



# Outsourcing capabilities, organizational structure and performance quality monitoring: Toward a fit model



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## ARTICLE INFO

### Article history:

Received 11 February 2012

Received in revised form 8 October 2012

Accepted 16 April 2013

Available online 9 May 2013

### Keywords:

IT outsourcing

Fit

Capabilities

Organizational structure

Performance

Providers

## ABSTRACT

Provider IT services has grown substantially, since the advent of IT. However, research on it has been limited and mainly qualitative. A recurring provider problem was identified: a lack of attention to the performance of the IT they provide. Due to uncertainty or change in the client environment, the fit between capabilities and organizational structure of outsourcing providers must be balanced. Here we present the results of an exploratory quantitative empirical study among outsourcing experts involved with three different types of IT outsourcing providers: domestic, offshore, and global.

We developed instruments that measured some core concepts such as *outsourcing capabilities*, *organizational structure dimensions*, and *performance monitoring*. We then used these in analyzing data gathered from three different types of IT outsourcing providers. We found that service providers who establish a fit between their outsourcing capabilities and their customers' organizational structures are less susceptible to problems resulting from unexpected change in the clients' environment.

Our results therefore extended our understanding of how critical determinants in provider organizations are related to continuous quality monitoring of their performance.

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## 1. Introduction

Most research in outsourcing has focused on customer-related aspects. Since these aspects have a significant effect on service provider organizations, regular communication between clients and providers is necessary. Therefore, clients are likely to discuss market developments and business needs with their service providers regularly. However, few studies in the field of outsourcing relations include the view of providers [3,5].

It has been noted that a lack of sustainability in service performance; i.e., continuous delivery of high quality services over time, has been a recurring problem that occurs due to a lack of capabilities of IT providers and/or the way in that they are organized [4]. A lack of provider performance will result in failures on the client side. When the quality of service delivery decreases the costs to overcome the resulting problems will increase. As a result, the lack of provider performance may have a negative impact on the client as the time-to-market of products and services increase. Therefore, performance monitoring and awareness of the importance of high quality performance is of utmost importance.

We argue that IT providers who manage to establish a fit between outsourcing capabilities and their own organizational

structure are less susceptible to change in their clients' environment. Moreover, this requires continuous monitoring of provider's performance and thus IT providers who monitor their client's developments are likely to be able to adapt to changing circumstances and provide high quality performance.

We decided to focus on how providers adapt their outsourcing capabilities and organizational structure in order to deal with the uncertainties that their clients face and consequently increase their performance. The leading research questions were:

- How does a service provider adapt its outsourcing capabilities in order to take into account uncertainties resulting from changes in their clients' needs?
- How do adjustments in service provider outsourcing capabilities affect their organizational structure?
- How does a service provider monitor the performance of an outsourced project under uncertainty?

## 2. Theoretical framework

### 2.1. Contingency theory

The central theme of contingency theory is that all an organization's components must "fit" well together or it will not perform optimally. Various types of fit include person-team fit and task-technology fit that links IS usage with individual

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performance. The concept of fit can be used to examine if changes in the outsourcing capabilities of service providers occur when there are changes in the organizational processes and structure [7]. A fit between a service provider's capabilities and its organizational structure will positively affect organizational performance. A misfit, however, may negatively affect the provider's competitive position and result in failures on the client side. Here, we focused on the fit between providers' outsourcing capabilities and the way they are internally organized.

## 2.2. Providers' outsourcing capabilities

Uncertainty due to environmental change forces firms to allocate greater resources to retain high performance. Such external contingencies are the major reason that a firm must be adaptable. Providers need to adapt their activities to interact easily with their client in order to maintain effective outsourcing. From the perspective of the provider an outsourcing capability is those 'IT capabilities that refer to an assembly of skills, techniques, and know-how, developed over time, which enable an organization to acquire, deploy, and leverage IT investments in pursuit of business strategies' [8]. Although provider capabilities are important there has been little insight provided by empirical past research. Apparently research in providers outsourcing capabilities is still very limited, as was also concluded by Lacity et al. [9]. They showed that research has been directed to IS human resource management capability; supplier's IS technical and methodological capability, and domain understanding. In the Strategic Management literature on outsourcing capabilities the interpretation of capabilities is limited; system architecture, system reliability, user training and consulting, value and quality of project management, and relationship management have been seen as core capabilities [18]. In econometric analyses of IT knowledge transfer between providers and clients, IT knowledge is an important determinant of productivity [2,10].

However, the way in which capabilities are conceptualized is generic, and therefore we followed the view of Feeny's et al. [4] who considered a capability for outsourcing as building on twelve provider outsourcing capabilities related to three organizational competences: delivery (which determines the extent to which a provider is able to react to a customer's day-to-day need for operational services, including business management, domain expertise, and behavior management), transformation (including technology exploitation, process improvement, program management and customer development), and relationship (focusing on the relationship between provider and client, including planning and contracting, organizational design, governance and leadership). Palvia et al. [16] developed a three level capability-quality-performance model. Their provider capabilities were relationship, contract and IT management. Ai et al. [1] discussed IT based skills (communication, cultural and collaboration related) for knowledge sharing, its coordination and expertise management.

However, in our effort we focused on providers outsourcing capabilities and organizational structure with respect to performance, under uncertainty.

## 2.3. Providers' organizational structure

Formal organizational structure and the roles that people play, including the competences and responsibilities involved, have been investigated extensively in organizational literature. Firms select their organizational structure to achieve internal coordination, which is imperative in realizing value from an outsourcing capability. Moreover, coordination is necessary in attempting to achieve effective activities, such as the delivery of day-to-day IT services. Several factors have been shown to matter, such as the

degree of formalization, specialization, standardization, number of layers in the hierarchy, horizontal integration, and professionalism. The three generally considered important factors: the locus of decision-making (the degree to which decisions are made high versus low in the organization), level of hierarchy of a decision (whether the organization has many or few levels of management), and horizontal integration (the degree to which departments and workers are functionally specialized versus integrated in their works, skills and training) were deemed relevant in our study. The organizational structure of an IT provider can be seen as a moderator of the relationship between the actions of the client and the provider's outsourcing capabilities that were designed to support the client. Therefore, we focused on examining the impact of the fit between the outsourcing capabilities and organizational structure and its effect on organizational performance.

## 2.4. Providers' performance

Few studies have empirically examined the impact of the fit between client and provider's organizational structures and organizational performance. Capabilities and organizational structure can be perceived as influencing factors on firm performance. Research on IS performance has suggested that the ability to leverage distinctive internal capabilities is related to environmental dynamism of the firm's organizational performance and ultimately the provisioning of services [11,14]. Gaining a high quality of outsourcing performance should result in long-term benefits for a provider. However, it is difficult to measure the effect of outsourcing capabilities and organizational structure on firm performance. Ai et al. [1] used product success and personal satisfaction as indicators for performance, but did not describe their measurement tool.

In our work, we used a proxy for performance by looking into the importance that is attributed to a performance measurement. This can be considered as an alternative to direct measurement.

## 2.5. Development of hypotheses

### 2.5.1. Relations between client environment and provider outsourcing capabilities

The environment of organizations, such as their market, changes frequently. So it is of key importance for an organization to know what changes take place in their environment, and which resources and capabilities need to be modified. Lacity et al. [9] asserted that this is under-researched. Moreover, outsourcing literature is more focused on provider competition than understanding the competitive environment in which clients have to perform. According to Gottschalk and Solli-Saether [6] core competence management and provider resource management are critical factors in outsourcing relations. Therefore, we argue that IT outsourcing providers have to re-assess their outsourcing capabilities regularly and strengthen them, as necessary, to adapt to the changing needs of their client. Therefore:

**H 1a:** *The outsourcing service provider's sensitivity to change and uncertainty, which a client has to deal with, will lead to adjustment in service provider outsourcing capabilities.*

Thus providers have to manage their internal adaptability process to modify their capabilities. In doing so, adaptability procedures can guide the internal adaptability processes that, in turn, require regular attention and investment. The outsourcing provider's responsiveness and the adaptability of their employees, is a condition for the adjustment of outsourcing capabilities [17]. As Zhao et al. [19] argue uncertainties caused by a competitive environment have to be mitigated, and therefore a company that outsources its IT function must adopt an aggressive outsourcing strategy and requires an agile provider. Thus:

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