OUTSOURCING SUCCESS: CRITICAL MANAGERIAL FACTORS IN THE SERVICES SECTOR

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Abstract
Competition in modern business is competition among business networks. In businesses, outsourcing has become a common practice. Managers’ responsibility has broadened from managing business to managing business context including outsourcing. The overall aim of this paper is to develop a framework which considers all the important factors and their interactions in measuring outsourcing success. The framework is derived from the perspectives of resource dependency and social exchange theories. Degrees of outsourcing, vendor management capability and vendor’s service performance, have been deduced as the most critical factors which influence outsourcing success. Compatibility between partners and partnership quality are proposed to respectively mediate and moderate the effect on outsourcing success.

Key words: Compatibility, outsourcing success, partnership quality, vendor management capability, vendors’ service performance.
1. Introduction

The major issue that organizations are facing today is the dynamic nature of the business environment. This is largely due to increasing globalization, technological advancements, and increased awareness of customer knowledge. Therefore, the sustainability of the organisation has become more challenging than ever. Sustainable organizations have adopted best practices to utilize their resources. But, sometimes utilization of existing resources is not sufficient to perform well in the market. This is because organizations cannot possibly acquire all the required resources. Establishing strategic collaborations with other stakeholders is one of the methods that organizations use to share external resources (Hessels and Terjesen, 2010). The purpose of collaboration is to strengthen the competitiveness and to develop the organisation’s resource base for the future (Al-Natour and Cavusoglu, 2009). Such collaborations may be in the form of strategic alliances, mergers, partnerships or outsourcing. All these collaborations rely highly on the strength of the relationship among members and beyond the ambit of traditional purchasing. When an organization is engaging in sharing external resources, it will be depending on another firm(s). Therefore, organizations need to decide the appropriate level of involvement by external parties (Hessels & Terjesen, 2010). Among all the aforementioned collaborations, outsourcing has been identified as a ubiquitous strategy (Li and Choi, 2009) in achieving both operational and strategic objectives for sustainable development in modern business context.

Outsourcing is the transfer of control (Donada and Nogatchewsky, 2009) of internal business activities and processes to an external party in order to enhance business performances (Kotabe and Mol, 2009; Lee, 2001; Li and Choi, 2009; Kroes and Ghosh, 2009). Many authors (e.g. Li and Choi, 2009, Lee 2001; Zhang et al., 2009; Kroes and Ghosh, 2010; Thouin et al., 2009; Espino-Rodríguez, and Padro’n-Robaina, 2004) see it as a strategic tool to enhance organizational performance. However others (e.g. Gilley and Rasheed, 2000; Hsiao at al. 2010; Bardhan et al. 2009) discovered there is no significant effect of outsourcing on organizational performance. These contradictory findings epistemologically diminish the implicational value of outsourcing.

More recently, much of the academic research has attempted to identify different aspects of managing outsourcing. Among them are critical success factors (Whipple and Frankel, 2000; Ogden 2006; Banerjee and Williams, 2009; Cusmano, Mancusi and Morrison, 2009), outsourcing agility (Kroes and Ghosh, 2009; Liou and Chuang, 2009; Young 2008), outsourcing structural dimensions (Gilley and Rasheed, 2000; Rodriguez and Robaina, 2004; Thouin et al.,2009; Marshall, et al., 2007) and partnership characteristics (Marshall, et al., 2007; Cui et al., 2009; Lee, 2001; Han, Lee and Seo, 2008; Dyer 1997). Besides, manufacturing sector outsourcing has been subjected to more rigorous empirical investigations compared to the services sector outsourcing (Donada and Nogatchewsky, 2009) simply because of the intangible and the simultaneous nature of services (Gounaris, 2005).

Studies identifying factors affecting outsourcing success are twofold. Some are beyond the organizational control, while others are controllable. The controllable factors affecting the success of outsourcing are organizational resource capability (Han et al.,2008), vendor management capability (Han et al., 2008; Lee 2001; Chan and Chin, 2007), asset specificity (Zhang et al., 2009; De Vita et al., 2009), organizational culture (Lam and Han, 2005; Jarvenpaa and Mao, 2008; Young, 2008; Jean et al., 2008) and vendor’s contribution (Carr,et
Market uncertainty (Gilley and Rasheed, 2000; Kotabe and Mol, 2007; Espino-Rodríguez, and Padro’n-Robaina, 2004; Banerjee and Williams, 2009; Jean et al., 2008), market thickness (Li and Choi, 2009; Dyer, 1997; De Vita et al., 2010) and anticipated rivalry (Lahiri, Kedia, Raghunath and Agrawal, 2009) have been tested as external factors which are beyond the organizational control.

Success is a subjective phenomenon which evaluates the achieved level of expectations. In practice, different organizations have different drivers to outsource and hence different outcomes would be expected (Marshall, Mc Ivor and Lamming, 2007). Outsourcing outcomes have been evaluated with different theories. Among them are transaction cost economies (TCE), resource based view (RBV) and knowledge based view (KBV). However some theories could explain the context only within a confined boundary (Rajabzadeh et al., 2008; Marshall et al., 2007). For instance, firm ‘A’ applied outsourcing to share expertise of knowledge but, the researcher used transaction cost economies (TCE) as a theoretical lens which perceived outsourcing as a cost reduction mechanism. In this case, there is a greater possibility to misinterpret the outcomes of outsourcing. Aligning to this argument, Watjatrakul (2005) also found that different underpinning theories suggest different outsourcing decisions for the same context. Consequently, different studies have drawn fragmented conclusions largely due to the differences in the underpinning theories applied (Marshall, Mc Ivor and Lamming, 2007). Therefore, researchers should select an appropriate theory which better describes the research context. Furthermore, the theory should not lead to the generation of questionable conclusions.

In addition to the aforementioned issue, Kotabe and Mol (2009) observed a curvilinear relationship between outsourcing and performance. Therefore, firms need to identify the appropriate level of outsourcing (Kotabe and Mol, 2007; Espino-Rodríguez, and Padro’n-Robaina, 2005; Quinn 1992; Gilley and Rasheed, 2000). The success of outsourcing depends on how keen are managers in administering the context (Rajabzadeh, Rostamy&Hosseini, 2008). Thus, academicians can provide only insights about critical management aspects for successful outsourcing practices. As far as business to business (B2B) context is concerned, there are only a few studies (e.g. Lacity et al., 2009; Han, Lee and Seo, 2008; Jean, Sinkovics and Kim, 2006; and Sheth, 1994) have attempted to identify critical management factors in successful outsourcing execution. Understanding these factors will help managers to reconcile the issues dealing with outsourcing practices. Since, theoretical developments and empirical investigations are lacking in the outsourcing of services sector (Gounaris, 2005), this paper aims to identify the critical management factors for successful outsourcing outcomes in the services sector. Two main theories that will be used to develop the framework of this paper are the resource dependency theory and the social exchange theory. As claimed by Al-Natour & Cavusoglu (2009), the two are complementary to each other to oversee the outsourcing context.

The paper is structured as follows. In the next section, it will provide a comprehensive review of ontological and epistemological backgrounds of strategic outsourcing. This is followed by the proposed conceptual framework together with research propositions. Before concluding the paper, the discussion section highlights some of the implicational values of the proposed research framework and future research directions.
2. Literature Review

Ontological overview of the outsourcing literature reveals that previous studies are based on two paradigms of theories. These are the transaction cost economies (TCE) and the resource based view (RBV). TCE perceives outsourcing as a cost reduction method, while RBV oversees outsourcing as a strategic tool for gaining competitive advantage. Kroes and Ghosh (2010) classified theories used to analyze outsourcing into four categories: ‘agency theory’, TCE, RBV and knowledge-based view (KBV). In addition to that, there are also researchers who examined the issue more subjectively from the perspective of social exchange theory (Li and Choi, 2009; Lee, 2001) and process theory (Han, Lee and Seo, 2008).

Transaction cost economies (TCE) mainly focus on evaluating operational performance. Operational outcomes are short-term oriented and hence facilitate the evaluation of short term business performance. Further, operational performance of a single transaction can easily be quantified and specifically measured. However, the ultimate purpose of each party engaging in transaction process is to gain benefits from the costs incurred (Byramjee et al., 2010). Thus, the TCE domain is also valid for business-to-business transaction analysis. There are some critiques however over TCE. These are the failure to recognize corporate capabilities (Holcomb and Hitt, 2007), the ignorance of other aspects of organizational behaviour (Espino-Rodríguez and Padroñ-Robaina, 2005) and the failure to analyze broader perspectives of outsourcing. Further, the TCE approach is incompatible within the highly uncertain environmental conditions (Kotabe and Mol, 2009; Williamson, 1979). This has been further elaborated by Williamson (1979) who stated that transaction difficulties depend on asset specificity, uncertainty and transaction frequency.

The Resource based view (RBV) avoids the weaknesses of TCE perspective and considers firm specific characteristics such as resource capability and competencies. Barney (1991) and Wu and Park (2009) explained that RBV mainly focuses on evaluating the capability of internal resources to produce profits and competitiveness. Some scholars however perceived TCE and RBV as complementary to each other (Marshall et al., 2007), while others viewed them as interconnected approaches which strengthened one another (Leiblein, 2003). Even though RBV is one of the most interesting and useful research paradigms in management discipline, it ignores the behavioural aspects of the strategic outsourcing.

The Knowledge based view (KBV) is an emerging research domain especially in the field of information system outsourcing. KBV considers the core competency of a firm as knowledge (Kroes and Ghosh, 2009) that creates value for the organization in the modern information era. KBV focuses on improving competitiveness but not on attempting to measure behavioural outcomes.

Concluding to the above facts, all three paradigms in general describe a specific set of outsourcing outcomes and hence do not provide a holistic picture about the context. Further, outsourcing is not merely an outcome but rather it also represents a system. Outsourcing includes inputs, processes, and outcomes and is also influenced by the task environment. Understanding the outsourcing context as a system provides answers to many questions. There are three basic questions which relate to the inputs. These are (1) why organizations outsource? (2) what do they outsource? (3) who is the vendor? Resource dependency theory (RDT) provides answers to these questions. When organizations are lacking in resources, they use external resources to accelerate activities which hopefully improve organizational
performance. Probably, the vendors would be the external body who own the required resources. In resource dependency perspective, outsourcing can be identified as an adoption of the required external resources (Liou and Chuang, 2009) to perform internal business activities which are currently not functioning well (Kedia and Lahiri, 2007; Barney, 1999). Therefore, understanding of outsourcing in terms of resource dependency perspective avoids the aforementioned issue which is attempts to perceive outsourcing through the specific outcomes.

As Kotabe and Mol (2009) observed, there is a curvilinear relationship between outsourcing and performance. They proposed that the firm needs to identify the appropriate level of outsourcing. Li and Choi (2009) viewed services outsourcing as a ‘choice of replacing internal service functions with the use of external agents to perform one or more services activities’ (p.28). Besides, there are two critical aspects highlighted by RDT. First, the insight provided by RDT for managing outsourcing context is common to any firm, which emphasizes success as a matter of managing dependency (Li and Choi 2009; Haiso et al. 2010; De Vita et al. 2010). Therefore, organizations have to determine the appropriate level of outsourcing, in order to gain better outcomes (Kotabe and Mol 2007; Gilley and Rasheed 2000; Espino-Rodríguez, & Padró´n-Robaina, 2004). Determining the appropriate level of outsourcing is a structural decision taken by the managers. Basically they have to decide the activities to be outsourced and the intensity of the power assigned to the vendor. Espino-Rodríguez, and Padró´n-Robaina (2005) and Gilley and Rasheed (2000) recognized that the above decisions are dealing with the degree of outsourcing. Therefore, the degree of outsourcing is a critical managerial factor (Bon &Hughes, 2009; Lacity et al., 2009) which determines the organizational dependency on external resources.

Next, success is matter of strategic fit between partners. Resource dependency theory assumes that the organizations make active choice to achieve their objectives (Hessels & Terjesen, 2010). Thus, managers have to carefully determine the nature of the vendor(s) with whom they are considering collaboration (Liou and Chuang, 2009; Shamdasani and Sheth, 1994; Sengupta et al., 2006; Whipple and Frankel, 2000; Jarvenpaa and Mao, 2008).But evaluating the nature of the appropriate partner for successful outsourcing has not been sufficiently subjected to empirical examinations in the services sector. Jarvenpaa and Mao (2008) and Liou and Chuang (2009) have conducted qualitative investigations on partners’ compatibility. Shamdasani and Sheth (1994) identified partners’ compatibility as a mediator to satisfaction and a continuity in strategic alliances. But many studies (e.g. Sengupta et al., 2006; Whipple and Frankel, 2000; Bettis, et al.,1992; Selviaridis et al. 2008; Jean, Sinkovics and Kim, 2000) have discovered the importance of compatible partnerships in business to business context. Selecting compatible partners is vital to produce positive expected outcomes (Liou, and Chuang, 2009).

Once the appropriate partner is selected both buyer firm and vendor firm will agree on a contract to exchange resources. Exchanging resources is a process whereby each party has its own responsibilities and expected performance outcomes (Byramjee et al. 2010; Marshall et al., 2007; Han et al., 2008; Park-Pops & Rees, 2009). Therefore, an outsourcing system involves a process of exchanging resources and hence success also depends on the success of the exchange. In this aspect, the nature of the outsourcing relationship is shifted from contractual to partnership (Lee, 2001, Chan and Chin, 2007; Lahiri et al, 2007). Relational resources are fundamental for success (Lahiri et al., 2007; Ferguson, Paulin and Bergeron et al., 2005). Therefore, a successful partnership is based on both contractual governance and
Contractual governance constitutes managing the formal contract (Lacity et al., 2009) which is a negotiated exchange. Relational governance is the reciprocal exchange which is contingent upon each other’s behaviour. The nature of negotiated exchange and reciprocal exchange is better described by the social exchange theory (SET).

Social exchange theory has been identified as one of the most important theories which explain social network structures and relational norms. Sierra and McQuitty (2005) highlighted the applicability of SET to the services sector as it requires a natural social exchange between buyer and seller. The theory serves as a general paradigm for the social and anthropology research domain (Zafirovski, 2005). It basically discusses shared responsibility and mutual benefits over activities which are performed jointly by two or more parties (Lawler, 2001). SET assumes that successful exchange is based on mutual exchange of reinforcement and relationship (Homans, 1961). The exchange is successful when partners are well matched to each other (Whipple and Frankel, 2000). Outsourcing effort collapses due to the incompatibility in culture between buyer and vendor (Liou, and Chuang, 2009; Lam and Han, 2005). Thus, social exchange theory also stresses the importance of compatibility between partners in collaborative business. Outsourcing involves a long term relationship with partners and hence there is a need to manage a trustworthy (Cui et al., 2009; Marshall et al., 2007) and long term collaborative relationship with the vendor (Dyer, 1997). In short SET is an appropriate theory to address the issue of how to manage the exchange.

Outsourcing success can be measured in terms of the achieved level of performance outcomes. Zhang et al. (2009) measured outsourcing success in terms of ‘financial’, ‘operational’ and ‘overall’ while, Grover, Cheon and Teng (1996) employed ‘strategic’, economical and ‘technological’ indicators. Lee (2001) and Han et al. (2008) also applied economic, strategic and technological indicators to measure the success in outsourcing of information systems. Some other studies used mixed approaches rather than group them under specific categories. For example Lam and Han (2005) conceived that the purpose of outsourcing in the hotel industry is to ‘squeeze the operating cost’. They applied productivity (operational dimension) and reduction of risk (strategic dimension) together with financial measures such as increase in revenue and lower operating cost, in order to measure outsourcing success. However, outcomes in services are both tangible and intangible. Thus, some studies (e.g. Lee 2001; De Vita et al., 2010; Espino-Rodríguez, and Padro´n-Robaina, 2005; Han et al., 2008; Benamati and Rajkumar, 2008) have also applied behavioural dimensions to measure the success of outsourcing.

Summarizing the epistemology, the critical managerial factors for successful outsourcing are the degree of outsourcing, partners’ compatibility, contractual governance and reciprocal governance. The next section attempts to develop a conceptual framework based on the factors discussed above. The conceptual framework will help managers to simplify their responsibilities and duties for successful execution of outsourcing activity.

### 3. Conceptual Framework

This section attempts to build relationships among factors identified in the previous section with regards to outsourcing success from the perspective of managers in business to business context. Therefore, only dyadic relationship structure has been taken into consideration. As discussed in the literature review, the resource dependency theory and the social exchange theory will be applied in explaining the critical managerial factors in outsourcing success.
3.1 Degree of Outsourcing

Managers take active decisions in managing external dependencies to create favourable outcomes (Chin, Widding and Paladino, 2004). The organizational dependency emerges as a result of the inability of an organization to accomplish its goals independently (Al-Natour & Cavusoglu, 2009, p. 109). Therefore, managers have to determine the level of dependency prior to making any type of collaboration with external bodies. In outsourcing strategy, the degree of outsourcing determines the level of dependency on external resources. With regard to the organization as a whole, the total power assigned to the vendor(s) is depending on two factors. These are the number of activities outsourced and the intensity of power assigned to the vendor in each activity (Espino-Rodríguez, and Padro´n-Robaina, 2005; Gilley and Rasheed 2000). The degree of outsourcing is basically determined by the costs and the benefits of outsourcing (Banerjee and Williams 2009; Byramjee et al., 2010). Pfeffer and Salancik (1978) proposed that there are three factors that influence the level of dependency. These are (1) the level of importance of the resource to the performance of the business, (2) the scarcity of the resources, and (3) the competition between organizations for control of those resources. Therefore, different organizations have different optimal levels of outsourcing. All together these factors determine the relative importance of a particular task to perform in the business. This also helps managers to clarify core and non-core activities in a particular firm.

Espino-Rodríguez, and Padro´n-Robaina (2005), Kotabe and Murray (2004), and Quinn and Hilmer (1994) suggested that organizations should only outsource non-core functions. Any attempt to outsource the core function must be carefully examined (Cusmano, Mancusi and Morrison, 2009; Marshall, Mc Ivor and Lamming, 2007; Alexender and Young 1996; McCarthy and Anagnostou 2004; Jiang et al., 2007; Wu and Park, 2009). But recent debates on core and non-core logic are quite neutral. Marshall et al. (2007) challenged the value of using core and non-core logic. They reported that different businesses have different interpretations over what is core and non-core. Specifically logic is not applicable for industries which are extremely dynamic. According to Wu and Park (2009) and Leavy (2004) in certain firms, there is no clear boundary to classify core from non-core due to changing nature of core competencies. Wu and Park (2009) in fact proposed the use of ‘dynamic outsourcing’ instead of ‘core and non-core logic’. Leavy (2004) further highlighted the importance of defining core competencies in terms of customer perspective rather than organizational perspective. Nonetheless organizations are unique systems and defining what is core and non-core is unique to each organization. Therefore, it is difficult to generalize core and non-core logic across organizations.

According to Barney (1999) the buyer firm capabilities and resources determine the best of the outsourcing decision. Therefore in RDT perspective, managers have to decide which activities need external resources to enhance their competitiveness rather than following ‘core and non-core logic’. They also have to determine the level of external resources for those activities identified. Based on the aforementioned facts, the most important structural decision is the determination of the ‘level / degree of outsourcing’.

Outsourcing makes a firm more nimble (Kotabe and Mol, 2009). Porter (1997) claimed that it increases organizational performance. Accordingly, Espino-Rodríguez, and Padro´n-Robaina (2004) found a positive correlation between the degree of outsourcing and organizational
performance. Gilley and Rasheed (2000) and Leiblein et al. (2002) argued that, the above relationship is moderated by environmental factors. As an example, outsourcing produces greater organizational performance outcomes for the firms which are pursuing cost leadership and innovative differentiation strategy (Gilley and Rasheed, 2000). Espino-Rodríguez, and Padro’n-Robaina (2004) discovered that the hotel industry has a greater propensity to outsource for strategic performance outcomes rather than tactical outcomes. However, Gilley and Rasheed, (2000) also stated that outsourcing suits better the firms which operate in a relatively stable business environment. Thus, organizations have to select the appropriate level of outsourcing due to negative outcomes that could result after optimal level (Kotabe and Mol, 2009; Espino-Rodríguez, and Padro’n-Robaina, 2004). Based on the arguments, we propose,

**Proposition 01:** There is a significant association between degree of outsourcing and outsourcing success.

### 3.2 Governance in Exchange

Transactional-relational continuum explains two types of opposing governance in exchange (Morgan and Hunt, 1994; Ferguson et al., 2005). These are transactional governance and relational governance. The continuum includes discrete combinations of different transactional and relational characteristics in the exchange. Day (2001) stated that exchange starts with transactional characteristics and ends with relational characteristics. However, both aspects are important in analyzing successful exchanges in business to business context (Ford, 2002).

#### 3.2.1 Contractual Governance

As mentioned earlier the exchange is better described by social exchange theory (SET). It basically discusses managing interests in resource exchange (Lawler, 2001; Cook and Rice, 2003). Each party has its own responsibilities and expects certain performance outcomes (Byramjee et al., 2010; Marshall et al. 2007; Han et al. 2008; Park-Pops & Rees, 2009). In management perspective, managing inter-firm bilateral exchanges are basically two fold (Ferguson et al., 2005; Zafirovski, 2005; Cook and Rice 2003). Partners are exchanging resources as agreed in contract and also they exchange relationships in the form of successful execution of resources. Contract has been identified as the formal governance mechanism of interests. The transaction cost economies (TCE) view contractual governance as terms of a specific set of transaction responsibilities (Williamson, 1996; Ferguson et al., 2005). The purpose of a formal contract is to reduce the risk associated with resource exchange (Williamson, 1996). However, in SET perspective, contractual governance is a negotiated exchange which includes a set of responsibilities and benefits.

Basically, managers’ responsibility over exchange is to carry out a successful vendor management system (Lam and Han 2005; Lam and Han, 2005; Chan and Chin 2007; Han et al., 2008; Rajabzadeh et al., 2008). Vendor management includes vendor evaluation, selection, monitoring and evaluation of performance (Rajabzedeh et al., 2008; Chan and Chin, 2007). In more constructive view, vendor management is corrective action for improvements (Chan and Chin, 2007). Managing lesser number of vendors (Ogden, 2006) and close monitoring of vendors (Lam and Han, 2005) are required to gain the best out of them. Byramjee et al. (2010) commented that firms are spending a considerable amount of
money to monitor service performance of outsourced activities. Chan and Chin (2007) further viewed that ‘managing vendor’ is a key success factor for strategic outsourcing success. Likewise, vendor management is one of the core capabilities that results in outsourcing success (Han et al., 2008, p. 34). Summarizing the above arguments, managing vendors has been identified as the core responsibility of the buyer firm which is critical for the successful execution of outsourcing. Based on the arguments, we have derived the following proposition.

**Proposition 2**: There is a positive relationship between vendor management capability and outsourcing success.

The managers are expected to receive at least vendor’s performance outcomes as provided in the contract (Bettis et al., 1992; Byramjee et al., 2010; Liou and Chuang, 2009; Young 2008; Carr et al. 2008). The vendor’s responsibility is to provide the agreed service. The role of outsourcing has changed from traditional purchasing to strategic activity (Chan and Chin, 2007). Simultaneously, other than confining to that of traditional vendor, their role has also been expanded to that of business partner dealing with operational control of functions (Rajabzadeh, Rostamy, and Hosseini, 2008), business process added values (Liou and Chuang, 2010) and sustainable competitive advantage (Miles and Snow, 2007). Thus, it is clear that, recent studies have already identified the strategic value of the vendors’ role. Wipple and Frankel (2000) carried out an empirical study on strategic alliance success factors for both buyer and vendor and they found that the ability to meet performance expectations as a significant key success factor. They further viewed that the vendors’ performance has greater impact on supply chain efficiency and overall firm’s performance.

In modern business context, outsourcing has been recognized as a value creation strategy to enhance organizational competitiveness (Rajabzadeh et al., 2008; Byramjee et al., 2010; Petersen, Handfield and Ragatz, 2005) and best practice to improve organizational performance (Kotabe and Mol, 2009). Therefore, the vendor is identified as a specialist who can contribute to breakthrough ideas and activities (Chi et al., 2009, P. 60). Accordingly, empirical evidence shows that, outsourcing and vendor relations are two strongly related phenomena (Takeishi, 2001). Outsourcing is a better option if the vendor can provide the expected support to the focal firm for a better competitive position than the firm can accomplish on its’ own (Venkatesan, 1992; Rajabzadeh et al., 2008). Based on the above arguments it is clear that vendors’ service performance has direct impact on outsourcing success. Therefore,

**Proposition 3**: Vendors’ service performance impacts positively on outsourcing success.

Propositions 2 and 3 explain the responsibility and benefit of contractual governance in service outsourcing. The next section discusses the importance of relational governance in outsourcing success.

### 3.2.2 Relational Governance

In modern business context, relational resources are argued as being more important than tangible resources in order to gain the maximum benefits. Therefore, relational governance has been identified as the ‘golden key for getting the best of supplies’ (Donada and Nogetchewsky, 2009, Page 368). Relational governance represents a set of norms that
develop over time (Ferguson et al., 2005, p. 221). The governance basically emphasizes mutual co-operation for mutual benefits (Cook and Rice, 2003; Zafirovski, 2005) and hence it covers the soft issues in managing relationships (Lacity et al., 2009). Ferguson et al. (2005) found that greater relational governance results in greater exchange performance in the banking industry. But, relational governance is passive because it is contingent upon each other’s behaviour. The nature of the contingent behaviour is based on the reciprocal stimuli (intrinsic or extrinsic) received by the partners (Zafirovski, 2005). Examples of intrinsic stimulus are trust and commitment (Lahiri et al., 2009; Lai et al., 2009; Han et al., 2008; Lee, 2001), knowledge and information sharing (Marshall et al., 2007; Han et al., 2008), quality of communication (Park-Pops and Rees, 2010; Han et al., 2008) and risk sharing (Cui et al., 2009; Lee, 2001). Providing training and financial assistance are some of the extrinsic stimuli in relational specific assets (Dyer, 1997; Bernades, 2010). In social exchange perspective, successful reciprocal exchange establishes sustainable relationship. Outsourcing as a social exchange phenomenon is also required to maintain appropriate level of relationship with business partners. The aforementioned characteristics in relational governance have been studied with different terminologies such as, ‘social embeddedness’ (Uzzi, 1999), ‘relationship quality’ (Byramjee, Bhagat and Klein, 2010; De Vita, Tekaya and Wang 2009, and ‘partnership quality’ (Kedia and Lahiri, 2007; Lee 2001; Han et al., 2008). However, all of them measured the strength of the relationship. Nevertheless, the commonly used term to explain relational governance in outsourcing is ‘partnership quality’.

Partnership is an inter-organizational relationship to achieve shared goals of participants (Lee, 2001) and effective supply chain management relies highly on the quality of the relationship (Zhang, Song, and Huang, 2009). Han et al. (2008) viewed partnership quality in terms of trust and commitment of vendors. In more abstract perspective, Lahiri et al. (2009) explained partnership quality as a relational resource which includes trust, commitment, and mutual interdependence and joint-problem solving. However social exchange theory explains that, a relationship exists when each party feels that they enjoy fair privileges and justice in the exchange. Lee (2001: p. 325) defined partnership quality as ‘an inter-organizational relationship to achieve shared goals of the participants’. Accordingly, the nature and the structure of the partnership can determine the success or the failure of outsourcing. However, partnership quality has been conceived as playing different roles in different studies, such as direct impact (Lai, Lee and Hsu, 2009; Whipple and Frankel, 2000), mediating impact (Lee, 2001; Cheng, Yeh, and Tu, 2008; Lee and Kim, 1999) and moderating impact (Byramjee et al., 2010). Thus, there is no consistent identification for role of partnership quality in the literature. However, greater implementation of relational governance results greater favourable outcomes (Ferguson et al., 2005).

As explained by social exchange theory, the exchange process collapses and will not continue in long-run if there is no reciprocity (Zafirovski, 2005). The actors’ role in the exchange is determined by the reciprocal stimulus they receive. Thus mutual reinforcement is vital in achieving expected outcomes in exchange (Cook and Rice, 2003; Zafirovski, 2005; Homans 1961). Aligning to that, Petersen et al. (2005) stated that, the degree of trust between buyer and vendor impacts collaborative planning effectiveness and thereby supply chain and firm performance. A most recent study carried out by Byramjee et al. (2010) also conceived that relationship quality is a moderating variable in determining the “total value orientation” in the partnership business context. But, relational governance individually could not produce economic benefits in outsourcing. Therefore, we propose the moderating effect of relational governance (i.e. partnership quality) on the relationship between contractual governance and
outsourcing success. More specifically, ‘vendor management capability’ has been identified as the managers’ role and vendor’s performance has been identified as the benefit in contractual governance. Thus, the relationship between both ‘vendor management capability’ and ‘vendors’ performance’ on outsourcing success will be moderated by ‘partnership quality’. Based on the arguments, the propositions are:

Proposition 4a: Partnership quality moderates the relationship between vendor management capability and outsourcing success.

Proposition 4b: Partnership quality moderates the relationship between vendor service performance and outsourcing success.

In addition to partnership quality, outsourcing success is also influenced by the degree of closeness between the focal firm and its vendors (Bernardes, 2010; Liou and Chuang, 2009; Shamdasani and Sheth, 1994; Jarvenpaa and Mao, 2008; Sengupta et al. 2006; Whipple and Frankel 2000; Bettis, et al.,1992; Selviaridis et al., 2008; Jean, Sinkovics and Kim, 2006). This however, has not been subjected to empirical investigation on the outsourcing success of the services sector. Nevertheless, the degree of outsourcing success depends on the degree of congruence existing between buyer and vendor (Whipple and Frankel, 2000; Shamdasani and Sheth, 1995). The next section explains the role and the importance of compatibility in achieving the expected outcomes in outsourcing.

3.3 Mediating Role of Partners’ Compatibility

In resource dependence perspective, the failure of one party in the dependency might affect the dependee’s goals in the resource exchange process (Al-Natour and Cavusoglu, 2009). Therefore, dependees (both, the organization and vendor) should guarantee the success of the dependency. Since organizations make active choice (Hessels & Terjesen, 2010) they have to assess vendors’ compatibility to select the most suitable partner (Liou, and Chuang, 2009). Thus, managers must carefully analyze the vendor’s capabilities (Kroes and Ghosh, 2010; Selviaridis et al., 2008) before entering into outsourcing contract (Chamberland, 2003).

Social exchange theory also assumes that, mutual exchange of reinforcement and relationship is fundamental (Homans 1961) for successful exchange. Accordingly, the exchange is successful when partners match each other (Whipple and Frankel, 2000). Otherwise, outsourcing effort may fail due to the incompatibility between buyer and vendor (Liou, and Chuang, 2009; Lam and Han, 2005; Shamdasani and Sheth, 1995). Consequently, the level of success in resource exchange is determined by the level of compatibility between the organization and the vendor.

The partners’ compatibility is a key success factor in outsourcing (Whipple and Frankel, 2000; Jarvenpaa and Mao, 2008). Harrigan (1985) has identified three types of compatibility: strategic, cultural and functional. Whipple and Frankel (2000) perceived compatibility as the ability to plan and work together. Therefore it demands, a shared vision, objectives, shared values and operating philosophies (Park-Pops and Rees, 2009; Bernardes, 2010; Jarvenpaa and Mao, 2008; Lam and Han, 2005). Accordingly, the organizational culture has been identified as a common dimension that needs to be compatible to each other for successful resource exchange (Liou and Chuang, 2010). In addition to that, Quinn (1999) explained outsourcing as a platform for innovation. The drawbacks of innovations could be the result of mismatch of process technology between buyer and vendor (Cusmano et al., 2009). Therefore, ‘technology compatibility’ is crucial for innovative and sustaining
organizations (Bettis et al., 1992; Tallon, 2008; Jarvenpaa and Mao, 2008). Bettis et al. (1992) further warned of the negative consequences of technology as a threat to demolish the contractual relationship with vendors; and this is due to the fast evolution of technology. Summarizing the aforementioned arguments, ‘compatibility between partners’ is proposed to have a mediating impact on the relationship between both dependency and exchange on outsourcing success (Shamdasani and Sheth, 1994; Jean, Sinkovics and Kim, 2006). Therefore, we further propose that,

**Proposition 5d**: The compatibility between partners has a significant impact on the degree of outsourcing success.

Based on the arguments built above, the conceptual framework is developed by integrating the aspects of resource dependency theory and social exchange theory. The study identifies that, the degree of outsourcing, vendor management capability and vendor performances have direct impact on outsourcing success. The partnership quality moderates the relationship between both vendor management capability and vendors’ performance on outsourcing success. Partners’ compatibility is proposed to have a mediating impact on the outsourcing success. Figure 1 depicts the proposed conceptual framework which comprises of importance factors influencing outsourcing success. The framework provides guidelines for practicing managers about critical managerial factors for successful execution of outsourcing.

![Figure 01: Proposed framework](image)

Thus far, we have covered fundamental insights in managing outsourcing activity. Determining whether the outsourcing is a successful strategy or not, is unique to each organization. Therefore, in general outsourcing success can be measured in terms of ‘the level of contribution to the organizational performance’. The next section will discuss the managerial implications of the research framework.
4. Discussion

The model developed by this paper is useful for services sector managers to identify the requirement of managing organizational dependency and exchange for a successful execution of outsourcing. The following are some of the model’s managerial implications.

With regards to the dependency, there is no general agreement on the degree of outsourcing. Thus, managers have to select what activities should be outsourced and at what level. The optimal level of outsourcing can be defined as the maximum level of outsourcing which creates the maximum benefits to the organizational performance (Kotabe & Mol 2007; Shamdasani and Sheth, 1994; Jarvenpaa and Mao, 2008). However, if partners’ compatibility is highly correlated with outsourcing success, selecting a compatible partner for joint business is a fundamental requirement (Selviaridis et al. 2008; Tallon, 2008; Jean et al., 2006) for success. With respect to the degree of outsourcing, the managers will able to select the activities to be outsourced and the extent of power to be assigned to the vendor based on the compatibility of the vendor(s). For an example, there will be a greater chance to outsource the function totally to a highly compatible partner than incompatible partner.

In the exchange process, a managing contract is essential to reduce the risk of exchange while relationship management plays important role in covering soft aspects of that. As identified previously, vendor management capability (Han et al., 2008; Lee, 2001; Ogden, 2006; Chan and Chin, 2007; Lam and Han, 2005) and vendors’ service performance (Banerjee and Williams, 2009; Liou & Chuang, 2009; Carr et al., 2008; Gounaris, 2005) have positive impact on outsourcing success. However, partnership quality will moderate the above two relationships. Byramjee et al.(2010) stated that firms are spending a considerable amount of money on vendor management activities (e.g. on monitoring). If higher level of partnership quality strengthens the relationship between vendor management and outsourcing success, organizations can invest more on softer aspects to enhance performance, such as joint problem solving, commitment etc. Furthermore, vendors perform well if they experience higher level of partnership quality. Thus, organizations could benefit by gaining higher level of contribution from their vendors. The managerial implications of investing on partnership quality can be two fold. First, it will help to reduce expenses on vendor management and then, it will offer vendors’ maximum contribution to the outsourcing success.

Partners’ compatibility also influences the contractual governance. Thus, managers can decide the impact of having a compatible partner on vendor management activities to acquire expected vendors’ performance. If partners’ compatibility totally mediates the relationship between vendor management capability and outsourcing success, strong ‘vendor management capability’ will not be the only reason to produce expected outcomes. In fact, investment on vendor management activities will be useless with incompatible vendors. Similarly, if partners’ compatibility moderates vendors’ performance on outsourcing success, the organization could not expect the desired benefits from incompatible vendors. As a whole, organizations would not be able to get maximum benefits in contractual governance unless partners are compatible to each other. In addition to that, the model will be able to test whether contractual governance alone could result in outsourcing success even with a vendor who is not compatible with the focal firm competencies, culture and technology. Therefore, the framework developed by the study strives to answer the previously unseen issues and dilemmas in managing outsourcing context.
5. Conclusion

Service outsourcing has not much been subjected to theoretical conceptualization and empirical investigation compared to the manufacturing sector. Thus, the purpose of this paper is to identify critical factors in managing outsourcing success. The paper identifies some drawbacks of previous theories applied in different studies such as transaction cost economies, resource based view and knowledge based view. The applicability and validity of the resource dependency theory and the social exchange theory have been used in deriving the conceptual framework. The framework presents the critical managerial factors in outsourcing which are dependence and exchange. The degree of outsourcing is a critical determining point as it indicates the level of external resource implication. Social exchange theory facilitates in the interpretation of the governance in the exchange process. To the perspective of managers, they are responsible for carrying out vendor management activities and expected to achieve favourable performance. The paper identifies the moderating role of relational governance in the resources exchange. In addition to that, compatibility between partners is proposed to have a mediating impact on outsourcing success. Based on the model developed, the paper also indicates some possible alternative decisions on outsourcing success which will be useful for practitioners in planning and executing outsourcing activities.

Empirical research is required to test the applicability of this model. The main weakness of the model is its consideration only from the managerial perspective. There is room for further exploration from the vendor's perspective as well as the effect of external factors in influencing outsourcing success. However, the proposed model contributes substantially to the existing body of knowledge by compressing important and comprehensive aspects or factors in managing the success of services sector outsourcing.

References


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