EXPLORING INFORMATION TECHNOLOGY OUTSOURCING RELATIONSHIPS: THEORY AND PRACTICE

Thomas **KERN**[1]
Information and Decision Sciences, F1-16
Rotterdam School of Management
Erasmus University Rotterdam
Burg. Oudlaan 50
P.O. Box 1738
3000 DR Rotterdam
The Netherlands
Tel +31 (0)10 - 4081908
Email: tkern@fac.fbk.eur.nl

Leslie **WILLCOCKS**
Templeton College
University of Oxford
Kennington,
Oxford OX1 5NY
Tel. 01865 422500
Email: leslie.willcocks@templeton.ox.ac.uk

Sent to Journal of Strategic Information Systems

[1] Address for correspondence

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ABSTRACT

A growing concern among the organisations who are actively involved in Information Technology outsourcing is post-contract management and the ensuing development of what many practitioners and scholars have coined the ‘outsourcing partnership’. This paper integrates theoretical concepts from organisation theory, social exchange theory, and relational contract theory with existing research on IT outsourcing, to develop a conceptual model for understanding the relationship. In particular, we conceptually elaborate and then address the relationship’s properties - identified as interactions, contract, context, structure, and behavioural dimensions. Preliminary exploratory research into relationship practice in twelve organisations involved in outsourcing presents some interesting findings that advance the thinking about the outsourcing relationship. We found the conceptual model useful in elucidating important relationship management areas, highlighting not only the outsourcing relationship’s contractual, social, and economic characteristics, but also many additional elements found to have relevance in practice.

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KEYWORDS

IT outsourcing, Relationships, Relational Contract Theory and Social Exchange Theory

1. INTRODUCTION

Ever since the 'Kodak effect' in 1989 (Applegate and Montealegre, 1991) information technology (IT) outsourcing has grown in organisational influence and market size, causing it to become considered an integral component of the Information Management agenda of the 1990s (Feeny and Willcocks 1998; Rockart, Earl, *et al.* 1996; Rockart and Ross 1995). IT outsourcing is broadly defined as a decision taken by an organisation to contract-out or sell the organisation's IT assets, people and/or activities to a third party supplier, who in exchange provides and manages assets and services for monetary returns over an agreed time period (Loh and Venkatraman 1992; Lacity and Hirschheim 1993). Best practice in the 1990s requires - in many circumstances - an in-depth comparison of contracting-out IT with the performance of the in-house IT department (Willcocks, Fitzgerald et al. 1996). Once the decision to outsource has been made and contract negotiations have led to an agreement, the ensuing concern of IS practitioners is: 'how best to manage an outsourcing venture to achieve a win-win situation, that ensures savings, service levels, and other outsourcing objectives are attained as stipulated in the contract'. In practice, this may require both sides to look beyond the traditional arm-length's buyer-supplier type arrangements, and to move more towards a closer relationship that operates within the 'spirit of the contract'.

Understanding the relationship that arises in IT outsourcing is critical, since it comes about not only through the operationalisation of the contract, but also as a natural consequence of the resulting issue of dependency (Kirkpatrick 1991; Grover, Cheon et al. 1995; McFarlan and Nolan 1995; Kern & Willcocks 1996). In effect outsourcing prescribes the 'vertical quasi-integration' of the supplier (Blois, 1972). Paradoxically, the area in IT outsourcing that has received the least research attention so far, is the outsourcing relationship, and more precisely the characteristics that describe such a relationship. A few notable exceptions have focused on the management (Klepper & Jones, 1998; McFarlan & Nolan 1995; Willcocks & Choi 1995), the behavioural issues (Klepper 1994), and the evolutionary development (Klepper 1995). Only initial research has covered the relationship holistically to the extent that a descriptive model exists that outlines the key dimensions (Kern, 1997; Willcocks & Kern, 1998). In this research we determined context, contract, structure, behaviour and interactions (cf. Kern, 1997; Willcocks & Kern, 1998) as the key dimensions. However, more exploratory research is necessary, which is also the starting point of this paper, to understand the outsourcing relationship conceptually and empirically.

In this quest we discovered a plethora of relationship approaches in the inter-organisational relationship (IOR) and marketing literature, but no single explanatory approach was found applicable in its entirety without making major amendments prior to its use. The primary conceptual focus underpinning marketing and indeed a number of IOR approaches is exchange relations (Dwyer *et al.* 1987), which we argue also undergirds IT outsourcing. In fact, we propose to extend the notion of exchange in this paper by integrating both the theoretical concepts from social exchange theory and social contract theory to develop a conceptual framework to understand the properties of the outsourcing relationship. We argue on the lines of Dwyer *et al.* (1987) that firstly, exchange or interactions is the focal event of the relationship. Secondly, the core exchanges in outsourcing are contractually stipulated. Outsourcing can thus be termed a contractual-based exchange relation. Thirdly exchanges define an important frame of reference for understanding the inter-organisational structure of the relations between the individuals and the organisations that participate in the relation's development and execution. Finally, exchange permits the examination of the behavioural dimensions that evolve between individuals as relations continue over time.

With exchange as the guiding principle we structured this paper into four sections to explore outsourcing relationships. The first reviews some of the key literature on business-to-business relationships in information systems, inter-organisational relationship and marketing theory, which led us to look more carefully at social exchange theory and relational contracting. In the second section, a brief discussion of social exchange theory and social contract theory elucidates the conceptual underpinning of the client-supplier framework. In the third section, we discuss the findings from research into twelve organisations with a focus on particular relationship practices as elucidated by the framework. The concluding section discusses relationship practice in light of the conceptual framework. The objective of this study was not to test the framework but to explore both conceptually and empirically outsourcing relationship and to present avenues for further research.

2. EXISTING RELATIONSHIP APPROACHES

The search through the IS literature for inter-firm relationship approaches revealed a dearth of explanatory frameworks that could be used to holistically delineate the client-supplier relationship's properties (see **Table 1**). The variance in IS research on inter-firm relations ranged from management (e.g. Henderson, 1990; Konsynski & McFarlan, 1990), evolutionary development (Lasher, *et al.* 1991), relation type prescription (Elam, 1988) to leveraging IT for inter-organisational coordination and cooperation (Bensaou & Venkatraman, 1996; Cunningham & Tynan, 1993; Kumar & Dissel, 1996; Reekers & Smithson, 1996). The prescriptive management studies revealed little insights into the general constructs of relations and potential underlying theory (e.g. Henderson, 1990; Konsynski & McFarlan, 1990; Lasher *et al.*, 1991), whereas the others were too niche focused. More perplexing was the fact that none explicitly addressed contracting and its management. This is unsurprising in part, as most were theoretically driven and empirical research would have shown the intrinsic importance of the contract in business-to-business relations (see Levine & White, 1961; Williamson, 1979).

Table 1 - IS literature on dyadic relationships

The inconclusiveness of the IS literature is corroborated by Willcocks & Choi's (1995) and Klepper's (1995) research, causing them to seek alternative explanatory approaches in the organisation literature. Klepper (1994 & 1995) for example employs theoretical frameworks from the marketing field (i.e. Anderson & Narus, 1990 and Dwyer, *et al.*, 1987 approaches) as an explanatory means, but encounters the dilemma between theory and practical reality. Klepper (1995 p.257) concedes that: "in the future an effort should be made to combine elements of several theories to obtain a better understanding of the mechanisms by which partnerships evolve and how this process can be managed."

In light of these findings we broadened our search to organisation theory, in particular to the inter-organisational relationship and marketing literature (see **Table 2**). Inter-organisational relationship theories (Aiken & Hage, 1968; Levine & White, 1961) and marketing research into distribution channels (Ford, 1980a; Hunt & Nevin, 1974; McAmmon & Whittle, 1963) identify some of the earliest attempts by researchers to determine the relationship between two or more independent organisations. Research focused chiefly on their structural and behavioural characteristics, which more recently has expanded into antecedent conditions (Oliver, 1990) and the processes defining evolutionary development (Wilson, 1989; Dwyer, *et al.* 1987). Across the business-to-business relationship types, studies reveal that the overall structure consists of the parties, the exchanges or interactions, the external environment, and the working atmosphere, i.e. behavioural issues (Levine & White, 1961; Cunningham, 1980;

Hakanson, 1982; Van de Ven, 1976). The relevance of these perspectives for our research is that they delineate inter-firm relations as including a context, structural and behavioural constructs. We ignore the evolutionary processes for the time being, for little is known about the actual dimension that delineate the outsourcing relationship.

Table 2 - Management literature on dyadic relationships

Although insightful, IOR theory has its limitations in for example its simple extension and adaptation of an within-the-organisation view to an across-the-organisation view without elaborating the benefits or addressing the usefulness of doing so (Bensaou & Venkatraman, 1996). Moreover early work has been found to focus predominantly on public sector institutions (e.g. Levine & White, 1961; White, 1974) and buyer-seller relations (Cunningham, 1980; Ford, 1980). Another major limitation of IOR research is the neglected contractual dimension, which was shown as an integral part in many inter-firm relations, including outsourcing. Actually in outsourcing, the contract regulates the venture and builds the foundation (Kern, 1997). If any approach were to be applicable it would need to incorporate the contract. Nevertheless, we argue that inter-organisational theory prescribes the general macro structure of the relationship in outsourcing as consisting of context, structure, interactions and behavioural dimensions, which are informed by the antecedent conditions. Conditions such as procurement or efficiency, asymmetry, reciprocity, political advocacy, stability, and legitimacy determine the reasons for relations (see Galaskiewicz, 1985 and Oliver, 1990). In outsourcing antecedent conditions and the resulting incomplete contract pertain to a relational governance structure (Ring & Van de Ven, 1992; Stinchcombe, 1985; Williamson, 1979).

3. TOWARDS A THEORETICAL FRAMEWORK

Social Exchange Theory

The underlying concept of IT outsourcing is the acquisition of services and/or products, through continuous interactions between the parties to the agreement. Research in outsourcing has heavily drawn upon transaction cost economics (Williamson, 1975 & 1981) for an explanatory framework (e.g. Alpar & Saharia, 1995; Aubert *et al.*, 1996; Clark *et al.*, 1995; De Loof, 1995 & 1997; Jurison, 1995; Klepper, 1994; Klepper & Jones, 1998; Lacity & Hirschheim, 1993). However, transaction cost economics (TCE) at its core views the actor (i.e. person or company) as not interacting with another actor but directly with the market. In fact, in the economic context decisions are made by actors not in response to, or in anticipation of, the decision of another party, but in response to environmental parameters (Emerson, 1987). To explain the outsourcing relationship we need more than solely an economic view; we need an understanding of the episodes of exchanges from an individual's stand point, which is guided by the contract and lapses into voluntary exchanges (Hakansson 1982).

Social exchange theory, as formalised by Thibaut and Kelley (1959), Homans (1961), Blau (1964), Emerson (1972), and Cook (1977), explains dyadic exchange relations as consisting of 'voluntary transactions involving transfer of resources between two or more individuals, i.e. actors for mutual benefit'. Exchange actions are contingent on rewarding reactions from others, but as Levine and White (1961) emphasise, it does not connote 'reciprocity'. Exchanges can be solely unidirectional actions, the core concept being longitudinal exchange relations between two specific individuals. It focuses directly on the social process of give-and-take, and aims to understand the behaviour of each actor contributing to the exchange. The reason for employing exchange theory is to understand the underlying social structures, which after all, "…are structures composed of the social relations among actors, whether these actors are individual or collective" (Cook, 1987). Homan's (1958) psychological focus on interactions identifies exchanges of goods, materials and non-materials as reinforcing mutuality, which Blau (1964) adapts to analyse the parts of an exchange relation and then the whole relationship. According to Rogers-Gillmore (1987, p. 172), Blau provides a vision where "the whole can be greater than the sum of its parts, while at the same time proceeding from the parts to useful insights about the whole."

Social exchange theory has the potential as Blau (1987, p. 87) explains to "…dissect the transaction process to explain the interdependent contingencies in which each response is dependent on the other's prior action and is simultaneously the stimulus evoking the other's further reaction". Its main limitation is its focus on interactions solely between individual and groups. In addition, data supporting these theorems is based so far mainly on laboratory experiments. However, we argue that in the context of a contractual based venture such as outsourcing, social exchange determines that once exchanges of goods, materials and non-materials occur, it leads to a continuous cycle of interactions reinforced by mutuality.

Social Contract Theory

The nature of a contract according to Macneil (1974, 1978, 1980) evolves from the four principles of society: specialisation of labour, exchange, choice, and awareness of the future. With the *specialisation of labour* over the centuries individuals and/or companies no longer produce for themselves everything they need to thrive. They have become dependent on *exchanges* with others for products/services. The level of *choice* individuals and/or companies have among a range of exchanges explains the extent of freedom they enjoy. However, without an *awareness of the future*, a contract defining these exchanges is not worthwhile pursuing, since consciousness of the future determines the need for a contract. Contract thus according to Macneil (1980, p.1-2) is “no more and no less than the relations among parties to the process of projecting exchange into the future”.

Macneil (1974) proposes that one should look towards exchange as an activity, tangible or intangible, and more or less rewarding or costly, that arises between at least two individuals and/or companies. Macneil’s (1978) explanation of exchange - ‘voluntary actions of individuals that are motivated by the returns they are expected to bring and typically do in fact bring from others’ (p. 863) - is very similar to that of the Exchange Theorists. The integration of ongoing reciprocal exchange with classical and neo-classical contract theory is severely restricted though by the letters of law. He thus proposes revamping contract theory so that it caters for prior and future actions of individuals participating in such an exchange relation. This can be achieved through conjoining the notion of time (i.e. past, present and future) and the behavioural or normative issues with the legal dogmas of classical contract theory, which he coins as a relational contract. **Appendix A** outlines the difference between the traditional transactional and relational contract.

However, specifying in detail long-term exchange relations is understandably complex as they have to cover various unspecified obligations and thus are inherently incomplete (Hart, 1995). In such circumstances of high uncertainty Macneil (1974) and Williamson (1979) postulate that a bi-party agreement should regulate the contractual relation. This is further complicated when considering that “relational exchange participants can be expected to derive complex, personal, non-economic satisfactions and continue to engage in social exchange” (Dwyer, *et al.* 1987, p. 12). Conversely, today’s classical or neo-classical contracts dictate specification of all exchanges to be made for a long-term into the future, but intrinsically they lack the flexibility needed to cater for the ‘ongoingness’ of relations. In addition, they give little consideration to the social or psychological dimension that evolve between individuals enforcing the contract (Rousseau, 1995).

The weakness of social contract theory lies in its focus on the extreme poles of transactional and relational contracts, which lends itself to choosing the preferable equilibrium (Barnett, 1992; Whitford, 1985). In turn, this was suggested to affect the underlying notion behind most contracts - wealth maximisation. In relational contracting the multiplicity of objectives compromises this goal. Thus preservation of contractual relations takes on a form of socialism (Whitford, 1985). Indeed, relational contracting integrates no form of ownership whatsoever (Barnett, 1992), suggesting a lack of breadth. Nevertheless, irrespective of these shortcomings we argue that its integration of the legal, economic, and social dimensions in contracting presents unique insights into the contract likely to influence inter-organisational relations.

Synthesis

Social exchange and relational contract theory contribute to our understanding of the outsourcing relationship, but each is truly concerned with a specific part of a larger phenomenon. Combined they address the fact that interactions, i.e. exchanges underpinning business-to-business arrangements that are long-term in nature require a relational governance, in form of a contract that can cater for the voluntary exchanges that will undoubtedly occur to preserve the relational ongoingness. We argue therefore that social exchange complements the relational contract approach as together they not only address the recurrence of exchanges, the legal ,and economic issues, but also the social, i.e. behavioural dimensions that arise with the operationalisation of the contract. Combined they provide insights into the likely determinants, dimensions and implications of building the relationship in outsourcing.

4. CONCEPTUAL FRAMEWORK OF THE CLIENT-SUPPLIER RELATIONSHIP

Informed by social exchange and relational contract theory we synthesised the findings from the organisation theory literature with the existing research on IT outsourcing, to develop an exploratory model illustrating the constructs of the client-supplier relationship (see Figure 1). Applicable chiefly to the client's point of departure and focusing on the management level, the model elucidates those factors that characterise the nature of the outsourcing relationship and the likely behavioural traits of the parties involved. It also indicates what we argue to be the change in focus from contractual to 'embeddedness' and vice versa in the relationship. Embeddedness in this context refers to the processes that foster social structures between individuals to a business-to-business relationship (see Granovetter, 1985; Naphiet & Goshal, 1996; Uzzi, 1997). Outsourcing should however not be mistaken as being solely a reciprocal inter-organisational relationship, since many exchanges will occur unilaterally as compliance of the supplier to the contract.

Figure 1 - Outsourcing relationship model

The model is purposely arranged to illustrate the key interactions and the behavioural dimension pervading the working atmosphere. The interactions vary in their nature of either contractual or embeddedness, which are pervaded by factors that affect both the working climate and behaviour of the individuals. To emphasise the developmental process of relations the model is based on a *time* continuum. Success of a relationship relies chiefly on the level of customer satisfaction, achievement of expectations and objectives, and more importantly longevity of the venture (Stralkowski and Billon 1988; Riley and Collins 1996).

Context, Contract, & Structure

The outsourcing relationship depends largely on the contextual dimension which encapsulates the specific objectives and expectations (e.g. financial, business, technical and political), which in turn reflect the antecedent conditions (Lacity *et al.* 1994). These then filter into the *contract*, which not only prescribes the dimensions of success for the client, but also outlines the foundation of the relationship (Halvey & Murphy, 1995). In turn, a well developed contract greatly influences the resulting quality of the relationship (Lacity and Hirshheim,1993; Fitzgerald and Willcocks, 1994a). The contract and the integrated service level agreements 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 initial management infrastructure is specified by the key personnel in charge of the contract and any resulting disputes. In fact, we surmise that the escalation procedures describe a multi-level client-supplier relationship and infrastructure (i.e. user-service line manager, technical manager-operations support manager, operational manager-account manager and IS director-account director).

Interactions

The interactions between the parties can be characterised by such dimensions as timeliness, value, regularity, quality, and content (Rothery & Robertson, 1995). Regularity of exchanges provides the medium through which firms can slowly begin to change their relationship, i.e. from contractual to cooperative (Easton 1992). Early realisation of the stipulated terms in the contract is dependent on good *communication* between the participants, as only through ongoing *exchanges of information* can either side fulfill its legal obligations, achieve expectations and satisfaction, avoid conflicts, facilitate solutions to problems, reduce uncertainty levels, and ensure flexibility (Aiken and Hage, 1968; Easton 1992). Flexibility at the contractual level is absolutely fundamental, since adjustments, changes, and investments that were not foreseeable in the initial agreement have to be made to ensure the ventures ongoingness (Gietzmann, 1996). The ensuing management process for this is dependent on daily communication, and possibly weekly, monthly or yearly oversight meetings. Formal communication in this context is characterised by hard facts such as technical, legal or commercial data, whereas informal is more likely to be personal, supportive or soft data (Hakansson and Snehota, 1995). Frequent communication is likely to lead to greater trust, and contrastingly greater trustworthiness can cause improved formal and informal communication (Anderson and Narus, 1990; Dwyer *et al.*, 1987). In turn, meaningful communication is a necessary antecedent of trust.

In parallel, *cultural adaptations* are mutually initiated to smooth the transition to a working, i.e. *normative* relationship (Klepper & Jones, 1998). Cultural adjustments may not be explicit. They tend to evolve as processes, procedures, and exchanges become institutionalised (Ford 1980). The process is largely a task of communication, cooperation, and developing trust in the counterpart (Willcocks & Kern, 1998). According to Forsgen *et al.* (1995) adaptations take place in attitudes, rules, norms, knowledge, and corporate strategies. They can be manifested in various ways, most clearly though in the evolving common language (Mills and Murgatroyd, 1991). This is important as the visible running of the operation can be integrated quite easily in a relationship, but the unwritten norms that are part of an organisation can only be grasped through a phasing-in period and a process of adaptation. Fitzgerald and Willcocks

(1994b) found that a degree of cultural understanding, an element of flexibility regarding the contract, and a notion of fair deal has to exist in outsourcing relations. Problems in ventures tend to arise when the parties involved do not share the same social and cultural traits and norms. To enact, follow and resist these rules and norms is what makes the individual corporate culture (Mills and Murgatroyd 1991). These complex ‘rites and rituals of corporate life’ pose difficulties during a period of change (Deal and Kennedy 1982), since changes to these values require time for staff to adjust. In various cases the differences in culture cause a level of anxiety in employees (Lacity & Hirschheim, 1993).

Pursuing a successful relationship will in part require *investments such as time, knowledge, and resources* from both the client and supplier (Johanson, 1994). These investments are specific to the relationship, but the returns obtained can be such that they include the rendering of current transactions, increase the accumulation of knowledge, and improve control. The knowledge acquired may, for example, cover the level of technical, administrative or logistical competence of the partner (Easton 1992). Therefore, any type of investment signals strong commitment, since the economic consequences that the party will incur if the relationship ends, are quite considerable (Cassel, 1996; Shankar, 1996).

Investments may necessitate awareness of the client company’s *vision*, which in this context is characterised by the purpose for being, cultural beliefs and values, mission, goals, and objectives (Thornberry, 1997). These need to be shared and both parties need to exhibit ownership of the vision to ensure the IT services delivered complement its achievement. Initially, the vision may need adapting and, as time passes, alteration, to ensure the service and expertise available from the supplier is fully integrated. On achievement of mutually agreed goals and objectives the vision may need adapting to cover future goals and objectives.

Embeddeness of relationships are particularly evident in the *social and personal bonds* formed between individuals from both parties. Social ties provide an already existing network through which coalitions can be built, but strong bonds engender trust and compliance (Rogers-Gillmore, 1987). A bond between individuals implies tying together of relations between partners (Easton 1992). Strong bonding is dependent upon the satisfaction of each partner with the other (Robinson & Morrison, 1995). Thus, the development of the relationship depends on social and personal bonds, so much so that alleviation of conflicts, achieving satisfaction, and continuing adaptation all depend to a certain extent on the closeness of the bonds between the individuals. In certain cases the strength of the personal and social bond transcends and even replaces the economic focus, thus determining the *raison d'être* for the relationship's flourishing (Robinson, 1996).

Behavioural Dimensions

The various interactions occurring within both levels, largely depend upon the atmosphere that pervades the overall outsourcing deal. It can be characterised by commitment and trust, satisfaction and expectations, co-operation and conflict, and power and dependency. These can be operational simultaneously at every point of time in the relationship, but may also arise at intervals and in problem situations.

Commitment and trust are interdependent, as greater commitment leads to greater trust and vice versa. Either party's commitment to the relationship is a clear indication that the party is serious about achieving success and is willing to exert effort on behalf of the relationship (Mohr and Spekman, 1996). Commitment in an outsourcing relationship might be measurable by the supplier's allocation of specific people to the contract, the regularity with which the service team interacts with the client, the frequency with which the service team might change and any other adaptations. Trust grows with commitment, and it starts with taking the risk to trust the other party. As experience with the partner develops, trust will evolve. Trust is the belief that a party's word is reliable and that it will fulfill its obligation as stipulated in the agreement, by acting predictably and fairly (Anderson and Narus, 1990; Mohr and Spekman, 1996). Fairness encompasses two key aspects: the perceived fairness of the outcomes received, and the perceived fairness of the supplier's process for managing the relationship (Kumar, 1996), the latter implying for example the amount of experts the supplier commits to handling the relationship.

Once a party develops trust in the other, a pattern of commonality arises and both parties will become increasingly ready to work cooperatively towards established goals and objectives (Brunard and Kleiner, 1994). Hence, trust could be assessed by whether mutual goals and/or objectives have been established, what time frame these cover, and in which intervals these are revised. Regardless though of how deeply two partners trust each other, there will always be areas of difference, as the two parties inevitably will have some goals that are specific to their interest (Kumar, 1996). Therefore, trust as a construct in an outsourcing relationship tends to be less intensive, and involve lower personal commitment, then interpersonal relations in general (Anderson and Narus, 1990).

Satisfaction in the outsourcing relationship will come about naturally with the achievement of the client's expectations. Misalignment of ambitions and expectations is often found to be the root cause of problems (Vowler 1996). To avoid such mishaps, ongoing communication is vital to manage each other's expectations by taking care that dissatisfaction is kept at a minimum (Lacity, Hirschheim et al. 1994). The expectations are partly defined by the service level agreements, the contract and the company's initial outsourcing strategy terms, but will also depend on how the supplier reacts and responds to demands and changes made by the client's end-users. 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 and Narus, 1990) (p.66). The pursuit of mutual benefits increases the client's perception of closeness and trust in the partner. The closeness and achievement of expectations affords a strong feeling of 'chemistry' and results in satisfaction with the supplier (Kumar, 1996). Satisfaction with the outcomes increases the supplier's trustworthiness over time and determines the overall success of the relationship.

Cooperation underpins the relationship, and depends, according to Axelrod (1984), on four strategic elements: (i.) avoid unnecessary conflict by co-operating, as long as the other party does; (ii.) avoid provocation in the face of conflict; (iii.) practice forgiveness after provocation; and (iv.) practice clarity of behaviour so the other party can adapt to your behaviour. Obviously, key to the effectiveness of these strategies is durability of the relationship, but generally long-term operation of the relationship justifies cooperative operation at any point in time. This is "…based on the assumption that if parties can negotiate minimal, congruent expectations for a cooperative inter-organisational relationship, they will make commitments to an initial course of action" (Van De Ven and Ring 1994) (p.99). The course of action depends though on interactions occurring between individuals within the context of an overall relationship that persists over time. Punishing non-cooperatives at any point in time creates hostility, diminishes social solidarity, breaks down satisfaction and trust (Rogers-Gillmore, 1987). This should be avoided as much as possible.

Power-play in outsourcing relations is mainly a result of dependency, and tends to cause a power-control dilemma (Easton 1992). Power-dependency becomes evident through the influence one party can exert over the other (Cunningham and Tynan 1993). Power though, is dependent on the interests of the parties in the exchange relationship. For example in total outsourcing deals, the supplier will dominate the relationship, as the client is totally dependent on services, whereas, in selective outsourcing the situation may be more balanced. Generally though, a dependency automatically takes shape once a company has transferred a significant amount of assets and/or staff.

5. RESEARCH APPROACH

In early 1997 we contacted seven organisations who had outsourced either selectively or totally their IT and had been in a relationship with their supplier partner for at least one year. In parallel we also tried to get access to the client organisations respective supplier(s), which in some cases was possible in others not. A qualitative research method of multiple interviews was adopted to bridge the notions of generalisability of results and achieve exposure to as many nuances of relationship practice in outsourcing as possible (Eisenhardt, 1989). Our approach to researching and understanding the outsourcing relationship was guided by the 'knowledge of reality as socially constructed by the individual human actors' (Walsham, 1995).

5.1. Data Collection and Analysis

Using a semi-structured interview protocol we undertook a series of interviews with fourteen participants, including IT managers, contract managers, account executives, general managers, and support managers in both customer and supplier companies. Questions addressing the contract, post-contract management, relationship management, the nature of a working relationship and the evolution of a relationship were posed, with a strong emphasis on what characteristics influenced the operationalisation of the contract. The interviews were scheduled for one hour but in many cases lasted anywhere up to three hours. All interviewees were assured anonymity to promote openness. Interviews were tape-recorded, transcribed, and posted to interviewees for validation. The responses from both parties were then grouped together into subject categories that corresponded to the variables of the model by use of a data display method (Miles and Huberman, 1994). The resulting checklist matrices of the subject categories were then classified into areas of agreement and commonality, and into sets of disagreement and contradiction. The areas of agreement that illustrated a within-group similarity (Eisenhardt, 1989) identified those variables which underpinned the outsourcing relationship, and also provided the means for further subjective cross-case analysis. In some cases it was possible to cross-case analyse the client's response with their respective supplier's response. The interviews presented first-hand exploratory empirical insights into relationship practice, which were further corroborated by the collection and the ensuing analysis of secondary documentation, such as magazine and newspaper articles, internal memos, minutes of meetings, and outsourcing contracts. Tables 3 & 4 present an overview of the client and supplier organisations, which we disguised to respect their request for confidentiality.

Table 3 & 4- Research into client and supplier organisations

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6. CASE STUDIES – Key Findings[2]

Relationship Context and Contract

Throughout the interviews both parties keenly emphasised the importance of the relationship in IT outsourcing. To derive their understanding of the relationship, we asked client managers to indicate whether their relationship is either contractual, close and integrational, or partnering focused. The majority positioned them as being either totally contract focused or beginning to move towards partnering, i.e. operating within the 'spirit of the contract' (see table 3). On the other hand supplier managers emphasised most of their ventures are focused on partnering, even though a recent study into suppliers by the Meta-Group (1996) revealed their rather meagre partnering capabilities (see table 4). The general move towards a closer relationship seemed imperative though to outsourcing, since operationalisation of the contract in post-contract management only came about through co-operating and working together.

> "The contract defines how you are going to work more than anything else, but you then still have to make it work. The contract is just paper, it's people that make things work. It gives them the guidelines, the stepping stones, the structure" (Management Services Manager, Client C).

Suppliers corroborated this view, but emphasised the importance of having a well documented contract as it guides the individual party's efforts.

> "The contract determines how one faces the relationship and certainly the things you go for and things you don't go for" (Business Director, Supplier E).

Those factors that define the supplier's efforts are essentially determined by the client's objectives for outsourcing. Indeed, post-contract management as such was dependent on the sourcing context and prescribed the contract:

> "The nature of the contract depends enormously on what it is you contracted for" (Executive Director, Supplier D).

However, some differed on the suggestion that easily definable services and products in commodity-based outsourcing arrangements, may cause the relationship to remain strictly

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[2] Note: the behavioural issues pervaded all the findings and discussions with the participants about the relationship and were inherent and integral to the interactions and operations between the parties and the venture

contract-or-service level focused. It was argued instead that the longevity of the outsourcing deal naturally leads towards a closer and integrated relationship, which eventually exhibits partnering traits.

> "You get more strength out of an IT outsourcing relationship if you are making it more a partnership, strategic relationship. [However] you can only have a partnership if both parties are equally strong and equally capable of balancing it. The most creative partnerships come through two very strong players" (Group IS Manager, Client B).

The inherent dilemma though of going down a track of partnering, is that the closer the parties got, the more difficult it became for the client company to retain control. In effect, the boundaries of the parties became blurred. Clients thus became more concerned about affirming control over their destiny.

> "For a partnership to really work, the business half of the partnership has to be in the hands of business leadership who themselves are sufficiently literate about information management, and know how it is an integral part of business strategies, so that they have a strong grasp on the steering wheel and can guide the relationship" (Group IS Manager, Client B).

Contract and Exchanges

The contract was revealed to delimit the bare bones of the relationship, defining the expectations, the services, products, and financial exchanges, the dispute resolution mechanisms and change management procedures. It connoted a clear commitment and gave the client ultimate control through exit clauses. It also guided the initial 'honeymoon phase', i.e. transition phase which was normally completed after 6 months to 1 year - depending on the venture. Early post-contract management then focused on the service level and the costs, which were measurable through the stipulated terms in the service level agreement (SLA). The objective measures were determined by the SLAs, but they neglected to show whether the actual user community is satisfied. Hence, subjective measures also deemed consideration, which were dealt with by user satisfaction surveys and question and answer type sessions. A combination of these was used to measure performance.

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in general.

> “You have got to be able to put together an analysis that is partly people’s subjective reaction to what’s going on, partly objective measures of where their contribution has been…. And it’s a combination of those different measures all coming together that allows you to do it. You must have some very hard measures in there, the more of those hard measures that are output oriented the better” (IT Coordinator, Client F).

Interestingly, both parties revealed the existence of a paradox between objective measures being accomplished as specified and the high level of end-users’ dissatisfaction. To improve user satisfaction clients found that suppliers needed to improve their understanding of the client’s business to ensure services reflect user requirements and to be able to apply their expertise. In part, this required investments beyond the terms stipulated in the agreement to assure the working relationship was maintained.

> “They [supplier] have got to have an intense commitment to understanding their customer, what the customer’s requirements are what the customer’s drivers are. They’ve got to have this ability to sit as much as possible in the customer seat and understand the world from the customer’s viewpoint” (Business Support Manager, Client A).

Managers explained that confidence in the supplier can only be built through high satisfaction levels and a good track record of service delivery. This ultimately leads to trust. Trust was emphasised as key by all interviewees, but for some it implied confidence, whereas for others it meant openness and honesty. Suppliers were strongly in favour of the former, deriving trust via a proven track record.

> “In business you can only build trust we believe by delivering something hard, delivering particular benefits or maximising value which can then be measured by user satisfaction and other means” (Managing Director, Supplier A).

Adaptation through ongoing Exchanges and Communication

Indeed, service and/or product delivery and its monitoring was found to be the fundamental driver of the relationship for client companies. As these exchanges became institutionalised the relationship began to gain in status and benefits became visible.

> “In the very hard nosed atmosphere we are in nowadays, unless you can articulate the performance change and say this company's contribution to that is very clear, and this is what they want to gain, then it won't stand much scrutiny at the time” (Business Support Manager, Client A).

To ensure the smooth operation clients suggested identifying and/or establishing a communication structure in form of key contact points, i.e. people. This in part was explained as defining the necessary management infrastructure for post-contract management. In those deals where staff had been transferred, the residual IS group determined the management structure which the supplier was required to mirror. Both parties stressed that the key contacts actually define those people who act as the drivers for the relationship. In the instances when managers on either side were moved, it imposed a set-back for the whole relationship, requiring a fresh start in some areas.

> "So, you lose a relationship there and you have to try and rebuild. We have rebuilt many and it's very dependent on the outsourcing companies account manager who is the main source of information for us. If they keep changing then the relationship keeps changing. But in general we manage to keep a reasonable relationship with these people. I think the main problem in outsourcing is the change in personnel" (IT Coordinator, Client F).

The importance of the contact points were their information dispersion and exchange roles. Communication as such was seen to underpin relationship efforts, so much so that only through communication were problems identified, alleviated, geographical distances covered, and cultural adaptation catered for.

> "The basic things: are you getting the level of dialogue that really ensures that you've got a supplier who is working hard to understand you and your business, where you are, and to see where they can respond constructively, creatively" (Corporate IT Adviser, Client G).

Good communication was also identified as a critical indicator of whether the relationship was perceived as effective. Managers implied by this the level of interaction, openness, and honesty between the managers in charge.

> "if they miss a target date and I don't know about it until after they miss the target date then there's something wrong with the relationship. If they were having problems somewhere that I would be informed early enough so that we could jointly agree what actions to take to either minimise the damage or remove the problem" (Management Service Manager, Client C).

A successful relationship as both parties explained is identifiable by the way it handles conflict situations. In those circumstances when problems arose, both sides needed to prove their willingness to cooperate. Finding a solution without falling-out or having to refer to the contract was found as a sign of understanding and cultural synergy. In turn, this implied that some level of cultural adaptation had occurred over time. In the early stages cultural differences often lead to clashes. For example in one deal:

> "They [supplier] weren't quite as nimble as we were because they hadn't been through this reengineering process and that caused an awful lot of conflicts, on both sides. It was a cultural difference" (MIS Executive, Client E)

Adaptation in most cases came about without having to take strict measures to change, it was more a process of developing rapport. In those cases where staff had been transferred the culture clash for people transferred was enormous, whereas for the client company buying back the service, it was minimal, as former employees were delivering the service. Over time however, cultural differences mounted which demanded mutual efforts to establish rapport.

Cultural convergence to Achieve Goals and Objectives

Minimising the cultural difference, and establishing working procedures then progressed relations to the 'vertical-quasi integration' of the supplier. The supplier became a critical contributor to achieving the company's goals and objectives. Clients flagged this issue as complex, as the parties generally had different objectives. It was implied that clients and suppliers do not have the same objectives but compatible objectives.

> "What you want to achieve and what I am trying to achieve with my business are they compatible? And therefore is there a shared vision where we might be together in the next 5 years? So, it's compatible objective, shared vision, that kind of stuff which tells you whether you are going to able to work together or not" (Executive Director, Supplier D).

The prerequisite for compatible objectives is a high level of understanding of the client's business.

> "What we need to do is have people who are getting close in with the customer, getting to understand about the business, bringing in the appropriate people from the central group and when in order to put forward proactive ideas about how IT can be used to bring benefit to the business" (European Strategic Director, Supplier B).

The intention behind understanding, providing benefits, working towards common goals was achieving a win:win scenario, where both parties mutually benefited from the venture. For the client this was achieved when the supplier applied its capabilities and expertise to contribute to their business vision. In other words when the IT function added actual value to the business. This was however not to be confused with handing over strategic control of the company's IT.

> "I'm not giving them control of it [strategy], I'm saying I will share with you a real understanding of what our business strategy is so that you are better placed to help me understand the real capabilities that I need to draw on. I will make the decisions, my strategy, my responsibility, but I will bring you into the team closely enough that you really understand what I'm trying to achieve, and therefore you can really say this particular capability is really going to help you make a big change. And then we get into the partnership to make it happen" (Group IS Manager, Client B).

In many cases this went beyond the agreement, but for the supplier new opportunities arose with such interests by the client. In turn, the supplier had to make investments in time and resources to become closer integrated. The implications for the client was a greater demand on managing the relationship. Indeed, client managers emphasised they spend approximately 70% on managing the relationship and 30% on the contract and the rest.

Evolving towards Social and Personal Bonds

Ongoing exchanges and management processes were found to become institutionalised over time by both parties. Integral to that happening was the development of close and personal relations. In some cases where staff were transferred these relations already existed. In others, these were fostered through 'ongoingness' and social events.

> "Spending two to three hours over a good lunch to get to know the supplier is an excellent investment of time. It is the best way to learn to judge whether you can rely on someone because you know something about that person as a person as opposed to a supplier. I tend to think that as a supplier-customer relationship develops a limited amount of social fraternisation - for want of a better word - actually adds to the relationship and makes the relationship work better because you get to know someone personally. …then he's going to be more disposed to help you" (Management Services Manager, Client C).

Personal relations were found to be particularly helpful in resolving conflict situations. However, it was emphasised that one always needs to respect that these are business relations, which needed to be handled accordingly.

> “The more you get to know a supplier personally the better the overall relationship will work. What you have to guard against, and this is the other extreme, is that a bond does not develop so that you can never walk away from that guy. … Some how you have to get a relationship which is relatively close and friendly, but on the other hand still gives you the capability to turn your back on it when you need to” (IT Coordinator, Client F).

7. DISCUSSION

The findings demonstrate the wealth of views on the outsourcing relationship, yet no one seemed to have a definitive answer on how to develop and maintain a successful relationship. In essence, our research elicited the little attention managers had attributed to reflecting about how they actually manage their outsourcing relations - many answers were strongly influenced by ‘gut feelings’. No common findings became apparent that suggested an indication of what defines a successful relationship. Interestingly, all interviewees were keen to discuss their practices, and generally found the questions raised as helpful in focusing their minds. Using the conceptual model, we discuss some of the pointers we picked up from the exploratory research.

Context, Contract, and Structure

Contracting in outsourcing is traditionally seen as the beginning of the relationship. Past studies have thus focused on how the contract governs the ensuing relationship, alluding to its dichotomic focus on transactions or relations (Klepper, 1994; Lacity & Willcocks, 1995). Our findings corroborated this concern, which in essence obscures the fact that IT outsourcing by nature enters a client organisation into a dependency where a supplier’s service delivery infiltrates the organisation at both a vertical and lateral level. Although the outsourcing relationship is contractually governed to ensure opportunistic behaviour can be at any point radically regulated by termination, the contract is no panacea nor does it ensure successful relations. Instead, outsourcing has to be understood as a ‘quasi-vertical integration’ of the supplier (Blois, 1972). To this extent outsourcing connotes relationship irrespective of whether the function(s) contracted out were commodity or strategically focused (see table 4). As one of the interviewees explained:

> “the contract provides a sub-stratum, it's about getting the foundations right. But to really get the partnership working and delivering you've got to have the confidence in the personal relationships and the ways of working together and these processes of working together are very difficult to capture in the contract. But the things that you are talking about in a outsourcing partnership are more about process and relationships and common visions which are difficult things to track in a contract” (Group IS Manager, Client B).

For most the debate really centred on the level of relationship integration - either formalistic or in the ‘spirit of the agreement’. Our model attempts to address this debate by outlining conceptually how these may be bridged. Interestingly, the research findings into relationship practice emphasised the importance of doing so. Drawing upon Macneil’s (1974) discussion of transactional and relational contracts, we can clarify that no long-term business contract can be operated as a transactional contract for its incompleteness and inflexibility makes it inherently prone to failure. Instead, such contracts necessarily are relational entailing non-contractual and voluntary dimensions. Granovetter’s (1985) argument that economic action is embedded in social relations is corroborative. Indeed, as alluded to by managers, the true benefits of outsourcing only emerged once the supplier began to understand the client’s business, and in transactional arrangements that would never be possible nor would it be required. Reaching a level of understanding, demands that the service exchanges for which the supplier was contracted are institutionalised, and supplier managers begin to reflect on areas where they could apply their expertise. Reaching this level which we called ‘embeddedness’, only evolved over time with the ongoingness of the deal and the adaptation of the supplier to the client’s idiosyncratic operations.

The ‘embeddedness’ level holds benefits for both parties. For the client firm it identifies potential areas of where the supplier can truly add value by applying its specific technological expertise, which in a number of client organisations had resulted in re-engineering programmes and new technology investments. For the supplier it entailed potential opportunities for new business and hence increased profits. Some referred to this level of client-supplier integration as a win-win situation, where both parties benefit in their ways from the relationship. Others have explained it as the result of embeddedness, where economic actions become embedded in ongoing social ties that facilitate further exchange relations (Uzzi, 1997).

Findings suggested that outsourcing seemingly is only successful when relations are effective and functioning. To build such relations requires active management involvement beyond what most expect when they contract out. Traditionally, clients expect the supplier to take over and deliver the service while the client managers stand back and monitor. Contrastingly, findings highlighted that 70% of the managers' time in post-contract management is spent on managing relations. This suggests three considerations - which also need closer integration into the conceptual model: firstly, it is critical for the client to establish an appropriate skilled management infrastructure prior to outsourcing, that it can implement during post-contract management. Recent research by Feeny and Willcocks (1998) suggests that the management group should cover nine core capabilities, including business systems thinking, relationship building, leadership, contract facilitation, supplier development, contract monitoring, informed buying, architecture planning and relationship building. Secondly, the client organisation should make it a requirement for the supplier to formalise an account team that mirrors the customer's management group. In other words, the contact structure should be formalised and both parties should be aware who their respective counterpart is. Thirdly, when evaluating the costs of outsourcing it seems rational to consider the costs of post-contract management, as findings indicated that management may be pre-occupied with developing and maintaining relations.

Interactions

Interactions that occur in the relationship seem to vary along a range between contractual and voluntary exchanges. Service level agreements and prices or costs define the formal contractual exchanges that underlie the exchange relationship. In addition, communication was found to pervade both the contractual and voluntary exchanges by its inherent nature of formality and informality. For example, monthly, quarterly and possibly yearly service performance reports in form of formal documents - that may or may not be agreed to in the contract – were essential for clients to justify payment or non-payment. On the other hand, informal communication outlines the essence of day-to-day interactions and is inherent to social events. In turn, it is a crucial building block of the relationship and reflects the kind of managers that are required at the interface points. These managers that ‘span the organisational boundary’ need to be good communicators at both the interpersonal, technical and business level (Katz & Kahn, 1978; Feeny & Willcocks, 1998).

Voluntary interactions and hence exchanges were revealed as those factors that enable the parties to adapt to the idiosyncratic working practices. They were investments in resources beyond the contract that were necessary to ensure the relationship’s ongoingness. In short, they sustained the relationship, especially in situations of dispute, conflict and moving of key management personnel. These exchanges conform to Macneil’s (1980) explanation of what comprises relational contracts and the inherent non-applicability of classical and neo-classical contracts for such long-term arrangements.

In addition, these interactions and exchanges were found to be responsible for fostering social ties and closer relations between managers. Key to developing these were informal and social events. As a client manager noted:

> "One of the things that I would like to do more often is some of the management meetings we have I would like to have a sandwich lunch before or afterwards when the meeting ends, because I think you get a lot of information in a short almost informal conversation and learn more about problems" (Business Support Manager, Client A).

In effect, there is another dimension to outsourcing that needs development - interpersonal relations between the two management teams. Their effect on the success of the venture was alluded to by the managers' suggestion that closer ties are critical for attaining benefits and value added, and developing a win-win scenario. In fact, endogenous to these interpersonal relations are behavioural and attitudinal factors that were found by others to affect the success of the whole inter-firm relations (see Mohr & Spekmann, 1994; Ring & Van de Ven, 1992).

Behavioural

Intrinsic to outsourcing is cooperation, commitment, conflict, power and dependency from the beginning of the venture. In fact, cooperation and commitment were rarely addressed at all as managers perceived them as implicit. Commitment to the venture is already affirmed by the contract and the service level agreement (SLA). Only in discussions about the contract or the SLA was commitment ever used by interviewees. Cooperation underpinned most interactions and exchanges. Although some relations may be adversarial, without cooperation it would have been impossible to operationalise the contract. The level of cooperation, however, may vary and develop over time. For example, interviewees revealed that their contracts included dispute resolution procedures that were relied upon especially in the beginning of the relationship, where a number of contract issues required further clarification. However as relations progressed, many of the disputes that arose could now be handled between managers without having to escalate them according to the procedures. We can speculate that this was in part due to an increased level of cooperation and understanding.

Trust was often quoted as critical to the relationship, although it was not clear whether managers meant confidence or interpersonal trust, i.e. honesty and openness. Indeed, trust took time to develop and in most cases evolved with the appearance of a good track record of accomplishing stipulated terms. Building confidence seemingly preceded trust. Satisfaction also played a role, but it was not clear how it influenced the relationship. It rather seemed satisfaction was a measure concerned with evaluating the users' perception of the services, which very likely could lead to confidence in the supplier's service quality.

8. CONCLUSION

In IT outsourcing, understanding the management issues surrounding the client-supplier relationship is of paramount importance to the success of such an undertaking. However, little is known about the relationship's *gestalt* (Kern, 1997) and greater attention must be directed to identifying its dimensions before suggesting management solutions (McFarlan & Nolan, 1995) and exploring its evolutionary development (Klepper, 1995b). Drawing on inter-organisational relationship theory, social exchange theory, relational contract theory and existing research on IT outsourcing, we conceptualised a framework to capture some of the key constructs and properties of the client-supplier relationship. Building on the notion that 'exchange' underpins IT outsourcing relations, we identified the core dimensions of the relationship as context, contract, structure, interactions and behaviour. Preliminary research exploring relationship practice in client and supplier organisations gave some insights into these dimensions and the criticality of the relationship to the venture's success. Outsourcing is clearly driven by economic actions, but evidently is embedded in social relations (Granovetter, 1985).

This research further highlighted that relationship management in outsourcing in essence has to focus on achieving the clients objectives. All management efforts have to be geared towards operationalising the contract, which mirrors in part these objectives, but also outlines what the supplier party needs to perform to receive its part of deal, i.e. payment. Initial efforts, in turn, have to concentrate on embedding the relationship in the core interactions, which this research determined and elicited as product/service exchanges, financial exchanges, service enforcement and monitoring, and communication/information exchanges. This contractual foundation will then guide the relationship. All management resources thus allocated to implement the venture, must concentrate on this contractual area. However, the relationship will evolve to a different status as it becomes embedded in day-to-day routines and each parties operations. As cultural and operational convergence occurs additional value added benefits may be freed through the improved understanding of each other's operations and business. Adaptation and convergence was identified as becoming strategically closer, where mutual benefits are identified and additional investment in resources may be made to improve the amount of additional benefits. The resulting danger though that emerges with convergence and becoming increasingly 'relationship-cozy', is the potential loss of focus on the core reasons for having ventured into such an outsourcing deal. Therefore, client managers should be aware that as they develop and foster closer ties between individuals, the centre of attention has to remain on the core outsourcing objectives as outlined in the contract.

Furthermore, because of the extraordinary complexity of outsourcing relationships our framework will, without a doubt, need further refinement, elaboration and testing. The objective of this study was not to test the framework but to explore both conceptually and empirically outsourcing relationships, and thus as it stands the framework may be seen to have many limitations especially in respect to its static view. However its usefulness derives from its heuristic and analytical potential, in a fashion that captures both the outsourcing relationship's contractual, social, and economic characteristics, as well as many additional elements. Although research into outsourcing relationships is challenging due to a number of constraints including access to both parties, we believe this framework has the potential to make a significant contribution not only to understanding outsourcing relationships, but also to understanding other business-to-business relations. Moreover combined the exploratory findings and the framework highlighted many avenues for further research. A particular important issue that requires further research was shown to be the management structure that needs to be in place to be able to operationalise, develop and maintain the relationship. Another area is the consequential dissolution of a venture, i.e. relationship when it no longer is viable or has come to its contractual end. So far existing research has focused on outsourcing and developing the relationship, but what are the practices to dissolve the relationship?

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