify the role of the relationship length in the governance of the IT outsourcing deals.

Given the divergence of profit motives between IT buyers and suppliers (Lacity & Hirschheim, 1993), many researches argued in favor of contractually governed IT outsourcing relationships (Lonsedale, 2001; Lacity & Hirschhaim, 1993; Lusch & Brown, 1996; Jorgensen, 1996). These researchers insist that shorter term outsourcing contracts with precise and clear Service Level Agreements as well as attached to them penalties and rewards should be the major governance mechanisms of the IT outsourcing deals. Client A seems to follow this popular point of view only to a certain extent. This client indeed embarks on shorter-term outsourcing deals and pays close attention to the contractual clauses that deal with price and termination penalties issues, which is in agreement with transaction cost perspective expressed above. However, the company deviates from the contractual methods of day-to-day relationship management and resorts to the relational tactics in order to ensure the quality of the service and the flexibility of the relationship. Such combination seams to lead to the overall IT outsourcing relationship success.

6.6. Limitations

It has to be noted that the presented above initial exploratory case study has several limitations. Aside from the small sample size (two cases), which is not inappropriate for this type of study, a key concern is that only "successful" IT outsourcing relationships were evaluated. In order to expand and validate the findings it would also be appropriate to compare these findings to those of "less successful" IT outsourcing deals. This would help to ascertain if the features identified above are only applicable to "successful" IT outsourcing relationships.

Moreover, it would be very essential to test the developed here conceptual model in another client-industry setting, which would enhance the external validity of the model by defining the boundaries of its relevance (Yin, 1994). Finally, the IT outsourcing client in this study pursues a selective outsourcing strategy, therefore both of its' IT outsourcing relationships involve relatively commoditized IT services that require lesser transaction specific investments on the client's apart and lesser contractual hazards (Barthélemy, 2003). It would be imperative to compare these research findings and apply the developed integrative model to larger more complex IT outsourcing deals.

7. Second Stage of the Research

7.1. Methodology

Considering all of the above and in order to enhance the external validity of the integrative IT outsourcing relationship model, the second stage of the research was undertaken comprised of three replication case studies that would address the limitations of the initial research. The importance of the replication studies is in the development of a richer theoretical framework (Yin, 1994). Each case presented below was carefully selected so that (a) one of them predicts similar results (*a literal replication*), while the other two produce contrasting results, but for predictable reasons (*a theoretical* *replication*) (Yin, 1994). The necessity and contribution of these subsequent case studies is in that they collectively address the limitations of the initial research sample. In fact, two out of three relationships are unsuccessful. In addition, all three IT outsourcing relationships belong to a different industry, and one of them represents a very large outsourcing arrangement.

7.2. Case Study Sample & Data Collection

For the subsequent three control case studies, four representatives of three organizations that were involved in a triadic IT outsourcing relationship were interviewed. The parties to the relationship as well as the nature and the structure of the IT outsourcing dealings between them are described in the following.

Client B organization is the eleventh largest airline in the world with passenger and freight operations to more than 160 destinations on five continents. The airline employs 33,000 people worldwide serving 31 million customers annually with a fleet of more than 300 aircraft maintained at major facilities across North America. It is important to notice that over the past three years, traditional airlines around the world have been battered by a series of events: the high tech meltdown which started in 2000, the economic slowdown starting in 2001, the terrorist attacks of September 11, 2001, the rapid growth of new low cost airlines, high oil prices, the war in Iraq and SARS, - have all contributed to the crisis which all international airlines including Client B faced at the time of the study. In an effort to head off a drop in the number of passengers and rising costs for security, airline companies laid off staff and trimmed services. Many of them even had to file for bankruptcy protection. Present industry situation is such that businesses of mainline air carriers are under immense pressure to increase efficiencies and reduce costs, operating in a highly competitive market with huge pressure to achieve profitability. Profit recovery in the future clearly rests on cost reduction and efficiency gains. In order to achieve those financial goals, airlines are certainly putting IT to work to help cut costs and enable the simplification and transformation of the business (Financial Times, October 2003). Indeed, president of Client B recognizes that "in the 21st century the airline business will be based on information technology, not just aircraft". Therefore the airline's present strategic commitment is to actively invest in new Internet applications and hi-tech innovations which make the air travel experience easier or more economical for both passengers and the company (Speaking Notes For President and CEO, Client B, The Speakers Forum: The leaders Lecture Series, The World has Changed: [Client B] responds to the challenges facing the airline industry during turbulent times, 2003). In fact, Client B seems to live up to its strategic IT orientation as it became one of the first airlines in North America to introduce the convenience of self-serve check-in kiosks at major airports. Moreover, Client B offers electronic ticketing on virtually all of its North American routes, and is expanding this convenient service to include international destinations as well.

Overall, this particular client's direction is representative of the entire airline industry. The industry experts forecast that air travel, which already provides the web with it highest value business, could become the first sector to have a majority of sales on line (Airline Business, July 2004). However, although across the airline industry the transition to Internet systems continues to develop, the industry is, in many ways, still hampered by the past. The collapsed IT budgets of the airlines have not yet recovered and the IT departments face harsh corporate demands of doing more for less. According to *Airline IT Trends Survey 2004*, airlines report, on average, 2.1% of their revenue devoted to IT, which is slightly down on the previous year and also on a lower revenue base.

Given the strategic importance of IT to the future of airline industry and taking into account the companies' presently tight IT budgets, it becomes increasingly imperative for the airlines to effectively manage their IT suppliers. Hence, the research question: "*How should the relationship between IT suppliers and customers be governed in order to ensure the relationship success?*" is very relevant to this particular industry setting. In fact, high reliance by the airlines on IT and their difficult financial situation could both affect the nature of the IT outsourcing governance in this industry. As airlines seek to restructure their core businesses around new internet technologies, which could provide them with significant competitive advantage and cost savings, they might regard their relationships with the IT suppliers as innovative partnerships and thus resort to the more informal/relational governance. However, high budgetary restrains presently facing airlines may influence them to use more of transactional approach to the governance of the IT outsourcing relationships. It seems important to address these specifics of the airline industry before proceeding to the analyses of the cases that follow.

Supplier C is a Canadian branch of the world's largest information technology company and largest supplier to the airline industry. Supplier C creates, develops, and manufactures various advanced information technologies, including computer systems, storage devices and microelectronics. Supplier C is also the world's largest information technology services provider, with nearly 150,000 IT professionals serving customers in 160 countries worldwide. In 1994, Client B and Supplier C signed a large (1.4 billion) 7-year IT outsourcing contract, under which Supplier C managed all of Client B's computer and IT operations. Supplier C also managed Client B's global IT infrastructure, including application development and maintenance, 20,000 workstations, employee help desk services and network and computer server operations. In 2001 the first contract expired. Since, Client B reevaluated this IT outsourcing deal and awarded Supplier C with a new somewhat modified 7-year IT outsourcing contract. The new agreement expands on the previous IT outsourcing relationship in that the client and the supplier started working together on pursuing new business opportunities in the areas of customer service and leading-edge travel industry solutions. For that matter, the parties established a joint project management office, and the jointly-developed solutions will be offered to other companies through a marketing alliance created between Client B and Supplier C. In addition, Supplier C pledged to invest in various venture capital and technology projects at Client B. Overall, this later IT outsourcing agreement created a strategic partnership between these companies. It is the largest airline services agreement worldwide for Supplier C, while Client B expects to save approximately $200 million dollars in IT costs over the term of the contract.

Supplier D is the world's leading provider of global Information Technology and Telecommunications (IT&T) solutions to the air transport and related industries. With over 50 years of experience, it has 3400 employees and offers a portfolio of telecommunication, application and desktop services specifically for the air transport industry. Supplier D is an international organization which is owned by the industry and provides the widest portfolio of managed data and voice network services over the largest in the world single seamless network to around 700 member-airlines and 1,800 customers It was founded primarily in order to bring together the airlines' existing communications facilities so that all users could take advantage of the cost efficiencies of a shared infrastructure. As of today, Supplier D has a network presence in over 2,100 locations in over 220 countries/territories. It provides services to airlines, airports, aerospace companies - organizations involved in aircraft design and communication - as well as logistics and travel distribution organizations, international organizations and governments. In addition to the network solutions, Supplier D now provides application and desktop solutions specific to the industry. As one of the founding members of Supplier D, Client B has multiple IT outsourcing agreements with them for delivery of different network and desktop services. One specific outsourcing contract that will be discussed in this study is the contract for desktop equipment support. Client B used to have a direct desktop equipment support contract with Supplier D, the implementation of which was supervised by the client's other major IT supplier, Supplier C. Thus, Supplier C was responsible for overseeing the contract between the client and Supplier D, but they were not involved in the contract writing process, and hence they were not accountable for the results of the relationship. Such relationship governance arrangement was discontinued in 2003, when Client B made a decision to reassign its contract with Supplier D completely to the Supplier C. As result of this rearrangement Supplier D became subcontractor of Supplier C in delivering essentially the same rage of services to the client. Only now, Supplier D's service delivery was completely managed and paid by Supplier C. Client B, however, would get a complete "pass through" on all potential cost savings.

Although somewhat complex, this triadic IT outsourcing relationship can be easily divided into three separate client-supplier arrangements, one of which had come to an end in 2003. More specifically, the present study investigated Client B-Supplier C and Supplier C-Supplier D relationships as well as at the discontinued direct relationship between Client B and Supplier D. The general information about the client and the supplier organizations presented above is summarized in Tables 5 and 6.

To ensure the internal validity of the findings, the research procedures employed in the previous study were carefully followed. A total of five semi-structured interviews were conducted with four participants. Interviews lasted anywhere from 1h to 3.5 hrs; the average length of an interview was 2hrs. All interviews were tape-recorded, transcribed and stored in the developed case-study data base. The obtained interview data was further corroborated by secondary documentation such as press releases, specialized magazine articles, excerpts from interorganizational service delivery and performance reports, and IT outsourcing contracts. In total, there was gathered over 150 pages of qualitative and quantitative data on the three organizations and IT outsourcing relationships between them.

Table 5

Client B Organization and Interviewee

Client company & interviewees	*Industry*	*Origin*	*Outsourced*	*Start of deal*	*Length of deal*	*Size of deal*	*People transfer*	*Customer of vendor company*
Client B • Manager, Strategic Sourcing	Air transportation industry	North America	3.Management of the entire IT infrastructure	2001	7 years	Over 75% of the IT budget	1200	Supplier C
			4.International Desktop Equipment Support	Ended in 2003	5 years	5000 equipment units	None	Supplier D

Table 6

Supplier C and D Organizations and Interviewees

Supplier company and interviewees	*Origin*
Supplier C • Vendor Manager	Multinational information technology corporation with head quarters in North America
Supplier D • Contract Delivery Manager • Contract Transition Manager	North American office of a multinational IT services provider for airline industry

The collected data were analyzed by following the same as in the previous case study process of developing concept cards, writing theoretical memorandums, looking for matching patterns across the cases, and building explanation for discovered causal relations. Like in the previous study, the cross-case summary of the exploratory findings presented below has been structured by use of the main dimensions and constructs of the integrative IT outsourcing relationship model.

8. Cross-case exploratory findings

8.1. IT Outsourcing Context

Following the data analysis process of the previous case studies, before proceeding to analyzing the crucial constructs of relationship success and relational governance mechanisms, it was important to take a closer look at the context variables of relationship length and power-dependency situation.

8.1.1. Relationship Length

It is important to notice that all three organizations have significantly long experiences of working with each other. Client B-Supplier C relationship started in 1994 when the client took what at the time was an unusual step and decided to outsource all of its IT operations to Supplier C. The parties singed an initial 7-year IT outsourcing agreement by which Client B moved its IT department onto the Supplier C's payroll. At the same time, the airline retained IT professionals who were experts on the regulations that affect how certain airline-specific technologies, such as reservations systems, are configured. Since then the client went back to tender in 2001 and the parties signed a new 7-year 1.4 billion CND IT outsourcing deal, which in fact represents the unit of analysis for the purposes of this research. The new contract calls for Supplier C to manage Client B's global IT infrastructure. The agreement also made the two companies investment partners in the client's attempt to recoup some of its expenses in developing airline-specific technology. It is evident that the strategic goals of the relationship between Client B and Supplier C have evolved significantly over time. The rest of this section will investigate whether the nature of interorganizational relationship governance and the overall relationship success have evolved as well.

The relationship between Client B and Supplier D dates back to the 80-s when Client B became a member and joined the shared ownership of the international airline industry's IT and Telecom provider, Supplier D. Since then the relationship between the parties has been multifaceted and developed on many levels. Supplier D has been providing Client B with wide range of IT services, including telecom networks, IP services, common use stations, application development, passenger travel and cargo solutions, desktop/IT infrastructure solutions and many others. The relationship between parties has been structured in a way that a separate contract was signed for each of the named above IT services provided by Supplier D. For the purposes of this research and based on the information availability, one such IT outsourcing agreement pertaining to international desktop equipment support services was investigated in course of the data collection period. As it was mentioned above the relationship started in the 80-s when Client B joined the ownership of Supplier D organization. Until 2003, the companies have signed several consecutive 5-year IT outsourcing contracts for the client's internationally located desktop equipment support. However since in 1994 Client B signed a major IT outsourcing deal with Supplier C, the latter was appointed to supervise this relationship between the airline and Supplier D. Finally in 2003, the direct contract between the client and Supplier D was ceased and the contract was completely reassigned to Supplier C.

Thus, the IT outsourcing relationship between Supplier C and Supplier D started where the IT outsourcing relationship between Client B and Supplier D ended. As a result, Supplier D became a subcontractor of Supplier C for providing essentially the same international desktop equipment support services to Client B. The Supplier C-Supplier D relationship started in 2003 with a one-year outsourcing contract. In 2004 they signed a new 5-year deal that is the focus of analysis in this research.

To summarize, all three organizations have an extensive experience of working with each other. Even though the IT outsourcing contract between Supplier C and Supplier D is recent, these two companies have been interacting and dealing with each other since 1994.

In the previous insurance industry case studies, the length of relationship has been found to have no effect on the nature of governance and the success of the IT outsourcing deals. The following analyses of the three outsourcing relationships will either confirm or challenge the initial findings.

8.1.2. Power-Dependency Situation

The findings of the previous case studies support the notion that unfavorable to the client power-dependency imbalance is inherent to the IT outsourcing deals and lays in the center of the client's motivation to employ different relationship governance mechanisms in order to protect their interests and ensure the relationship success. The analyses of data collected in course of these three consecutive case studies further confirm the pervasive dependency situation described in the literature. Although Client B is one of the largest companies of the world airline industry, it finds itself in the objective dependency position relative to its IT suppliers. Similarly, Supplier C, although being much larger multinational IT company than Supplier D, found them selves in dependent on the latter.

Client B ⇔ Supplier C

The relationship between Client B and Supplier C accounts for about 75% of the client's annual IT budget. Given that airline's core business of air transportation is heavily dependent on the underlying information technology and taking into account that the majority of the client's employees (about 1200) were transferred to the supplier under the first IT outsourcing contract in 1994, Client B can be objectively considered dependent on Supplier C. The following statement from Supplier C's IT manager illustrates well such dependency:

> We could crash [Client B] if we took 1200 people and said "Ok, thank you, you did not award me the contract. I am walking out of the door." The airline would shut down within 24 hours. It is guaranteed! The main system, if they did not have the right people to run it, - it would shut down immediately. When the main systems go down, it takes 6 hours before the airline stops all the flights. That is how critical it is to have it 365 days a year. (Vendor Manager, Supplier C)

In addition both the client and the supplier agree that there are very few players in the IT world that are capable of providing IT services to the airline industry. To begin with, there are not a lot of IT companies that can handle such large corporate accounts; and even those IT companies that could handle the international scope of the airline IT operations would most probably lacks the understanding of and the experience with airline business.

When asked whether it seems possible for the client to switch from Supplier C, the client's representative responded: "…the scope of the services that it [contract] relates to is so wide that taking away all of it? No, I do not think we would easily entertain that idea." (Manager, Strategic Sourcing, Client B) This statement supports the existing among academics view that larger IT outsourcing agreements bring larger switching costs (Heide & Weiss, 1995) and greater technological uncertainties for the clients and thus increase their dependency on the suppliers (Barthélemy, 2003).

It should be noticed however that this client is also very important to Supplier C. It provides them with very significant annual revenues, and even though for the past few years this corporate account was not very profitable for the supplier, it sill contributes significantly to their bottom line:

> It really comes down to numbers game. And that is because the contract is so big whether or not we are winning money or loosing money, it is irrelevant. It is the balance sheet in Toronto. [Corporate office of Supplier C] wants to retain several hundred million dollars per year revenue on their balance sheet. (*Vendor manager, Supplier C)*

Moreover, Supplier C is currently trying to position itself as the world's leading IT provider to the air travel industries. Thus they look to partner on more projects with Client B in order to learn more about airlines' business and the strategic objectives of the companies in the industry. The supplier's representative indicated that such knowledge would help them greatly in the future biddings for the IT outsourcing contracts with other airlines, airports, and air travel agencies.

Overall, it seems that both the client and the supplier in this IT outsourcing dyad are aware of their dependence on each other. However, while Supplier C's dependence on Client B is mostly based on their strategic intentions, Client B is greatly dependent on its IT provider for both the every day core business operations and the strategic IT developments.

Client B ⇔ Supplier D

As one of the funding members of Supplier D, Client B has extensive IT outsourcing arrangements with the former. One of them, pertaining to international desktop equipment support and reassigned in 2003 to Supplier C, constituted the focus of this case study. The investigated IT outsourcing agreement was relatively small as for the client same for the supplier judging by its absolute dollar value and the quantity of equipment covered (5000 equipment units).

Nonetheless, Client B found itself in highly dependent on Supplier D position for two important reasons. First, most of the companies in the airline industry are international with many offices and operations around the globe. Supplier D, as a cooperative IT provider for the industry, is the only IT organization in the world that has a network presence in over 2,100 locations in over 220 countries/territories. Thus, the only alternative to sourcing from Supplier D would be to sign many small agreements with different local IT suppliers around the world, which would of course involve much higher contract management costs for the client. Second source of the client's dependency is the fact that to this day Supplier D remains a monopolistic provider of numerous telecom and business solutions specific to the airline industry: "Often times, [Supplier D] is the only supplier of certain services - monopoly supplier, in other words. So we do not have a choice…" (Manager, Strategic Sourcing, Client B) Thus, even though Supplier D was awarded this specific contract mostly due to its geographical presence advantage, they gained additional bargaining power in this relationship by being a monopolistic supplier of many other IT services provided to the client.

The client's representative insisted that the reassignment of this contract to Supplier C is not an indication of the client's lesser dependency position relative to Supplier D, rather the contract had to be transferred due to the changes in nature of the relationship between Client B and Supplier C:

> *Researcher*: Why then you reassigned the contract with Supplier D to Supplier C?
> *Respondent*: Because [*under the new agreement signed in 2001*] we sold all of our assets to Supplier C. We used to manage our own assets, especially internationally, but in 2001 we sold all of our assets to Supplier C, so it became their responsibility to do the maintenance, so we had to assign this contract to them. (Manager, Strategic Sourcing, Client B)

It seems important to point out that by assigning the contract to Supplier C rather than terminating it, Client B has successfully avoided the negative consequences of their dependency on Supplier D, namely the switching costs and possible "retaliation" by the supplier on the other IT outsourcing agreements.

Supplier C ⇔ Supplier D

Supplier C inherited the dependency position from Client B with regard to the international desktop equipment support services provided by Supplier D. Although Supplier C is a large multinational corporation and could possibly provide this type of IT services themselves, they still do not have such extensive global presence as Supplier D does. Besides, being owned by over 700 airlines of more than 200 nations, Supplier D has opportunities to negotiate better customs clearance conditions with many local governments. Thus, to efficiently provide Client B with international desktop equipment support services, Supplier C needs Supplier D's assistance.

Moreover since Supplier D has much more expertise in the airline industry, Supplier C wants to keep on good terms with them because they will need to partner with Supplier D and draw on their expertise in the future bids for other airlines and in order to strengthen their own position on the air travel market:

> And that is why you need to establish a long term relationship. It builds confidence over time, it opens the doors. May be new initiatives that Supplier D has, they will come to us first. They will say "You guys are our business partners. We like doing business with you." Do not forget that when I go to the airport bids a year from now, I have already talked to Supplier D about partnering together against our competitors. It is a small industry, we buy services from each other for Client B, and we also compete head to head on the airport base… (Vendor Manager, Supplier C)

Overall, it can be concluded that in all three IT outsourcing relationships the buying parties find themselves in objective dependency positions relative to their suppliers, which in turn exposes them to the suppliers' opportunism. Interestingly, the high dependency position of the clients in the airline industry is very similar to that of the clients in the insurance industry. Together these findings show considerable support for the existing academic view of IT outsourcing dyads as relationships where clients are locked-in. It seems that the power-dependency imbalance of IT outsourcing relationships is a pervasive phenomenon independently of the client-industry type.

Under such circumstances, the next important data analysis step was to investigate whether the clients were able to ensure the success of their IT outsourcing deals and what relationship governance mechanisms they employed in order to do so.

8.2. Assessment of Success of the IT Outsourcing Deals

The analyses of the data collected provide some additional support for the three-dimensional customer satisfaction construct as operationalization of IT outsourcing relationships success. The representatives of Client B and Supplier C organizations were asked to give their overall impressions of a relevant relationship and score the relationship success on the scale from 1 to 5. Client B scored their relationships with Supplier C and Supplier D as relatively unsuccessful, 2.0 and 2.5 respectively; while Supplier C gave a score of 4.5 to their outsourcing relationship with Supplier D. Further, the representatives were asked to support their opinion with examples and define characteristics of relationship that they see as very important to success of a particular deal. The obtained responses are organized below by the constructs of customer satisfaction with financial returns, product/services, and suppliers' service representatives.

8.2.1. Satisfaction with Products/Services

The main concern for Client B, in their relationship with Supplier C, is inadequate service quality: "Well, our contract was negotiated very tightly with respect to SLAs and critical service levels… Every missed is reported and analyzed and so on. I do not think that there is a week that goes by without a missed SLA of some kind." (Manager, Strategic Sourcing, Client B)

The client's representative admitted to have had much less service delivery problems with Supplier D. However, as she pointed out, such difference in absolute numbers of "misses" can be attributed to the fact that scope of the contract with Supplier D was much smaller, and the SLAs where much less exhaustive than those with Supplier C.

Supplier C however is rather satisfied with services provided by Supplier D. Moreover, they are very understanding of occasional delays in service delivery that are almost inevitable due to the geographical and cultural distance among international service delivery sites.

8.2.2. Satisfaction with Financial Returns

The two major goals Client B pursued when engaging into a large IT outsourcing agreement with Supplier C were to cut their IT costs and to better focus on their core business. In course of the second current contract, cutting costs became especially important objective since the airline found itself in a very difficult financial position and was struggling to reduce its operational costs on all levels in order to survive. September 11 happened literally eleven days into the client's new contract with Supplier C, and the whole airline industry went into an immediate slump. The client was compelled to go back to all of its partners and suppliers, including Supplier C and Supplier D, and try to renegotiate their deals on more favorable financial terms. This exercise did not go as well as Client B wished.

After a very long negotiations period (a year) Supplier C finally made some substantial price concessions (10 million per year), but more than 80% of this cost reduction came with reduction in scope and quality of services. Client B found Supplier D to be even more difficult than Supplier C when it came to financial negotiations. The client's representative pointed out that Supplier D most of the time exercises a monopolistic approach to pricing.

Supplier C on the other hand was quite satisfied with their financial exchanges with Supplier D. They indicated to have been able to achieve about 50% of cost savings comparing to the time when the account was managed directly by Client B.

8.2.3. Satisfaction with Service Representatives

Client B expressed general dissatisfaction with the service representatives of both Supplier C and Supplier D. According to the client's Strategic Sourcing manager, their relationship with Supplier C lacks collaboration and flexibility: "It is supposed to be more of a teamwork, it is supposed to be a variety of things, but there are still an awful a lot of frustrations and concerns on our part over a number of issues. You know, Supplier C is… they are a very bureaucratic company to deal with…" (Manager, Strategic Sourcing, Client B)

Supplier C's representative supported the client's opinion about lack of collaboration on both sides of the deal:

> The success rate of the relationship in the outsourcing agreement is highly dependent on who are the players on both sides. If I have an open-minded, flexible account team within a customer base and the same within [Supplier C], that is typically the environment that we work for. If I look at most [Client B's] accounts today that are having problems, it is mostly the executive teams that are having problems resolving the issues. (Vendor Manager, Supplier C)

With regard to their dissatisfaction with service representatives of Supplier D, the client expresses the following opinion:

> Oh, Supplier D is difficult to deal with also. They showed even less flexibility than we have found with Supplier C… It is very difficult for them. I think it is to some extent their monopolistic view that, you know…They are there to serve the airlines and in a lot of cases the airlines do not really have any other place to go. (Manager, Strategic Sourcing, Client B)

On the other hand, Supplier C sited a trustful and flexible relationship with Supplier D's representatives as a major contributing factor to their overall satisfaction with the relationship:

> Form 1 to 5, 5 being the highest, I would say right now we are about 4.5. I would not say it is perfect, I do not think there is such thing as perfect. But again a lot of it has to do with the fact that [Supplier D's contract delivery manager] and I can have a very rational discussion, be very objective, be very understanding and flexible. We each understand each others business. We both have a lot of experience and there is trust there. That is one reason that significantly contributes to the rating 4.5. (Vendor Manager, Supplier C)

To summarize, Client B expressed significant levels of dissatisfaction regarding financial returns, services and service representatives of both IT suppliers. Interestingly however, the major factor contributing to the low overall relationship success with Supplier C was the client's dissatisfaction with service deliveries, while the relationship with Supplier D mostly suffered because of the supplier's monopolistic attitude towards pricing. The fact that the client assigned a slightly higher score to their prior relationship with Supplier D (2.5 comparing to 2.0 for Supplier C) could be an indication that low satisfaction with financial returns might have less of a negative impact on the overall relationship success than does dissatisfaction with products/services. Although, such difference in scores may also be explained by significant differences in the relationships' scopes and sizes, and therefore the impact they have on the client's bottom line. Overall, both of these relationships represent good settings for the theoretical replication case studies. The two following sections will present the analyses of the combination of formal and informal governance mechanisms that led to such poor relationship success of these IT outsourcing deal.

Meanwhile, the IT outsourcing deal between Supplier C and Supplier D is a good example of a successful relationship. In fact, this relationship was assigned a higher success score (4.5) than the two previous case studies in the insurance industry (each relationship was scored as 4). Thus, it is important to investigate the nature of this relationship's governance in order to further confirm or challenge the integrative relationship governance model developed in the course of the initial case studies.

The findings of the initial case studies showed strong support for complementary use of formal/contractual and informal/relational governance mechanisms in order to ensure the IT outsourcing relationship success. Moreover, the interactive nature of such approach revealed itself in different roles assigned to formal and informal governance with regard to managing different types of interorganizational exchanges. For instance, formal governance was found to be the most important in managing interorganizational financial exchanges. Given the divergence of clients' and suppliers' monetary objectives, financial exchanges between them are better managed by adherence to shorter-term explicit contracts with written-in strict benchmarking and termination clauses. However, service exchanges between the companies are better managed through informal/relational governance which manifests itself in deviation from "management by SLAs and penalties" and promotes a spirit of "good playing" and "give-and-take" between the parties, thus increasing the technological flexibility and longevity of the relationship. At the same time, the interorganizational information exchanges need to be managed both formally and informally. Formal governance of interorganizational communications is performed through creation of management positions designated to facilitating communications between the parties, regular technical and financial reports, scheduled interorganizational meetings on all managerial levels directed at resolution of specific issues as well as at suppliers' learning of client's business environment and objectives, and frequent customer satisfaction surveys. Informal interorganizational communications were found to be even more important to the customer satisfaction with the suppliers' service representatives, and thus to the relationship success. Informal interorganizational communications increase as the key client and supplier representatives show more trust and flexibility towards each other.

The described above interactive governance approach seems to lead to the overall relationship success for the dyads Client A-Supplier A and Client A–Supplier B. At this research stage, it is important to investigate whether the successful Supplier C–Supplier D outsourcing relationship is also governed as the integrative model proposes (See Figure 3). In addition, it is even more important to investigate the governance mechanisms that lead to the low relationship success in dyads Client B-Supplier C and Client B-Supplier D as the findings of these case studies may enrich and extend the developed above theoretical model.

Interestingly, when comparing the findings of all five case studies, a potentially crucial observation was made: the relationship between Supplier C and Supplier D seems to be the "most successful", while both IT outsourcing relationships of Client A were "successful" and both IT outsourcing relationships involving Client B were "unsuccessful". There could be two probable explanations of this occurrence. First possible explanation is in agreement with the developed here integrative model which regards the relationship governance mechanisms as the major drivers of the relationship success. Under integrative approach, it was proposed in this thesis that the IT outsourcing clients will use a combination of formal/contractual and informal/relational governance mechanisms in order manage their relationships with the supplier. Thus, it could be that each of the investigated here IT clients employs its own combination of relationship governance mechanisms that ultimately leads to a certain level of relationship success. The initial case studies of Client A's IT outsourcing relationships, indeed, demonstrated that the client uses the same combination of formal and informal governance for both of its IT outsourcing deals. Thus in the following analysis of the Client B's IT outsourcing deals, it is important to verify whether the client used the same governance approach to the management of both of its suppliers.

Second plausible explanation of the trend detected above is not included in and, in fact, challenges the integrative IT outsourcing relationship model, as the differences in client-industry settings could be, in great part, responsible for the ultimate success or failure of the IT outsourcing relationships unfolding within them. Indeed, the initial insurance and airline industry analyses showed that the insurers are presently in much better financial situation than airlines. In the 90-s, while the airline industry was one of the pioneers in total IT outsourcing, the insurance industry was lagging behind by performing most of the IT functions in-house. Recently, however, these trends reversed. The insurance companies are now looking at IT outsourcing as means to gain competitive advantage, and for that they need to establish enduring and effective partnerships with their IT providers. Meanwhile, the airline industry is still in crisis. Many of the world's largest airlines have not yet emerged from bankruptcy protection, and those that did (like Client B) had to significantly cut their costs in all business areas, including IT outsourcing budgets. Such industry situation certainly could influence the airlines' IT outsourcing objectives and the way they deal with their IT suppliers. On the other hand, the apparent high level of Supplier C – Supplier D's relationship success could be explained by the fact that both companies belong to the same industry and therefore think in the same terms and understand clearly each others business objectives.

Overall, it was imperative to pay close attention to the possible client-industry effect on the nature and the success of IT outsourcing deals when conducting cross-case analysis of the relationship governance mechanisms employed by the parties in the exchange channels between them.

8.3. Formal/Contractual Governance

As in the initial case studies it was important to start with the analyses of contents of the contractual agreements between the parties. Since contract is an important foundation of the formal relationship governance, it has to be relatively short term and explicit with regard to the management of all three types of interorganizational exchanges.

As it was pointed out before, there are no "one-size-fits all" clauses (Barthelemy, 2003). The content of a good explicit contract varies depending on the type of outsourced IT activity and the contractual hazards associated with it (Williamson, 1991). Since Client B outsourced more then 75% of its IT activities to Supplier C, such relationship can be characterized by higher switching costs and contractual hazards (Barthelemy, 2003; Grover et al., 1996). Therefore contract between Client B and Supplier C is expected to be more complex and include more formal governance mechanisms than the relatively small contracts that Client B had with Supplier D and Supplier C has with Supplier D. The clauses employed in all three contracts are listed in Table 7.

Indeed, Client B-Supplier C outsourcing contract is much larger and more exhaustive than the other two contracts. Since this IT outsourcing agreement involves both a significant number of transferred employees and handing over to the vendor of the ownership of material assets, the "contract termination" section of this document is quite large and consists of the multiple human and material reversibility clauses. The parties to the agreement also pledged to jointly invest in various R&D projects specific to the airline industry and jointly market the developed solutions the other airlines. Hence, contract uses not only regular "fixed price" and "benchmarking" clause, but shared "risk and reward" clauses as well. Vendor management clauses of this contract are also very exostive and have multiple penalties attached to very explicit SLAs.

Table 7

The Content of the Three IT Outsourcing Contracts

Contractual Clauses	**Total IT Outsourcing Client B & Supplier C**	**Desktop Equipment Support Contract: Client B & Supplier D**	**Desktop Equipment Support Contract: Supplier C& Supplier D**
Contract amount	Over 75% of the client's annual IT budget	Undisclosed (5 000 units of equipment)	Undisclosed (5 000 units of equipment)
Transfer of employees	1200	None	None
Contract duration	7 years	terminated	5 years
Number of pages of the contract	200 pgs	15-20	70
Vendor management clauses			
Service level reports with service level measures	X	X	X
Bipartite committees with regular meetings	X		X
End-user surveys	X		
Cash penalties for nonperformance	X		X
Escalation procedures	X	X	X
Adaptation to the changing environment			
Adjustment of charges to changes in your business with a guaranteed minimum volume for the vendor	X	X	X
Adjustment of charges to changes in your business with a non-guaranteed minimum volume for the vendor			
Evolution of technology towards market standards	X		
Price clauses			
"Fixed Price" clause		X	X
"Benchmarking" clause	X		X
"Risk and reward" clause	X		
Contract Termination clauses			
Material reversibility with vendor's assistance at the end of the contract	X	X	
Human reversibility with vendor's assistance at the end of the contract	X		
Material reversibility with vendor's assistance in case of anticipated contract severance on behalf of the client	X		
Human reversibility with vendor's assistance in case of anticipated contract severance on behalf of the client	X		
Severance clause in case of gross mistake or negligence from the vendor.	X	X	X

The Client B's representative admits that the contract is quite long in duration, but given the scope of the services covered and joint investment projects intended by the parties, it was not viable at all to sign any shorter outsourcing agreement.

Interestingly, the contracts Client B-Supplier D and Supplier C-Supplier D although covering essentially the same services are quite different in content. The first indicator that the contract between Supplier C and Supplier D is more explicit is the different number of pages of the contracts: Supplier C-Supplier D contract is three times as long as Client B-Supplier D contract. The SLAs of the current contract are much more precise and exhaustive and have substantial monetary penalties attached to them. The same can not be said about the expired contract between Client B and Supplier D. Moreover, the old contract did not have any benchmarking clauses, while the new contract does. Overall it seems that Supplier C-Supplier D contract is much more explicit than Client B-Supplier D contract was. Both Client B's and Supplier C's representatives verbally expressed similar opinion that old Client B-Supplier D contract was not explicit enough. Finally, the 5-year length of a desktop equipment support contract considered to be a standard length in the industry.

To summarize, the IT outsourcing contracts between Client B and Supplier C and between Supplier C and Supplier D can be considered rather explicit, while the terminated contract between Client B and Supplier D was not considered adequate, and therefore did not empower Client B with sufficient formal relationship governance mechanisms. These findings show partial support for the TCT argument that contract is the foundation of a successful relationship. Like in previous Clint A's outsourcing dyads, Supplier C- Supplier D's successful IT outsourcing relationship started with them signing a good explicit contract. Meanwhile, the terminated unsuccessful Client B-Supplier D relationship did not have a good contractual foundation, which would preclude the client from relying on formal governance. Interestingly although the Client B - Supplier C relationship started with a very explicit outsourcing contract, the parties were not able to achieve high levels of relationship successful. It is important to further investigate whether the client manages its IT outsourcing relationship with Supplier C strictly by the "letter of contract". For now however, the findings suggest that a good contract is a key but not a single factor of the relationship success.

The following subsections present the findings with regard to the governance of interorganizational service, financial, and informational exchanges between the parties of the three IT outsourcing dyads through the contractually prescribed behaviors.

8.3.1. Product/Service Exchanges

The exchanges of IT services formed the core interactions in all three relationships, yet they were managed very differently in each of these IT outsourcing dyads.

In the beginning if the interview, Client B indicated that they were dissatisfied with ambiguity and extreme looseness of the SLAs in their initial contract with Supplier

C, which allowed the supplier constantly under deliver some of the critical IT services. Consequently, a new contract was vigorously negotiated by the client in order to make SLAs as explicit as possible, develop accurate and mutually acceptable measurements of service delivery with attached substantial monetary penalties to the supplier for failure to meet new SLAs. From the day this new agreement was completed and signed, the client consciously started governing service delivery "by the letter of contract." The supplier's SLA performance is carefully measured by people on both sides and these measurements are jointly reviewed on monthly bases. After each of these monthly reviews, Supplier C gets penalized if they miss an SLA on any of the critical IT services. When asked whether they consider such formal governance of interorganizational service exchanges to be successful, the client's response was:

> This is the difference about the new contract. In the old contract there was no notion of penalties for misses and outages. Applying the penalties in the new agreement is discretionary. It is optional on our part. We can choose to invoke it or not. We have chosen to invoke it right from the beginning and on consistent level. And still it does not seam to have removed whatever the probable causes that keep us having outages…not a week goes by without some kind of miss on their part… (Manager, Strategic Sourcing, Client B)

Obviously, managing interorganizational service exchanges by SLAs and penalties does not really work for this client. Not only Supplier C continues missing their critical service deliverable, but they also try to get away from penalties by disputing interpretation of various contractual terms. The following exert vividly illustrates the supplier's reaction to the formal service delivery governance:

> It is not normally the contract issues that cause problems. I think it really comes down to the people. That is really where the issues are. They are more political issues, they are not contractual issues. And contractual issues…anybody can make up a contractual issue. When we sit down to

> discus the problem, we either can discuss this one and that one and take on each point of the contract or we can sit in the room and say "Ok, I will be honest with you, we are a little bit low on SLA here. We have missed it last month. We need another month or two to get there". "Ok, that is fine. The other SLAs are good? Ok, fine…" and that type of soft relationship tends to get you where you excel much quicker. But when we get in to "Yeah, but appendix C and exhibits B say that you should do so and so" and then you get into contract interpretation disputes, and then we get legal teams involved, and then we spend 8 weeks trying to figure out what it is supposed to say, what was the intent. And the people who wrote it, and the people of [Client B] who signed it are no longer here, so we do not understand what the intent was… And those debates consume so many cycles that the supplier and the customer teams start focusing on what the intent was. The intent was to reduce IT costs! And second, the intent was to take [Client B] to the leading edge of technology! That is what supposed to matter the most! And you see how people can get tied up in this type of SLA management issues. (Vendor Manager, Supplier C)

Client B's past relationship with Supplier D was even less successful with regard to the formal governance of interorganizational service exchanges. To begin with, the IT outsourcing contract between the companies did not clearly spell out the SLAs, and there were no penalties attached to them either. As a result, there would be still regular joint performance reviews, but each party would measure the supplier's performance on SLAs differently. And even in instances where supplier would admit that they missed a certain SLA, there were no means of formal punishment available to the client.

The following remark from the Supplier D demonstrates the lack of the clear service delivery measures in their past relationship with Client B:

> We were measuring what we felt was SLA compliance. We would take a fault-management call from the client and say: "Oh, that is a peace of server that we do not cover...Next! Oh, this was a right call, but they did not provide us with the right ID…Next! Oh this looks OK and we made it on this one" …So we would measure ourselves only on that… (Contract Delivery Manager, Supplier D)

From the excerpt above, one can see that Supplier D responded only to one out of three service requests of the client. Nonetheless, the supplier considered itself fully meeting the SLAs, while Client B saw them as failing miserably. Since the SLAs of the contract were not specific enough from the beginning, it is impossible to judge who was right and who was wrong. The only thing is obvious however - the badly written IT outsourcing contract condemned this relationship for a failure, since the parties did not have clear expectations of each other, and the client had no formal means of punishing the supplier for their opportunistic behaviors.

The service exchanges in the relationship between Supplier C and Supplier D are governed quite differently from the other two relationships described above. From the beginning the parties spent a considerable amount of time (about 1 year) in order to restructure and optimize the reassigned to Supplier C from Client B desktop service agreement with Supplier D:

> So, as soon as I got [Supplier D's] contract, I reviewed it and said "Ok, let's do gap analyses." What we found was that we had to change the service levels; we had to rework the entire process… I said "Guys, we are going to go through a statement of work, and anything that is not clear to you – flag it! We will put as much framework as we can." So, first thing we started of with was a very clear contract. (Vendor Manager, Supplier C)

Both parties admit that initially they spent a lot of time discussing the contract and all of its possible interpretations. At the end, they came up with explicit and measurable SLAs and attached to them financial penalties. Indeed, Supplier C and Supplier D both agree that taking time at the beginning of the relationship to develop the contract as explicit as possible was very important to their relationship success. As result, the companies have only occasional contract interpretation issues, which allows them keeping interorganizational conflict at the minimum level.

Interestingly however, the parties resort to the informal day-to-day governance of service exchanges between them and keep the contract "on the shelf". In fact, Supplier C and Supplier D both consider it to be counterproductive when a relationship is managed strictly by SLAs and penalties. When asked why they prefer informal governance over contractual, Supplier C replied:

> Well, to me, once the contract gets put on the table and people start saying "According to exhibit A, C and so forth and so on…" Once you get to that discussion, your relationship is falling apart… So, we do have monthly performance reviews, we do look at the service levels. However, what I find is if you start to manage your vendor 100% by your SLAs and the contract, then you will force your supplier to only focus on delivering those SLA and the relationship inevitably looses its flexibility. (Vendor Manager, Supplier C)

Overall, Supplier C-Supplier D outsourcing relationship reveals a very interesting picture. On the first look it is similar to the Client A – Supplier A and Client A – Supplier B relationships in what concerns the clients' movement away from managing interorganizational service exchanges by SLAs and penalties. However, the representatives of Supplier C and Supplier D stressed the importance of starting the relationship by writing explicit contracts with clear SLAs and substantial penalties attached them. Why is it so important to the parties to spend a significant time writing the SLAs and the penalties, just to reverse to the informal service delivery governance when the contract begins? It appears that having explicit SLAs helps the parties to bring clarity and structure into service exchanges between them and to set up mutual behavioral expectations (Lusch & Brown, 1996). Moreover, the exhaustive SLAs lead to lesser misunderstandings and major interorganizational disputes, and thus to lesser costly rewrites of the contract (Jorgensen, 1996). It seems that substantial penalties attached to the SLAs provide a good opportunity for the client to show some flexibility and "good will" by not invoking them on the occasions of "misses" on the part of the supplier. Such flexibility can be later traded of for the supplier's various technological and financial concessions. At the same time, the written-in penalties allow the client to revert to the formal service delivery governance if the informal relationship governance does not bring the desired outcomes or if the supplier is thought to behave opportunistically.

The case studies of the Client A-Supplier A and Cleat A-Supplier B outsourcing dyads did not bring enough attention to the importance of the explicit contract to the governance of interorganizational service exchanges. In fact, the initial research seemed to suggest that the informal governance was put in place by the parties in order to get rid of the contract. This conclusion is now being challenged by the Supplier C –Supplier D case study. Moreover, when aggregating the analysis of all three successful IT outsourcing dyads, it becomes clear that each of the relationships begun with an explicit contract containing exhaustive SLAs and substantial penalties attached to them.

The importance of writing explicit contract is further stressed by the fact that unsuccessful Client B – Supplier D relationship did not have a well-written explicit agreement at its base. Both parties to the relationship confirmed that due to the lack of contractual detail they had a lot of misinterpretation disputes and were unable to govern their service exchanges effectively.

Interestingly although based on a very explicit IT outsourcing contract, the Client B – Supplier C relationship remained unsuccessful. This suggests that the explicit contract is an important but not a sufficient factor of the relationship success. In fact, it seems that when explicit contract is also actively enforced within interorganizational service exchanges it does not lead to the customer satisfaction with services provided by supplier. This particular observation, however, should not be analyzed outside of the Client B – Supplier C relationship context. It very well may be that the client's reliance on the formal service delivery management through SLAs and penalties has lead to the unsatisfactory relationship outcomes. However, it is also possible that the client reverted to the formal governance because the informal/relational governance had already failed to ensure the relationship success. Indeed, Client B indicated that their previous contract with Supplier C did not have written-in penalties, yet the service delivery was already bad. A more detail analysis of the prior IT outsourcing agreement between Client B and Supplier C would be necessary in order to support or disconfirm either of the made above propositions. Some limited information collected during the current case study however suggests that the previous contract was not adequately explicit; thus, the relationship might have developed by similar to Client B – Supplier D case scenario.

Overall, the analysis of these three IT outsourcing dyads revealed a more important role of the formal governance with regard to the interorganizational service exchanges than it was suggested by the findings of the initial case studies.

8.3.2. Financial Exchanges

Right after "focusing on the core business", "IT cost cutting" was Client B's most important financial reason for entering in to an extensive IT outsourcing agreement with Supplier C. Therefore, client has put a lot of efforts into negotiating financially sound arrangements with the supplier both times in 1994 and in 2001. The initial outsourcing contract previewed a benchmarking exercise by the customer which they performed in 2000 with a help of a third external party. This benchmarking exercise went well according to the customer but not according to the supplier. The benchmarking study showed that Client B could still negotiated better financial terms for their next outsourcing contract if they would go back to tender with an official Request For Proposal (RFP). Supplier C however insisted that benchmarking study used flawed methodology and did not take into account a lot of value-adding services they have delivered to the customer over the past six years. Finally, Supplier C provided Client B with an unsolicited bid. Nonetheless, the client chose to "play it hard" and went ahead with RFP:

> There was a re-bid process that lasted at least a year and a half before the contract was signed… When you go to RFP, you do not do it lightly…you do not go through the bother of RFP if you do not really intend to change or if you are not open to considering changing supplier. I would say, we

> were ready to change supplier if we had to. (Manager, Strategic Sourcing, Client B)

As a result of RFP, Supplier C was still awarded a contract, yet Client B obtained the favorable financial conditions they were looking for.

One very interesting remark came up in the interview with Client B. The client pointed out that the fact of them using formal governance in the interorganizational service exchanges has made interorganizational financial exchanges even more formally governed by both sides. Moreover, the client suspected that certain unfavorable to them financial provisions of the contract were now probably exploited by the supplier:

> Well, certainly the fact that we have invoked the penalties on SLA side, I think, has made the overall account less profitable for them. So yes, it has generated some tighter discussions on the financial side. Are they trying to recover through other costs? Probably. (Manager, Strategic Sourcing, Client B)

On the other hand, Client B's past relationship with Supplier D lacked vigorous financial controls. Client B explained that because of Supplier D's monopolistic market position they showed exceptional inflexibility with regard to price negotiations.

When this later relationship was transferred to Supplier C, their initial attempt was to negotiate better prices. Therefore they went back to tender and solicited bids from other companies:

> Typically with contracts, first of all we talk about pricing: pricing on the products, services, software, licenses, and applications and so on. Very simple: you must give me the best prices that you have based on your overall volume of all your customers. I had to look for the implications [of this contract] for our financial systems, how we would be handling it, and

coding it and managing it. And then we went directly to [Supplier D] as well as to other suppliers and started soliciting them for a bid. And then we worked through the bids. (Vendor manager, Supplier C)

At the end however, Supplier C probably realized an advantageous competitive position of Supplier D and singed an agreement with them. When asked why they finally decided to go with the same vendor, Supplier C's representative responded:

> Because even if prices become 1 or 2% higher, it is not always the price that is important. You may be paying 2% less, yet you are receiving less in a contractually managed relationship than you could get in a good working relationship. Internally, what I need to realize is that the fight I had to have to save those 2%, literally those 2% are being burned through because we can not make things change quickly. We are impacting my customer because we can not change and agree on things quickly. I need to involve legal all the time, I need to escalate...And so what people loose is that there is a whole infrastructure that you keep taping into that is costing you 1500 dollars an hour... because an average burglary of the legal people is overwhelming... (Vendor manager, Supplier C)

However, although reluctantly admitting that the prices of Supplier D are slightly higher than those of their potential competition, Supplier C's representative insisted that by reengineering service delivery processes they still managed to save over 50% costs, as compared to the size of the past deal between Client B and Supplier D. Moreover, the contract between Supplier C and Supplier D previews price renegotiation exercise by the parties every 18 months, and Supplier D is quite confident that Supplier C will perform a benchmarking procedure every time in order to make sure that the prices remain reasonable.

Overall, it seems that in the Client B – Supplier C and Supplier C – Supplier D IT outsourcing dyads the customers tend to rely on formal/contractual governance in their financial exchanges with the suppliers. By actively using benchmarking closes and going back to tender the clients are trying to negotiate better financial exchanges with their respective suppliers. Interestingly however, the Client B – Supplier C financial exchanges are more formally framed as both parties try to achieve better financial results, while the relationship between Supplier C and Supplier D is less financially stringent, in the way that Supplier C accepts somewhat elevated prices of Supplier D. This difference in the extent of reliance on formal governance can be explained by the fact that the continuing crisis of the airline industry forces Client B to concentrate predominantly on the cost cutting objective and exercise as much as possible of cost control over its major IT outsourcing deal with Supplier C, which represents more than 75% of the airline's IT budget. Moreover, Supplier C might emphasize less the formal governance of its financial exchanges with Supplier D because cost cutting is not their main objective, especially since they will ultimately pass the costs on to the end-user of the services, namely Client B. In addition, Supplier C most probably recognizes the monopolistic position of Supplier D and does not see a point in arguing with the latter over "cents and dimes".

Finally, the terminated Client B – Supplier D outsourcing relationship was not well contractually managed with regard to the interorganizational financial exchanges. The client's representative explained this by the fact that high dependency position relative to the supplier precluded them from being able to impose tighter financial controls on the supplier. The second reason of such bad formal financial governance is probably the fact that the IT outsourcing contract was not explicit enough to begin with and did not contain any benchmarking or price renegotiation clauses.

A general conclusion can be drawn that it is always imperative to write explicit contractual procedures that would govern the financial exchanges between the parties to the IT outsourcing relationship. However, such contextual factors as client-industry conditions and power-dependency imbalance may have a significant effect on the ability of the customers to effectively employ contractual governance when it comes to the financial interorganizational exchanges.

8.3.3. Information Exchanges

All three relationships seemed to have well organized formal communication procedures. Client B, although having outsourced most of its internal it department, has kept about 20 employees in the position of business analysts, whose primary role is to intercept with the business and a supplier:

> They are like an interface with the business, whose needs we are trying to support through IT, and the supplier, which is a very good thing because in my previous life I used to work with another company. In that company, when we originally outsourced, we let the business analysts go. So that was too much! Nobody could understand what our supplier was talking about any more. So, I think that was a wise move on the part of [Client B]. (Manager, Strategic Sourcing, Client B)

There are also some people within Client B company, whose responsibility is to perform contract management. These people are in direct contact with the suppliers' contract delivery groups. Together these people develop formal and informal dispute processes, in other words conflict resolution processes on issues that might be different for each outsourcing dyad. Through formal and informal dispute resolution processes the parties to the relationships try to address all differences in contract interpretations by the service delivery people on one side and the end-users on the other side before these interpretation differences turn into disruptive interorganizational conflicts. On the Client B-Supplier C relationship specifically, huge efforts were spent by both sides at the beginning of the contract to do some personnel training to insure that everybody understood the terms of the new contract in the same way. Supplier C expressed similar commitment to sustaining good interorganizational communications:

> What we need to do is to make sure that we have got a customer that understands our action plans, who understands that we are putting reasonable commercial efforts or excessive efforts if it is a critical service level, that we are doing everything we can, and that the communication is consistent. We are keeping them up to dates, and feed regularly their CIO and their core business units when we have issues. (Vendor manager, Supplier C)

Supplier C-Supplier D outsourcing relationship has two dedicated account management teams on both sides that carry out joint monthly performance reviews, and contact each other regularly and on ad-hoc bases.

In general, all three IT outsourcing dyads can be considered to have good formal interorganizational information exchanges. Interestingly, although Client B-Supplier C relationship seems to have the best organized formal communications, this fact did not have visible positive effect on the client's satisfaction with the supplier's service representatives. It could be that good formal information channels do not have an independent effect on the client's satisfaction with the supplier's service representatives but rather enhance the positive effect of good informal information channels.

8.4. Informal/Relational Governance

The initial research findings in the insurance industry showed the importance of both formal and informal relationship governance to the overall relationship success. Moreover, the informal/relational governance seemed to play more significant role when it came to managing interorganizational service and information exchanges. The analyses of the presented here three IT outsourcing dyads help to throw more light on the ultimate significance of the relational approach to IT outsourcing.

8.4.1. Product/Service Exchanges

Previous case studies have demonstrated the importance of informal/relational governance to all three interorganizational exchange episodes, but most especially to the service exchanges between the parties.

Client B explicitly stated that informal/relational governance played no role in their service exchanges with both IT suppliers. In fact, by negotiating tighter and more explicit SLAs for their new contract with Supplier C, client was hoping to improve their less than satisfactory service exchanges with the supplier. At this point in the relationship, the client is sincerely confused with regard to the obvious ineffectiveness of managing service delivery by SLAs and penalties, and they doubt they could improve situation by reverting to relational governance:

> Is it better to have a very strict and defined contract that you impose and that you follow by the rules versus to let things be more flexible? I would say that given how things are today from the service perspective, in spite of the amount of money that it costs them…and penalties…I would hate to think what it would be if there was no consequence to them. I do not know. Would it be worst? I have no idea, but I hate to think that if they did not have that threat, if all they had to do is just come up with an excuse or explain it in some way…would it be even worst? Could it be even worst? (Manager, Strategic sourcing, Client B)

The service exchanges between Supplier C and Supplier D, on the other hand, are governed mostly informally. The contract between the two parties previews some penalties for Supplier D for under performance on SLAs. However, Supplier C approached this issue very carefully because being IT supplier themselves, they know that excessive penalties in the contract are usually balanced by supplier's contingency charges that drive up the price of the services:

> One thing is, in the contract I will put some penalty clauses, but we need to be careful because the more penalty clauses you put in, typically, the more contingency your supplier will add to their price. Right? So if I say "You have 12 deliverables of which three are SLAs, the other ones you will provide me this report by this date, you will train us by this date, you will do this by this date, you will give me the inventory report by this date…" And they fail, and I charge them 2% penalty on each one. Then they take their review and say "Well, you know, if it is on everything, sure we are probably going to slip on something once in a while. Let's just say it happens once or twice a year." Then they start doing a little math. It comes up to 80-90 thousand a year, they say "hey, I will add that to the price, right?" because internally their reviewers will say "No, you can not do this 100% of the time. So, where is your contingency coverage?" And

> typically, contingency on a well defined clear deal on desktop maintenance and network equipment, it is about 3 to 5%. In an unknown deal supplier may start to push for 10 to 15%. (Vendor Manager, Supplier C)

Even though the penalties are written in the contract, both companies are persuaded that in order to keep relationship flexible they should not manage it by SLAs and penalties:

> If we keep telling them that the only thing that is important to me is your contractual deliverables, we will just force them to concentrate 100% here. In the case with [Supplier D's representative] I said "That is good. You did that, that, and that…We know you are a little bit behind here." And he will say "Yeah, I am a little bit behind here. I need two more months to fix this." And I will say "Fine." But in the same talking, I can turn to [Supplier D's representative] and say "You know what [Name], what would be really helpful for me is an inventory report every month showing consumption rates by country and device type." Because I am not forcing him to be 100% compliant and I am not managing him by the contract, he is giving me services at no charge!!!! So, it gives me the flexibility to say "You know what? I am not going to beat you up if you slip on one thing." And [Supplier D's representative] appreciates that and he says "Yeah, I could try to fix that tomorrow, but I might need some external people in and it will result in extra costs on my account. Could you give me a month or so to fix it up?" I say "Yeah, I will do that for you, no problem." And so what happens is that it leads us into environment where we do not talk contract change all the time. In theory, [Supplier D's representative] has a right to say "I am sorry, [Name], we did not commit to these reports. I need to hire somebody and there is a cost involved. And you need to pay for it, Mr. [Supplier C]." And he could say that, and he would probably say that if I managed the contract 100% by the words in the contract. That is the environment…as the vendor manager you have to decide on. (Vendor manager, Supplier C)

Supplier D seems to be also satisfied with Supplier C's relational approach to the governance of service exchanges between them. The following exert from the interview with Supplier D gives more clear idea of how the relational governance between the two companies is taking place:

> There are significant penalties in our contract with [Supplier C]. We have never had them coming back to us because we have changed the structure and methods of managing. I think we would be in that situation if the relationship was managed by SLAs. SLA is a contractual word. So what we've done, we said take that as a guideline. And what the guideline says is that we are attempting to provide them with the service roughly within 95% of the time for ours and 90% of the time for their hardware failures. Now, we realize that if that is the only thing we are measured on, we are in trouble because we will definitely fail from time to time. Hence, we refocused our strategy to get them involved in the work we are doing and get us involved in what important is going on in their business. So our revues of performance never actually report on SLAs. Instead, it looks at the critical service delivery points in the customers' eyes and measures our performance there. It also speaks about joint action plans between client and vendor on how we are going to fix this because usually the issues are not one-sided. It's not our issue, it's not [Supplier C]'s issue, but it is a joint problem. So we try to define in our reviews what steps each party has to take in order to resolve the issue. (Contract delivery manager, Supplier D)

Overall, the analyses of the informal service exchanges governance confirm the findings of the contractual governance section that informal service delivery governance is important but not sufficient factor of the client's satisfaction with the services. In fact, the successful IT outsourcers seem to resort to the informal governance of interorganizational service exchanges only after negotiating explicit contracts with written-in exhaustive SLAs and attached to them substantial financial penalties. Similar to the Client A-Supplier A and Client A –Supplier B case studies, the parties in Supplier C-Supplier D outsourcing dyad greatly credit the informal service delivery governance for the overall success of their relationship.

On the other hand, the fact that in one of the unsuccessful dyads service exchanges are governed contractually, while in the other unsuccessful dyad services were managed neither formally nor informally, showed additional support for the idea that relational governance of interorganizational service exchanges is a key factor of the overall relationship success.

8.4.2. Financial Exchanges

Although the financial exchanges between the parties in all three relationships are more formally framed, there are still some instances of financial flexibility exercised by the participants towards each other.

For instance, after the events of September 11, Client B found itself in a very difficult financial situation. Thus it had to back off on the initial financial terms of the new outsourcing contract and ask Supplier C for even more price concessions. Although, at that time Supplier C was already disappointed with the customer's aggressive "manage by SLAs" policy, they nevertheless agreed to further reduce their prices. At the end, Client B was not completely satisfied, but they acknowledged the supplier's limited collaboration: "They did not give us a whole a lot. They gave us a bit, but of all the reductions that we have got, I would say that maybe 10% of them were real price cuts. I would say 10 to 15%. The rest was redefinition of services." (Manager, Strategic Sourcing, Client B) It appears that formal governance by Client B of its service exchanges with Supplier C had a negative spill over effect on their informal financial governance as the supplier did not show a lot of flexibility in the critical to the client situation. During the interview however, Supplier C also referred to several instances when they did not charge the client for certain extra services provided to them in critical situations. It is difficult to reconcile the opposite opinions of the client and the supplier representatives. It is possible that being in the difficult financial situation Client B would find any reasonable amount of cooperation on the part of the supplier to be insufficient.

Interestingly, an already familiar relational strategy of acting as an equal power player was employed by the clients in all three dyads. Although, power-dependency analyses show that Client B and Supplier C were as customers to an extent locked-into their IT outsourcing relationships, they were still conveying to the other parties that they would walk out on a relationship at the first sign of unfair pricing or dishonest behavior on the part of a supplier.

8.4.3. Information Exchanges

From the beginning, it appears that the two unsuccessful IT outsourcing relationships lack good informal communication channels between the parties. Although Client B's representative indicated that all parties periodically initiate some kind of social interactions, she also admitted that those are not enough to create strong interpersonal ties among the people on both sides. The lack of open informal communications often results in contract misinterpretations by both parties that lead to the costly dispute resolution procedures. The client admits that some sincere efforts were made towards openness at the executive level, yet at the working level it was done only periodically and without significant success.

In both unsuccessful dyads, neither the client nor the suppliers have ever referred to the relationship as based on trust and commitment. Both representatives of the supplier organizations indicated that they did not have any social ties to their immediate counterparts within Client B organization. On the contrary, Supplier C expressed their disappointment with business analysts of Client B. According to the supplier, these people are more driven by their job descriptions rather than by relationship objectives.

On the contrary, in the successful relationship between Supplier C and Supplier D, informal communication is promoted by both parties. In fact, the current account manager of Supplier D was brought into the relationship because at one point he was an employee of Supplier C and had a good working experience with the current Supplier C's account manager. These two representatives indeed expressed significant amount of trust and respect for each other. The grater informal interorganizational communications are most likely further promoted by the fact that both organizations belong to the same IT consulting industry, and thus speak the same language and clearly understand each other's business objectives.

On the whole, it seems that the quality of informal information channels between the parties in the relationship is greatly related to the overall relationship success. Moreover, informal interpersonal communications and ties appear to be directly related for the client's satisfaction with the supplier's service representatives, while no amount of formal communications seems to compensate for the lack of informal. It could be assumed however that good informal communication channels promote the satisfaction with service representatives and vise versa. However in the light of the observation that formal communications alone do not promote client's satisfaction with service representatives, the proposed here integrative IT outsourcing relationship model does not provide any answers to the issue of promoting customer satisfaction with service representatives when the informal interorganizational communication channels have not yet been established.

8.5. Summary

The aim of the presented above replication case studies was to further test the integrative IT outsourcing relationship model developed in course of the initial explorative research (See Figure 3). Overall, these three replication studies contributed to the assessment of the external validity of the conceptual model, and most importantly enriched it with some new and crucial insights.

To summarize, Client B-Supplier C relationship appears to be governed formally by adhering to contractual provisions with regard to all three interorganizational exchange episodes. This in itself is a very surprising finding, since it goes against both parties' initial intent to build an innovative partnership. The companies' press releases and magazine articles announcing the new agreement between the parties in 2001, all described it as a very flexible and open-worded arrangement that would serve well business objectives of both parties. The reality does not seem to reflect these expectations. Overall, this relationship suggests that relying only on formal relational governance of interorganizational financial, service and information exchanges does not necessarily lead to the IT outsourcing relationship success.

On the other hand, Client B–Supplier D dyad lacked both strong formal and informal governance. The contract, according to both parties' representatives, was poorly written to begin with. From there on, the client seemed to consider this arrangement as unavoidable IT cost. Thus, the airline was accepting financial conditions of the supplier, while interorganizational service exchanges were complicated by contract misinterpretation issues. Interestingly however, the client expressed a little bit more satisfaction with service exchanges with this supplier than with Supplier C. This later fact raises a question of whether governing a relationship strictly formally, like in case of Client B-Supplier C relationship, is worst than governing neither formally nor informally, like in former Client B-Supplier D dyad.

Finally, Supplier C–Supplier D relationship shows considerable support for the integrative IT outsourcing relationship model developed in the course of the first stage of this research. As the integrative model proposes, when it comes to financial exchanges, both parties rely on formal governance by short-term explicit contracts with written-in benchmarking and price renegotiation clauses; for the service exchange management however, parties rely on informal flexible governance. At last, the companies have both interorganizational formal and informal communications as they facilitate greatly the other two types of exchanges between them.

9. Discussion

This section of the thesis will first address the aggregate research findings and the significance of conceptualizing formal and informal governance as mutually complementing factors of the relationship success. Then, theoretical and managerial implications of the developed here integrative model of IT outsourcing governance will be discussed. The final part of the section will attend to the limitations of the study and present suggestions for further research.

9.1. The Aggregate Research Findings

In the IT outsourcing relationship, what are the roles of informal and formal governance? Are contractual and relational approaches mutually exclusive IT outsourcing governance modes or can they complement each other in their influence on the relationship success? Theorizing that simultaneous use of formal and informal governance is beneficial to the IT outsourcing relationship success, a conceptual integrative model of the IT outsourcing relationship governance was developed, which then was tested in the contexts of Canadian insurance and airline industries. The findings not only support the integrative approach to IT outsourcing, but also reveal how exactly these seemingly opposite relationship governance approaches can complement each other by playing different roles within the structure of interorganizational exchanges:

9.1.1. The Interplay of Formal and Informal Governance of Interorganizational Financial Exchanges

To summarize, the aggregated research findings suggest that the interplay of contractual and relational approaches to management of financial interorganizational exchanges demonstrates itself in crucial role of the contracts, while some limited informal mechanisms might only be employed by the client in order to reinforce the influence of the formal governance.

Formal governance of interorganizational financial exchanges is an imperative tool for controlling client's IT costs, and it realizes itself through implementing frequent benchmarking and price renegotiation procedures spelled out in the contract. Power – dependency imbalance and the parties' divergent financial goals are the major reasons for the clients to implement formal governance of their financial exchanges with the suppliers (Poppo & Zenger, 2002). On the other hand, informal governance of interorganizational financial exchanges appears to be minimal because the parties are aware of their divergent monetary objectives; thus, they do not rely on notions of commitment and trust when it comes to improving each organization's bottom line. Only some limited informal relational techniques (e.g. downplaying the extent of dependence on a supplier) were found to be uses by the clients in order to encourage suppliers' adherence to contractual terms.

9.1.2. The Interplay of Formal and Informal Governance of Interorganizational Product/Service Exchanges

In the three successful IT outsourcing relationships investigated in this study, the parties resorted exclusively to informal governance of the service exchanges between them. Based on the opinions of all parties, informal governance of interorganizational service exchanges emerges as one of the key mechanisms of ensuring the relationship success. It does so by promoting technological and strategic flexibility of the relationship, which is something of a great value to both IT clients and suppliers. Informal governance of service exchanges between the parties manifests itself in not resorting to the management of the relationships by contractually prescribed SLA measures and not imposing penalties on the vendors for underperformance.

Formal governance of interorganizational service exchanges was employed in only one unsuccessful IT outsourcing dyad (Client B – Supplier C). It is unclear however, whether formal service delivery governance was the major factor responsible for the low relationship success. In fact, the representative of the client organization indicated that the relationship was unsuccessful even before they started to resort to the management by SLAs and penalties. It seems that in this particular relationship context, the client resorted to the formal governance because they were already dissatisfied with the relationship. One thing is clear however, this formal relationship governance mechanism did not improve Client B–Supplier C relationship success. Future research should further investigate the relationship between the formal service delivery governance and the IT outsourcing success.

9.1.3. The Interplay of Formal and Informal Governance of Interorganizational Information Exchanges

Formal governance of interorganizational information exchanges is important to facilitating service and financial exchanges between the parties. However, the analyses of unsuccessful IT outsourcing dyads revealed that even well structured formal interorganizational communications are not sufficient to promote customer satisfaction with service representatives and to ensure the relationship success. It seems that to make an impact formal communications structure needs to be backed up by the reliable informal communication channels between the parties.

Indeed, informal governance of interorganizational information exchanges appears to be even more important to relationship success than formal communications. Both parties of each successful IT outsourcing dyad admitted that the relationship success greatly depends on the people who represent the organizations in the exchanges. If the executives and the project managers of both the client and the supplier companies trust and openly communicate with each other, they will be able to get through any contract misinterpretation and service delivery issue much faster than a dyad that only relies on the formal communication structure.

9.1.4. IT Outsourcing Context

The research findings show support for the existing academic opinion that power-dependency imbalance is inherent to the IT outsourcing environment (Heide & Weiss, 1995; Lonsdale, 2001; Ireland, 1999). The nature of IT outsourcing is such that clients become locked-in to relationships for a variety of reasons, including high switching costs (Heide & John, 1990), loss of expertise (Lonsdale, 2001; Ireland, 1999), lack of competition on the IT market (Heide & Weiss, 1995) due to prevalent technological heterogeneity, and other. Power-dependency imbalance seems to be a pervasive phenomenon, since it was found in all five studied relationships. However, this characteristic of the IT outsourcing dyads, while creating necessity of employing relationship governance mechanisms in order to mitigate the suppliers' possible opportunism, does not seem to preclude parties from achieving successful relationship; neither does it appear to determine the combination of formal and informal governance employed by the parties in dealing with each other.

Similarly, length of the relationship does not appear to have any impact either on the parties' choice of the governance mechanisms or on the overall relationship success. The fact that such recent IT outsourcing relationships like Client A–Supplier B and Supplier C–Supplier D are successfully managed through interactive use of formal and informal governance, while such a long-term relationship as Client B-Supplier C is unsuccessful and governed through the formal governance only, leads me to conclude that Length of Relationship is not appropriate context variable for the integrative IT outsourcing relationship model (see Figure 3). Indeed in other buyer-supplier relationship contexts, researchers have found that relationship success is not associated with the perception of switching costs (power-dependency imbalance) and or the duration of the relationship (Cannon et al. 2000; Ferguson et al., 2005; Lusch & Brown, 1996). My research extends these findings to the IT outsourcing context. Moreover, the evidence suggests that neither power-dependency imbalance nor length of the relationship influence the parties' approach to IT outsourcing relationship governance.

9.2. Theoretical Implications

Although the integrative approach to IT outsourcing governance is recently shared by a number of authors (Barthélemy, 2003; Kern & Willcocks, 2002; Poppo & Zenger, 2002), these studies did not investigate the nature of the interplay between formal and informal governance, which makes it very difficult to formulate a clear advice for practitioners. The main theoretical contribution of this research lays in the development and use of a novel relationship framework for investigating IT outsourcing governance. Based on both TCT and RET perspectives, this model, through integration of the elements of context, interorganizational exchange structure and interactions between formal and informal governance, offers a potential comprehensiveness lacking in previous IT outsourcing studies. Indeed, the present research not only adds to the growing empirical evidence in favor of complementary use of contractual and relational IT governance, but goes a step further by exploring how exactly formal and informal governance may complement each other within the structure of interorganizational exchanges.

The theoretical significance of this study is in that it reveals the interplay between formal and informal relationship techniques as they applied by the parties to the three major interorganizational exchange areas: product/service, financial, and information exchanges. Indeed, by introducing into the model the structure of interorganizational exchanges, it became possible to discover the specifics of the interplay between contractual and relational management approaches employed by the parties.

Another important theoretical contribution of this study is in its pointing out and addressing the construct measurement problems of the previous research. In fact, the survey based studies of Barthélemy (2003) and Poppo and Zenger (2002) failed to differentiate between the notions of "good contracts" and "formal governance". In both studies, the researchers measured the quality of the contracts (e. g. preciseness, completeness, balance, length, etc.) in order to determine the extent of parties' reliance on formal/contractual governance. However, considering that the contract is neither self-enforcing nor self-adjusting (Goldberg, 1980), the present research argues that "formal/contractual governance" construct should be measured by assessing not only the quality of the negotiated IT outsourcing agreements, but also the extent to which theses contracts are being implemented by the parties as their relationships unfold. The aggregated results of the study suggest that the construct of "explicit contract" represents a fundamental component of the construct of "formal governance", but not its entire essence. A well-written explicit contract makes the means of the formal governance available to the client and facilitates the informal governance as well by setting clear mutual expectations.

Finally, this study contributes to the theoretical knowledge on IT outsourcing phenomenon by adopting and finding support for the use of the three-dimensional customer satisfaction construct (Jap & Ganesan, 2000) as operationalization of IT outsourcing relationships success. When asked to explain their understanding of the relationship success, the clients, in this study, referred to their satisfaction with services, financial returns, and service representatives. Indeed, such three-dimensional satisfaction construct is highly compatible with three types of interorganizational exchanges. It seems logical to assume that product/service exchanges between the parties determine a client's satisfactions with service delivery. Similarly, the nature of financial exchanges will influence a client's satisfaction with financial returns as well as the dynamics of informational exchanges will have an impact of a client's satisfaction with service representatives. It seems that the absence of agreement among researcher with regard to the driving factors of the successful IT outsourcing deals (Kern & Willcocks, 2000) is in large part due to the lack of common operational measures of the construct of IT outsourcing relationship success (McFarlan & Nolan, 1995; Ross & Westerman, 2004). If so, the three-dimensional satisfaction construct presented in the integrative model has a potential of providing such common ground for measurement by integrating client's assessments of their experiences with all three interorganizational exchange types.

9.3. Managerial Implications

Identifying whether formal and informal governance are better employed simultaneously in order to ensure the relationship success is critical to the managers' approach to their companies' IT outsourcing projects. My findings indicate that both formal and informal governance are important to relationship success. However, it is even more important to uncover the way for practitioners to follow the integrative approach to IT outsourcing, by providing them with the best combinations of the contractual and relational techniques. This research addresses the later issues and gives a constructive prescription to practitioners with regard to how they should combine formal and informal approaches to IT outsourcing governance in order to ensure the relationship success. Indeed, this research findings show that the successful IT outsourcing deals are those where the parties rely on contractual governance of their financial exchanges, while resorting exclusively to relational governance of service delivery. This finding reconciles the seemingly opposite practical implications of TCT and RET, by revealing that the parties different financial objectives are better safeguarded through the implementation of contractual provisions (Stump & Heide, 1996; Wathne & Heide, 2000) while relationship flexibility is attained by managing day-to-day service exchanges informally (Gareiss & Weston, 2002; Heckman, 1999).

My findings also stress the criticality of the explicit contract to IT outsourcing relationship success, apart from it being a fundamental component of formal/contractual governance. While TCT proponents recurrently emphasize the importance of a good explicit contract (Aubert et al., 2004; Feeny et al., 2003; Lacity et al., 1995), RET supporters often speak in favor of open-worded "gentlemen's agreements" (Joshi & Stump, 1999; Lonsdale, 2001; McFarlan & Nolan, 1995). This research however shows the importance of well-written contracts to both formal and informal governance approaches. A well-written explicit contract allows for a strong formal governance of interorganizational financial exchanges while facilitating the informal governance interorganizational service exchanges by setting clear mutual expectations. Given the above, the practitioners should be advised to start any IT outsourcing deal by negotiating a precise, complete and well-balanced short-term contract.

Lastly, IT outsourcing researchers and practitioners often tend to over-focus on the financial and product/service exchanges and fail to address information exchanges between organizations (Kern & Willcocks, 2002). This thesis is highlighting however the importance of both formal and informal communication channels to the overall success of the IT outsourcing deals. Among formal governance mechanisms of information exchanges are creation of management positions designated to facilitate communications between the parties, regular technical and financial reports, scheduled interorganizational meetings on all managerial levels, and frequent customer satisfaction surveys. It appears that formal interorganizational communications promote overall stability and structural integrity of the relationships by providing executives of both parties with regular performance reviews, mutually indicating the companies' strategic intentions and allowing the suppliers to learn more about their services' impact on the client's business. At the same time, it seems that informal communications based on trustful interpersonal affiliations play a significant role when problems need to be resolved and conflicts attenuated.

9.4. Limitations and Future Research

Several limitations of this research must be acknowledged. Due to the small sample size, which is not inappropriate for a case study research, it was impossible to control for possible client-industry and relationship size effects:

9.4.1. Client-Industry Effect

One of the assumptions of the integrative IT outsourcing relationship model is that the clients are in control of their IT outsourcing strategy and exercise aware and free choices between the formal and the informal relationship governance with regard to the different interorganizational exchange episodes. This basic statement may not be quite true. It remains possible that economic and IT outsourcing trends of the client-industries have significant impact on the customers' ability to resort to formal or informal governance mechanisms. For example, both Client A and Supplier C operate within very favorable economic industry contexts (insurance industry and information technology industry respectively); thus, these companies may afford not to impose penalties and absorb some extra costs incurred due to their suppliers' occasional underperformance. Meanwhile, the airline industry is currently in profound crisis. The most important survival objective for Client B is to cut their business costs as much as possible. Indeed, their IT outsourcing budget shrunk by more then 20% and they had to cut by 40% their internal IT department. Under such circumstances, the airline, most probably, can not afford to bare any additional costs due to inadequate service delivery on the part of the supplier. Thus, the client probably feels compelled to resort to the formal service delivery governance by imposing penalties for the supplier's underperformance. Future research should investigate some other IT outsourcing relationships from the insurance, airline, and other industries in order to better illuminate the possible client-industry effect on the nature and the outcomes of the IT outsourcing relationship governance.

9.4.2. Size of Relationship Effect

Similarly to the client-industry effect, the size of IT outsourcing agreement may also have an influence on the ability of a client to resort to either formal or informal relationship governance. Interestingly, all three successful IT outsourcing relationships were relatively small selective outsourcing agreements concerned with exchanges of a few IT services. Consequently, the volume of the financial, product/service and information exchanges required by these agreements was not overwhelming; thus, parties did not have a lot of difficulties managing informally certain types of interactions between them. Moreover, there were fewer representatives on both sides involved into day-to-day as well as strategic management of the relationships. Thus, these people could establish better and simpler informal communication channels that in turn promoted the informal governance of interorganizational service exchanges. On the other hand, Client B – Supplier C outsourcing agreement was very large. It integrated multiple IT product/service exchanges, mutual R&D and marketing investment projects, and intricate inter- and intra- organizational communication channels. Thus, it is logical to assume that the client did not find it possible to resort to informal relationship governance of such complex IT outsourcing agreement. Future research should look into some other large IT outsourcing deals in order to investigate the effect of the size of IT outsourcing deal on the nature of the relationship governance.

Finally, the developed here IT outsourcing relationship governance model views formal and informal governance as antecedents of relationship success. However, it also remains a possibility that formal and informal governance may be in turn reinforced or impeded by the success of the IT outsourcing deals. The research material collected during both stages of this research, however, is not sufficient to either support or disprove the proposition made above. Therefore, the model developed and tested here could benefit from being tested in longitudinal design.

The initial examination of the integrative IT outsourcing governance model in the contexts of the insurance and airline industries has been encouraging. However, much more research must be done in order to fully answer the question: *How should the relationship between IT suppliers and customers be governed in order to ensure the* *relationship success*. The model needs further explication, replication, extension, application, and critical evaluation.

10. Conclusion

Understanding the nature of client-supplier relationships governance in IT outsourcing deals is very important to identifying the ways of ensuring success of such undertakings. Drawing on transaction cost theory, relational exchange theory, and existing research on IT outsourcing, this thesis proposed and examined an integrative model of IT outsourcing relationship governance that views both formal/contractual and informal/relational governance as complementing factors of relationship success. Some researchers have already found preliminary support for complementary use of formal and informal approaches to the management of IT outsourcing deals (Barthélemy, 2003; Kern & Willcocks, 2000; Poppo & Zenger, 2002). This thesis however extends on the earlier works by investigating the specific nature of the interplay between these seemingly opposite governance modes.

The case study research exploring relationship practice in the IT client and supplier organizations gave some insights into the criticality of the interplay between formal and informal governance to the ventures' success. Indeed, successful IT outsourcing deals appeared to be governed through both "letter of contract" and "gentlemen's agreement". The research findings not only show support for the integrative approach to IT outsourcing, but also reveal how informal and formal governance mechanisms may complement each other by playing different roles within interorganizational financial, product/service, and information exchanges. It appears that in the successful IT outsourcing deals the parties actively practice formal/contractual management of the financial exchanges between them, while resorting to informal/relational governance of interorganizational service exchanges. Well developed both formal and informal information exchanges between organizations also seem to be essential to the IT outsourcing relationship success.

Moreover, this research highlights that relationship management in IT outsourcing in essence has to focus on achieving the clients' satisfactions with products/services, financial returns, and suppliers' service representatives. The IT outsourcing success appears to be attained by gearing managerial efforts within interorganizational exchange episodes towards increasing the value of this three-dimensional client satisfaction construct. Further, although many researchers seem to suggest that formal governance is often the most important and accessible to the clients at the beginning of the deals while informal governance arises naturally as the relationships unfolds and interpersonal trust develops with time (Barthélemy, 2003); the results of this research clearly demonstrate that in successful IT outsourcing dyads contractual and relational governance are employed simultaneously from the very start of the ventures. Overall, this thesis provides evidence to suggest that integrative approach to relationship governance can be strategically chosen by the clients as they attempt to ensure the success of their IT outsourcing deals.

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