Client dependence: A boon or bane for vendor innovation? A competitive mediation framework in IT outsourcing

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ARTICLE INFO

Keywords:
Outsourcing
Innovation
Client dependence
Relationship marketing
Resource dependence
Firm size

ABSTRACT

Information technology (IT) outsourcing has grown in volume and in importance since the 1990s. Clients and vendors are becoming more interdependent in a complex collaborative setting. Client dependence, however, happens to be a double-edged sword with respect to vendor performance. In this study, we build a competitive mediation model, which explores both the bright and the dark sides of client dependence for vendor innovation based on relationship marketing and resource dependence as our theoretical lenses. We further analyze the role of vendor size as a moderator. On the one hand, our results demonstrate that client dependence has a positive effect, mediated by relationship satisfaction, on vendor innovation. On the other hand, client dependence also has a direct negative effect on vendor innovation. Vendor size seems to play an interesting moderating role where it attenuates the direct negative effect of client dependence, but it does not affect the positive mediating effect of relationship satisfaction. This research highlights dual theoretical routes that expose opposing effects of client dependence on vendor innovation. The findings also provide practitioners with implications regarding how to maximize benefits and yet minimize the obstacles from dependency in a dyadic outsourcing relationship.

1. Introduction

The 1990s saw an explosion in the volume and importance of IT outsourcing. In the ensuing period there has been an increased focus on maintaining long-term outsourcing relationships between clients and vendors (Lee, Huynh, Kwok, & Pi, 2003; Mathur, 2006). The outsourcing decision is complex and determined by a number of factors, such as cost of back shoring (or bringing back activities to the client location) (Loh & Venkatraman, 1992), uncertainties due to cost escalation (Bahl & Rivard, 2005), access to market (Musteen, 2016), and relationship focus (Kern & Willcocks, 2000).

Meanwhile, the expansion of outsourcing activities is facilitated by vendor innovation. In order to remain a healthy relationship with their clients, vendors are undertaking more complex and innovative offerings that are difficult for clients to replace (Hsuan & Mahnke, 2011). The recession in the late 2000s caused a drop in global IT demand, creating considerable pressures on IT vendors. They had to change focus to sustain growth by offering more innovative products and services (www.businesstoday.in). It is evident that the nature of inter-organizational relationships is changing and clients are becoming increasingly more dependent on vendors (Johnsen & Lacoste, 2016). In this research, we focus on the role of client dependence and its impact on vendor innovation.

Although it is commonly surmised that vendors desire greater client dependence to gain more power, we argue that belonging to a network and having the client dependent on the vendor’s skills and resources can be a double-edged sword. On the one hand, dependence between members in a dyad offers advantages to both parties because of the “cooperative competency” derived from mutual-adjustment and the resultant relational capabilities that provide the infrastructure for continued collaboration (e.g., Morgan & Hunt, 1994; Sivadas & Dwyer, 2000). On the other hand, studies have expounded the dark side of dependence, which contends that excessive client dependence creates power imbalances and produces rigidities where vendors become more technologically conservative, inward looking, and thus less innovative (Gassmann, Zeschky, Wolff, & Stahl, 2010; Johnsen & Lacoste, 2016).

Following this logic, we adopt two competing theoretical foundations to explore the dual effects (the bright and the dark) of client dependence on vendor innovation in the IT outsourcing context. We use relationship marketing as our theoretical lens (Morgan & Hunt, 1994; Palmatier, Dant, Grewal, & Evans, 2006) to explain the bright side, and the resource dependence theory (Paulraj & Chen, 2007; Pfeffer &
Salancik, 1978) to understand the darker consequences of client dependence. Relationship marketing suggests that a main emphasis in the client-vendor relationship is on developing and retaining customer relationships (Palmatier et al., 2006). It is generally agreed that a relationship characterized by satisfaction benefits both business partners, and relationship satisfaction has been viewed in extant literature as a key positive mediator between various antecedents and performance outcomes (Palmatier et al., 2006). The resource dependence theory focuses on resources obtained from external or third party sources by imposing certain inter-organizational ties (Pfeffer & Salancik, 1978) and vertical disintegration (Paulraj & Chen, 2007). This theory suggests that clients and vendors manage their networks through developing inter-organizational links that attempt to balance power (Pfeffer & Salancik, 1978). However, the power distribution may not always be balanced between parties. When there is power asymmetry, dependency triggers behaviors that reduce the magnitude of overall rewards and affect individual party and overall group outcomes (Casciaro & Piskorski, 2005; Pfeffer & Salancik, 1978).

Since the two competitive theoretical routes result in both positive and negative effects of client dependence on vendor innovation, they tend to offset each other in terms of relationship strength. To make it more nuanced, we study the condition where one side outweighs another by focusing on vendor size as the contextual factor. Examination of the moderated mediation effect allows us to better understand how to manage both the bright and the dark sides of dependency in the outsourcing context.

We collect data from 120 IT vendors in India and focus on their outsourcing activities through a survey instrument. Results show that the vendor’s relationship satisfaction positively mediates the relationship between client dependence and vendor innovation, but client dependence negatively impacts vendor innovation. In addition, vendor size reduces the negative effect of client dependence on vendor innovation.

This research contributes to extant literature in several ways. First, many past studies have focused on either the favorable or the unfavorable aspects of the client-vendor relationship. However, in this research we challenge that assumption and suggest that there are dual theoretical routes that expose co-existing yet competitive effects of client dependence on vendor innovation. Thus, we provide a more systematic view of dynamics in the client-vendor relationship. Second, we view vendor size as a moderating variable and examine its impact on the dual effects. Findings will provide practitioners with pointers as to how to maximize benefits and yet minimize the hindrances caused by dependency in an inter-organizational dyadic relationship.

2. Research background and hypotheses

2.1. Innovation in outsourcing relationships

A critical strategic goal for firms is to stay competitive through an emphasis on adaptability and innovation. At the firm level, innovation is usually defined as the adoption of an idea or behavior, pertaining to a product, service, device, system, policy, or program that is new to the adopting organization (Gopalakrishnan & Damanpour, 2000). In the IT sector, products and services are often intangible and perishable. For example, an innovative solution to a client’s problem may include a product associated with a service, and the process of delivering the innovation is intangible (Hogan & Coote, 2014). As a result, we adopt a broad conceptualization of innovation as the new products and services developed by a firm (Gopalakrishnan & Damanpour, 2000).

As IT outsourcing has become more pervasive, managing these outsourcing relationships on a long-term basis has become more important both from a client’s and a vendor’s point of view (Lee et al., 2003). Cost escalation and the availability of numerous alternatives require that vendors become more competitive through focusing on new product and service development and increasing knowledge absorption from their collaborative networks (Hsu & Mahane, 2011; Kang, Wu, Hong, & Park, 2012; Stanko & Olleros, 2013).

Outsourcing is a dyadic version of a collaborative network where the vendor supplies required products and services to the client. Many previous studies have explored this relationship from the client’s perspective (Dibbern, Goles, Hirschheim, & Jayatilaka, 2004; Janita & Miranda, 2013). However, since the relationship involves both clients and vendors, it is important to understand both sides of the dyad. The functions that are being outsourced are increasingly critical to the client and consequently the vendors play a significant role in the success of the client’s organization (Kakabadse & Kakabadse, 2005). Additionally, if the vendor is not satisfied with the relationship it could have costly consequences for the client. The client may be forced to backshore the operations or switch them to another vendor at a time that is not of their choosing. Both of these actions could be expensive and fraught with uncertainty. In line with some prior studies (e.g., Palvia, King, Xia, & Palvia, 2010), this research shifts from a client to a vendor focus in the IT outsourcing context. Previous studies with a vendor focus have examined a variety of issues such as why vendors seek quality certification (Gopal & Gao, 2009) and how they can benefit from quality certification (Gao, Gopal, & Agarwal, 2010), and how vendor firms acquire legitimacy in host country markets (Pant & Ramachandran, 2012). Here, we investigate the nuanced and divergent relationship where client dependence can impact vendor innovation.

Although intuitively outsourcing seems to be an effective way to pursue new products and services, past research has not reached a consensus on the role of innovation in the outsourcing context (Stanko & Galantone, 2011). Some researchers find outsourcing hinders innovation outcomes (e.g., Stanko & Olleros, 2013), while others find that outsourcing is not inferior in terms of product innovation (e.g., O’Regan & Kling, 2011). In this research we argue that both perspectives are valid, as some outsourcing-related factors can be facilitators and others can be inhibitors. Following this logic, we build a competitive mediation model that showcases both the bright and the dark sides as co-existing in the outsourcing context. Fig. 1 displays our conceptual model.

2.2. The bright side of client dependence (mediation effect)

To explain the bright side of client dependence for vendor innovation, we draw from “relationship marketing,” which needs to be differentiated from a discrete transaction that has a beginning and an end. This process is longer in duration and is ongoing (Dwyer, Schurr, & Oh, 1987). The client-vendor relationship has been central to marketing since it embodies a customer orientation philosophy (Fournier, Dobscha & Mick 1998). Such a relationship is a typical vertical alliance (Kibbeling, der Bij, & Weele, 2013; Lahiri & Narayanan, 2013), where customer-focused relational factors play a crucial role in achieving superior performance (Palmatier et al., 2006).

The bright side of dependence focuses on the relationship aspects such as trust, commitment, and effective communication that are developed when clients and vendors work extensively with one another...
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