



## An empirical study on the source of vendors' relational performance in offshore information systems outsourcing

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### ABSTRACT

Despite keen interest in long-term strategic outsourcing and attention to factors affecting outsourcing success, the examination on relational performance, i.e., the difference between a vendor's performance with a particular client and that with its average client base, can be hardly found. This study adopts a relational view to offshore information systems (IS) outsourcing from a vendor's perspective to explore the source of relational performance. Results highlight the importance of client-specific capabilities and trust as a self-enforcing governance mechanism in a vendor's relational performance in terms of service quality. Project management and client-specific capabilities act as substitute for each other in affecting relational service quality. In addition, while trust and learning about client contribute to client-specific capabilities, trust is also positively related to learning about client. These findings enrich our understanding of the source of outsourcing relational performance and contribute to the literatures on vendors' capabilities in IS outsourcing.

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### 1. Introduction

Offshore information systems (IS) outsourcing is a contractual arrangement involving transferring IS development and related services to overseas vendors. In recent years, there has been an increasing trend for firms to realize their strategic aspiration through outsourcing initiatives. However, the success of such initiatives is largely determined by the vendor's value proposition (Levina & Ross, 2003). In light of a growing popularity of long-term strategic partnership-oriented outsourcing (Lee & Kim, 1999; Quinn, 1999; Simeon, 2010), it is likely that a vendor can provide super value proposition for a particular client over time, with the same capabilities. It reflects gains exclusive to a particular relationship, which can persist over time (Dyer & Hatch, 2006). It is referred to as relational performance (Mesquita, Anand, & Brush, 2008), which is the difference between a vendor's performance with a particular client and that with its average client base (Dyer & Singh, 1998).

Prior studies have examined the effects of vendor relationships on a client's competitive advantage (Kotabe, Martin, & Domoto, 2003), and advocated the importance of effective client–vendor relationship management for outsourcing success (Berger & Lewis, 2011; Levina & Ross, 2003; Rai, Maruping, & Venkatesh, 2009).

However, it is not clear under what inter-firm linkage conditions a vendor can provide super value proposition for a given client relative to its average client base, i.e., relational performance. Although various aspects of outsourcing outcomes and their determinants have been investigated (Berger & Lewis, 2011; Blumenberg, Wagner, & Beimborn, 2009; Dibbern, Goles, Hirscheim, & Jayatilaka, 2004; Ethiraj, Kale, Krishnan, & Singh, 2005; Lacity, Khan, Yan, & Willcocks, 2010), relational performance and its impacting factors have been largely overlooked in the extant literature.

This study adopts a relational view (Dyer & Singh, 1998) to offshore IS outsourcing from the vendor's perspective, exploring the source of relational performance. According to the relational view, partners in exchange relationships can potentially generate relational performance through relation-specific capabilities investment, inter-partner knowledge sharing, and employing an effective self-enforcing governance mechanism (e.g., informal safeguard of trust, Dyer & Singh, 1998). A relational view to offshore IS outsourcing can enrich our understanding of the source of relational performance, which helps clients to reap more benefits from their vendor in the long term. Correspondingly, we investigate the contributions of a vendor's client-specific capabilities, learning about client, and trust to relational performance in this paper.

Another oft-mentioned factor contributing to outsourcing performance is vendors' capabilities. Offshore IS outsourcing critically depends on the vendor's capabilities. Two sets of distinct capabilities, project management and client-specific capabilities, have been found critical for outsourcing success (Ethiraj et al., 2005;

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Feeny, Lacity, & Willcocks, 2005; Levina & Ross, 2003). However, our understanding of the marginal contributions of the different types of capabilities to outsourcing performance is still limited (Ethiraj et al., 2005). Do the client-specific capabilities and project management capabilities have the same marginal contributions to relational performance in offshore IS outsourcing? Do they play a substitute or complementary role in increasing relational performance? These questions are not well answered in prior literature. Understanding the contribution of each capability helps vendors decide what capabilities to develop with limited learning, financial, and managerial resources. Therefore, we attempt to compare their marginal contributions to relational performance.

This research is conducted in the context of China-based offshore IS outsourcing business. The context is appropriate for developing theories and practical guidelines for several reasons. First, China represents a typical emerging economy, where most vendors have experienced rapid capabilities development (Zheng, Willcocks, & Yang, 2010), which is ideal for this research on the vendor's capabilities and relational performance. Most existing literature adopts the client's perspective, which makes it hard to observe and test the relational performance and antecedents of it. Second, the focal context is a knowledge extensive business, which entails a high level of human resource specificity (Williamson, 1985). Most Chinese vendors, with a relationship-oriented business culture, are involved in long-term strategic partnerships, which facilitate learning about client, trust and client-specific capabilities development, and therefore relational performance generation. Lastly, the extant literature focuses on the offshore IS outsourcing to India vendors, especially U.S.–India business, whereas offshoring to Chinese vendors, which are mostly small to medium sized with limited resources, is under studied. Therefore, this research can broaden our understanding of different offshoring settings.

This paper is organized as follows. Next, Section 2 presents a literature review and the theoretical framework for this research. Subsequently, Section 3 describes the research methods including the measurement development process and survey. Then, results of data analysis are offered in Section 4. Section 5 follows with the discussion and conclusions.

## 2. Theoretical framework

### 2.1. Relational view of offshore IS outsourcing

Because of the challenges in cross-nation collaboration, how to achieve success has been one of the central issues in offshore IS outsourcing literature (King & Torkzadeh, 2008; Lacity et al., 2010). IS research on outsourcing success has considered various aspects, such as client characteristics, vendor characteristics, and the vendor-client relationship (Levina & Ross, 2003). Particularly, considerable efforts have been devoted to investigating the role of a vendor's value proposition potential and the relational factors in outsourcing success, such as the vendor's capabilities in providing value proposition (Levina & Ross, 2003), partnership quality (Lee & Kim, 1999), relationship governance (Gopal & Koka, 2009; Poppo & Zenger, 2002), cultural differences (Berger & Lewis, 2011), social embeddedness (Rai et al., 2009), and relational asset and capability (Fink, 2010).

However, despite a growing interest in these relational factors and vendors' value proposition, it remains unclear under what inter-firm linkage conditions vendors can offer super value proposition for a given client. As outsourcing arrangement runs towards strategic oriented (Willcocks & Kern, 1998), this gap limits our understanding of how clients can achieve competitive advantage through outsourcing initiatives. By considering what antecedents promote vendors' super value proposition, both vendors and their

client can start to build strong collaborative relationships aimed at achieving competitive advantage.

This paper specifically demonstrates that certain factors pertaining to a specific relationship can result in different levels of vendor performance among different clients of the same vendor. We adopt the relational view to explore the source of relational performance heterogeneity from the vendor's perspective (Dyer & Singh, 1998; Lavie, 2006). The relational view can be a relevant and sound theoretical lens for investigating relational performance owing to its emphasis on long-term strategic collaboration with repeated exchanges and its focus on the role of idiosyncratic relational factors pertaining to a specific relationship in relational performance generation.

The relational view was proposed to explain the differences in interorganizational performance across exchange partnerships. According to the relational view, those relational factors reflecting idiosyncratic inter-firm linkages can be the clues to understand the source of performance heterogeneity across trading partnerships (Dyer & Singh, 1998). Relational performance can be created through investing in relation-specific assets and capabilities, knowledge sharing, and setting up effective relationship governance mechanisms to safeguard the relational performance gains (Dyer & Singh, 1998). Evidence has also been found in strategic alliances concerning their importance in relational performance generation (Dyer & Chu, 2003; Dyer & Hatch, 2006; Dyer & Nobeoka, 2000; Kale, Dyer, & Singh, 2002).

### 2.2. Source of outsourcing relational performance

Relationship-specific assets in the relational view can be operationalized as client-specific capabilities in our focal context. The relational view has recognized inter-firm learning as another source of relational performance. Those relationships with effective knowledge-sharing mechanisms facilitating interorganizational learning are suggested to generate more relational performance. From the vendor's perspective, we argue that learning about client is such a critical source of relational performance in outsourcing. Governance is also deemed to be a critical enabler for the creation of relational performance, especially the informal self-enforcing safeguard of trust. Trust lies in the center of the outsourcing relationship literature. Trust can be more conducive to safeguard and generate relational performance than the third-party enforcing mechanisms (Dyer & Singh, 1998). As such, it is incorporated as another source of outsourcing relational performance.

The three factors mentioned above, i.e., client-specific capabilities, learning about client, and trust, cover three sources of relational performance put forth by Dyer and Singh (1998). They are coherently linked in that client-specific capabilities and learning about client can be the basic conditions for relational performance generation, whereas trust can partially directly generate relational performance through lowering transaction cost and boosting value-creation initiatives, and partially safeguarding relational performance generation through motivating client-specific capabilities investment and promoting learning about client.

Apart from client-specific capabilities, previous work has also identified another set of vendor's capabilities, project management capabilities, critical to offshore IS outsourcing success (Ethiraj et al., 2005; Levina & Ross, 2003). Client-specific and project management capabilities are different in nature and usage scope, and have different explanatory power in relational performance (Mesquita et al., 2008). Therefore, we also attempt to compare their relative contributions to relational performance.

It is imperative for vendors to provide high-quality service to cater for their client's competitive advantage aspiration (Gopal & Koka, 2009). As such, outsourcing service quality is central to both the vendor and client's concern (Poston, Kettinger, & Simon, 2009;

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