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Market reactions to E-business outsourcing announcements: An event study

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Abstract

Stock markets have reacted favorably to firms who announced their implementation of E-business projects for commercial exploitation. Those that outsourced E-business projects in order to achieve swift execution also achieved abnormal positive returns. Contrary to expectations, outsourcing E-business projects with high task complexity also led to positive results. We analyzed the process and found that these three factors explained more than 20% of the variance in abnormal returns. The results were obtained from an event study of 96 E-business-related announcements, including those made by firms in the S&P500 index during 1999–2002. This paper contains information that should therefore help firms identify E-business projects for outsourcing.
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1. Introduction

E-business projects have generated significant top-management attention recently. Indeed, outsourcing such projects has required management attention to ensure their success, because of their dynamic environments [8,10,33]. However, no research has been reported on this in the literature. Our work used E-business outsourcing announcements as the data used to investigate market reactions.

IS researchers have studied outsourcing from multiple perspectives to understand the contractual aspects and their consequences [23,49]. A number focused on contingency factors that have a bearing on outsourcing a particular IT asset; the factors have included internal IT cost structure, internal IT performance, production and transaction costs, firm cash needs, characteristics of IT portfolio to be sourced, internal IT capability factors, etc. [27,32,35,42,50,53]. While some studies have utilized objective firm-level data and metrics, most involved either a case study or a survey. Further, in almost all, the dependent variable of interest was the extent of outsourcing (e.g., in terms of ratio of outsourcing expenditure and total IT expenditure).

However, while the studies attempted to overcome response bias, key informant approaches have suffered from limitations. Respondents may have provided reasons that they *believe* to be the drivers of outsourcing and *considered* to be socially-acceptable reasons, but the arguments may have little to do with the real

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decision making process. Further, whether outsourcing is or is not appropriate cannot be discerned until the firm performance is studied in the context of the contingency factors of interest.

This paper adds to the research published in *Information and Management* by using financial metrics to evaluate IS decisions. For example, in [38], it was found that changes in textual data in financial reports indicated a stock change in the following quarter, while [17] presented a financial model to analyze IT investments and modeled their impacts on firm value after considering risk and industry or company events. Also [16] examined whether the market recognized competitive advantages earned from IT investments. Such studies are becoming common in the literature; e.g., the effect of CIO changes [12], IT infrastructure investments, IT investments [18,28], ERP systems [26] and E-commerce [51].

2. Theoretical development

2.1. Research model

Outsourcing is a term that includes contracting, minority equity arrangements, and joint ventures [24]. The decision to outsource an E-business project has significant influence on a firm's ability to balance competing needs and deploy its best talent and prevent leakage of knowledge embedded in assets. Therefore, the outsourcing decision may be expected to have a significant influence on market returns. However, the decision is contingent upon a number of factors including transaction costs [3], performance of internal IT operations, prior relations, and core competencies [39].

We argue that three contingencies – the strategic intent behind outsourcing, the project execution swiftness and the project task complexity – influence the stock market reactions to an E-business outsourcing decision. *Strategic intent* [19,25] in the context of investments in new E-business assets and capabilities indicates a firm's goals for producing returns. Rapidly changing corporate environments make business requirements a moving target, creating instabilities in system projects [5,48]. In such a scenario, time and *project execution swiftness* is of the essence, because E-business systems must be developed and delivered before the business environments have shifted and the delivered systems have become obsolete. *Project task complexity* arises from an increase in information load, information diversity, or the rate of information change during execution [9,46]. High task complexity will require a high degree of user participation, which creates greater task interdependence and task uncertainty and a consequent need for a higher degree of coordination. Markets react to information about these contingencies and penalize or reward the firm.

2.1.1. Project strategic intent

Following DiRomualdo and Gurbaxani, we identified two distinct IT project strategic intents—IS/IT improvement and commercial exploitation. These are at the extreme ends of a spectrum. IT improvement projects are focused on upgrading or acquiring IT capabilities; they serve to enhance a firm's IT competence in providing it with the capacity and the platform for using IT for business innovation [4,22]. Firms may go a step further and exploit their new E-business assets commercially by creating businesses that sell information products and services, and this will provide the firms with the most direct and tangible returns on investment. Such commercially-exploitable assets involve initiatives that break new ground, such as in the area of on-line auctions, on-line banking, trade exchanges, etc., and possess a high degree of rent generation potential.

Prior event studies suggest that stock markets react positively to investments that provide firms with strategic and innovative IT assets [20]. We postulated that stock markets could recognize the potential capabilities of various E-business projects based upon their strategic intent, as provided in firm announcements, and factor future returns into current stock prices. Announcements of E-business outsourcing projects with a strategic intent of commercial exploitation that provide firms with the most tangible and direct future rent generation capabilities would be rewarded with premium stock pricing resulting in above average returns for those firms. On the other hand, E-business improvement intents are only indirectly linked to firm's rent generation capabilities. Therefore, stock markets are expected to reward E-business projects with the strategic intent of commercial exploitation to a greater degree than projects with other non-commercial strategic intents. We, therefore, hypothesize that:

H1. E-business outsourcing announcements for projects that are launched with a commercial exploitation intent will generate a higher degree of significant positive abnormal returns for the announcing firms as compared to projects that are launched with no commercial exploitation intent.

2.1.2. Project execution swiftness

The mantra "on-time within-budget as-committed functionality" captures and signifies the three corner-

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