Journal of Strategic Information Systems 24 (2015) 203–216

Contents lists available at ScienceDirect

Journal of Strategic Information Systems

journal homepage: www.elsevier.com/locate/jsis

Strategic innovation through outsourcing: The role of relational and contractual governance

Ilan Oshri [a,*], Julia Kotlarsky [b], Alexandra Gerbasi [c]

[a] *Centre for Global Sourcing and Services, Loughborough School of Business and Economics, Loughborough LE22 3TU, United Kingdom*
[b] *Aston Business School, Aston University, Aston Triangle, Birmingham B4 7ET, United Kingdom*
[c] *Grenoble Ecole de Management, 2 rue Pierre Sémard, 38000 Grenoble, France*

ARTICLE INFO

Article history:
Available online 18 August 2015

Keywords:
Outsourcing
Strategic innovation
Quality of client–supplier relationship
Fixed-price contract
Time and materials contract
Joint venture contract

ABSTRACT

There is growing evidence that client firms expect outsourcing suppliers to transform their business. Indeed, most outsourcing suppliers have delivered IT operational and business process innovation to client firms; however, achieving strategic innovation through outsourcing has been perceived to be far more challenging. Building on the growing interest in the IS outsourcing literature, this paper seeks to advance our understanding of the role that relational and contractual governance plays in achieving strategic innovation through outsourcing. We hypothesized and tested empirically the relationship between the quality of client–supplier relationships and the likelihood of achieving strategic innovation, and the interaction effect of different contract types, such as fixed-price, time and materials, partnership and their combinations. Results from a pan-European survey of 248 large firms suggest that high-quality relationships between clients and suppliers may indeed help achieve strategic innovation through outsourcing. However, within the spectrum of various outsourcing contracts, only the partnership contract, when included in the client contract portfolio alongside either fixed-price, time and materials or their combination, presents a significant positive effect on relational governance and is likely to strengthen the positive effect of the quality of client–supplier relationships on strategic innovation.

Introduction

The last fifteen years have witnessed significant growth in the outsourcing industry (Oshri et al., 2015). While the early years of Information Technology (IT) and business process outsourcing (BPO) were mainly characterized by a quest for costs savings (Loh and Venkatraman, 1992; Lacity and Hirschheim, 1993) and a focus on core competences (Quinn and Hilmer, 1994), recent evidence suggests that client firms now seek to achieve added value from outsourcing by accessing suppliers' competences (e.g. Dyer and Nobeoka, 2000; Quinn, 2000; Whitley and Willcocks, 2011). Mol (2005: 571) argues that "firms are increasingly relying on partnering relationships with outside suppliers that can act as an effective substitute to the internal generation of knowledge and innovation". Similarly, Linder et al. (2003) and Weeks and Feeny (2008) argue that client firms rely on external suppliers in the search for new ideas. More recently, accepting that innovation is outsourced and offshored, Lewin et al. (2009) studied the determinants driving firms to offshore innovations only to conclude that firms have

* Corresponding author. Tel.: +44 1509 223115.
E-mail addresses: i.oshri@lboro.ac.uk (I. Oshri), j.kotlarsky@aston.ac.uk (J. Kotlarsky), alexandra.gerbasi@grenoble-em.com (A. Gerbasi).

http://dx.doi.org/10.1016/j.jsis.2015.08.001

been entering a global race for talent in which solutions will be sought wherever skills are available. Such observations suggest that innovation may be considered as one of the possible outcomes of outsourcing engagements.

Indeed, several recent studies have examined the practices through which innovation can be achieved in outsourcing settings (Weeks and Feeny, 2008; Whitley and Willcocks, 2011; Lacity and Willcocks, 2014). Weeks and Feeny (2008) offer a taxonomy of forms of *innovation through outsourcing* that distinguishes between IT operational and business process innovations, and strategic innovations. The former corresponds with incremental forms of innovation (Dewar and Dutton, 1986), while the latter matches the definition of radical innovation (Droege et al., 2009). Defined as ways to "significantly enhance the firm's product or service offerings for existing target customers, or enable the firm to enter new markets" (Weeks and Feeny, 2008: 131), strategic innovations have been traditionally perceived to be more challenging to achieve (Weeks and Feeny, 2008) and therefore will be the focus of this study. Strategic innovation requires significant product or service development and its success can be challenged by lack of cooperation, low levels of trust and information asymmetry between the supplier and client (Weeks and Feeny, 2008). Similarly, the lack of appropriate incentives for both client and supplier may inhibit the sides from developing collaborative innovation through outsourcing (Lacity and Willcocks, 2014). The limited literature on innovation in the outsourcing context has persistently highlighted the key role that relational governance plays in creating favorable conditions for strategic innovation through outsourcing (Whitley and Willcocks, 2011; Weeks and Feeny, 2008). We concur with such observations; however, we seek to advance and contribute to the Information Systems (IS) outsourcing literature by examining the role that relational and contractual governance plays in fostering strategic innovation through outsourcing. In particular, we seek to verify whether high-quality relationships between clients and suppliers do lead to strategic innovation, and whether certain contract types positively or negatively affect the impact of high-quality client–supplier relationships on the ability to achieve strategic innovation. *Relational governance* will be examined in this study as the quality of the client and supplier relationships (Lacity et al., 2010), while *contractual governance* will be explored through three contract types commonly used in outsourcing engagements: fixed-price, time and materials (Gopal et al., 2003; Gefen et al., 2008) and partnership-based (Willcocks and Choi, 1995; Dibbern et al., 2004), and the combinations of these contract types. This research relies on a pan-European cross-industry survey that included representatives of 248 firms that are buyers of IT and business process outsourcing services. Respondents were senior managers involved in the execution of outsourcing projects or programmes who were selected in accordance to the "key informant" methodology (e.g. Goo et al., 2008).

The contributions of this study are twofold. First, our paper is one of the early attempts to shed light on the link between a governance approach and strategic innovation through outsourcing. In this regard, our empirical results confirm a positive effect of the client–supplier relationships on the likelihood of achieving strategic innovation. Second, this study shows that the interaction of contractual governance with relational governance is central to achieving strategic innovation through outsourcing. We found that a partnership contract, when included in the client contract portfolio alongside a fixed-price or time and materials contract magnifies the positive effect of the client–supplier relationships on the possibility to achieve strategic innovation, but no effect for fixed-price and time and materials contracts, as stand-alone contracts.

The rest of the paper is organized as follows: first the literature on innovation in the context of strategic IT and business process outsourcing is reviewed; then we theorize about the role of relational and contractual governance in achieving strategic innovation. This is followed by an explanation of methods and results and a discussion of our findings in the light of the existing literature. We conclude with theoretical and practical contributions.

Theoretical background and hypotheses

Strategic innovation in the context of IT and business process outsourcing

The outsourcing of IT and business processes has been recognized as one of the risk factors that may lead to the loss of innovative capabilities inside a client's firm (Weeks and Feeny, 2008). Past studies, however, have persistently anticipated that outsourcing will deliver new ideas and value to both business operations and strategic objectives (Lacity and Hirschheim, 1993; Lacity et al., 2010). Despite the above risk, innovation is one of the potential promises of outsourcing; however, one which is poorly understood. For example, studies that discuss innovation in the context of IS outsourcing have mainly relied on a small number of cases or instances, shedding little light about the governance structures affecting innovation (e.g. Levina and Vaast, 2008; Weeks and Feeny, 2008; Whitley and Willcocks, 2011; Lacity and Willcocks, 2013). Further, in the few studies in the IS outsourcing literature that have attempted to model innovations, this concept was perceived to be an independent variable (e.g. Kishore et al., 2003) rather than a possible outcome of an outsourcing project (Lacity et al., 2010).

The innovation literature distinguishes between various types of innovations. For example, numerous studies on innovation have adopted the concepts of incremental and radical innovations (e.g. Ettlie et al., 1984; Dewar and Dutton, 1986; Malhotra et al., 2001) or exploitative and exploratory innovations (e.g. Jansen et al., 2006). In the IS literature, Weeks and Feeny (2008) offer a helpful taxonomy of innovation that could be achieved through outsourcing. They distinguish between IT operational innovation, business process innovation and strategic innovation. Indeed, the vast majority of firms seeking innovation through outsourcing engagements have reported achieving IT operational and business process innovations (Weeks and Feeny, 2008; Lacity and Willcocks, 2013; Whitley and Willcocks, 2011). Such innovations are achieved when