Contracts, Control and ‘Presentation’ in IT Outsourcing: Research in Thirteen UK Organisations

THOMAS KERN, Erasmus University Rotterdam, The Netherlands
LESLEY WILLCOCKS, University of Oxford, UK

INTRODUCTION

Information technology (IT) outsourcing continues to experience a phenomenal growth rate especially in North America, Europe and more recently Australia. Ever since the Kodak watershed deal in 1989, IT outsourcing has continued to mature to a status where nowadays it is considered a viable management option, making it an integral component of the information management agenda (Feeny and Willcocks 1997; Rockart, Earl, et al., 1996; Rockart and Ross 1995). This agenda in many circumstances deems it prudent to compare the performance of the in-house IT department with the services available externally (Willcocks, Fitzgerald et al. 1996). IT outsourcing is broadly defined as a decision taken by an organisation to contract out or sell the organisation’s IT assets, people and/or activities to a third-party vendor, who in exchange provides and manages assets and services for monetary returns over an agreed time period (Loh and Venkatraman, 1992; Lacity and Hirschheim, 1993).

Research so far has shown that the client-vendor relationship is indeed more complex than a mere contractual transaction-based relationship (Kern, 1997; Klepper, 1994, 1995; McFarlan and Nolan, 1995; Willcocks and Choi, 1995; Willcocks and Kern, 1998). A major complexity is the near impossibility of presentation of future requirements in long-term deals such as outsourcing, due to the volatility of information technology and the likely changes in user and company requirements. Suggestions have thus been made that the client-vendor relationship has to include relational contract and/or partnering dimensions (Kern, 1997; Willcocks and Kern, 1997). However, research and industry best practice has clearly shown that a central focus has to remain on the contract and hence its enforcement in the post-contract management stage (Lacity and Hirschheim, 1993, 1995).

So far, little to no research has focused on explaining which contractual dimensions are eventually operationalised. Such information would allow practitioners to better understand and prescribe the contractual dimensions of the client-vendor relationship. Moreover, we conjecture that these dimensions essentially define the client company’s, and to some extent the vendor’s, control agenda over whether the major objectives of the outsourcing arrangement are being achieved. Pilot analysis of two IT outsourcing contracts revealed a number of dimensions that pervaded the post-contract management agenda. In each case the client at-
tempted to maintain control through two detailed contractual clauses/schedules, acting essentially as a third-party judicial entity. By control we mean the process by which the client company initiates activities to assure contractually agreed terms are by the vendor(s) company delivered in full and according to expectations and objectives. “Control, in other words, is aimed at ensuring that a predictable level and type of performance is attained and maintained” (Child, 1984, p. 136).

In this paper we discuss and analyse the role of the contract in IT outsourcing to elucidate the post-contract management agenda. This agenda essentially prescribes the operationalisation of the contract and the control dimension in IT outsourcing. Drawing upon two precedent contracts, we highlight some of the clauses being effectuated. Next, we present findings from an exploratory research study into the client-vendor relationship that reveals how organisations attempt to enforce the contract. The ensuing discussion identifies five different purposes of the contract in the client-vendor relationship, which allow us to infer that a number of contractual dimensions also define the control agenda for the client in the post-contract management stage.

IT OUTSOURCING CONTRACT

The contract in outsourcing has been described as a mechanism that establishes the balance of power between the client-vendor (Lacity and Hirschheim, 1993). Contracts essentially have to be as ‘airtight’ as possible (Lacity and Hirschheim, 1993; Fitzgerald and Willcocks, 1994abc; Saunders et al., 1997), because research has shown that vendors tend to refer to it as their chief source of obligation. Vendors however would prefer to see the contract as a working document (cf. EDS lawyers Hartstang and Forster, 1995), giving them flexibility to suggest improvements and new services. Clearly, this is in the interest of most vendor companies for their goal is one of profit margins.

An IT outsourcing contract tends to be more complicated than other business contracts, resembling as it does a “hybrid between an asset purchase and sale agreement, and a sale/leaseback agreement, in that there is a sale of assets or transfer of operations, transfer of employees, and a lease back to the customer of the information technology services that were divested” (Halvey and Melby, 1996, p.43). This legal complexity is evident in the detail and in the time typically invested in negotiating agreement. Third-party legal experts have for quite some time emphasised the need for a comprehensive contract, not only because it is their livelihood, but also because it basically becomes a reference point specifying how the client and vendor relate (Fitzgerald and Willcocks, 1994). The table in the appendix summarises the main clauses of an outsourcing agreement as specified by legal experts (Burnett, 1998; Clifford Chance, 1997; Halvey and Melby, 1996; Klinger and Burnett, 1994; Mayer, et al., 1996).

The Nature of the Outsourcing Contract

As previously discussed, the outsourcing contract is unlike other service contracts because of the nature of what is being contracted for and the length of the contracts. This makes it extremely difficult to presentiate service provision or any other exchanges that may be needed in the future. Outsourcing contracts, and indeed most long-term contracts, have a tendency to be incomplete, which raises the possibility of opportunistic behaviour by the vendor (Williamson, 1975; Hart, 1995). Macneil (1974b and 1980) in turn proposes to alleviate the incompleteness and presentation situation through a relational, as opposed to a transactional, contract. However, there is evidence that, despite Macneil’s theorem, most effective outsourcing contracts are essentially neither completely transactional nor relational but mainly transactional intertwined with relational aspects (Currie and Willcocks, 1997; Lacity and Hirschheim, 1993; Wilcocks and Kern, 1998). Actual operationalisation of the written letter of any contract requires procedures that Macneil (1974ab) prescribes to the relational contract (e.g., extensive cooperation). In this paper we will focus solely on the transactional aspect of how the contract is enforced, which we identify as determining the control agenda. In the following sections we first discuss control, before looking at the post-contract management agenda in outsourcing. The analysis of two pro forma precedent contracts elicits the dimensions which pervade post-contract management and further defines the ‘transactional’ level of the client-vendor relationship (or ‘contractual’ as we have termed it elsewhere—see Kern, 1997).

THE CONCEPT OF CONTROL

Control is a complex issue that has received considerable attention in the literature. Table 1 lists some important contributions. Anthony’s (1965) contribution in particular is often referred to and well known for its distinction between strategic planning, management control and operational control. Strategic planning is defined as the process of deciding on the objectives of the organisation, on changing these objectives, on the resources used to attain these objectives, and on the policies that are to govern the acquisition, use and disposition of these resources. Anthony distinguishes strategic planning from the more management and operational control issues like Child (1984) does. Management control is defined as the process by which management assures that resources are obtained and used effectively and efficiently in the accomplishment of organisational objectives, whereas operational control focuses more on the actual efficient and effective performance of activities. Child (1984), Eisenhardt (1985), Hofstede (1981) and Ouchi (1979) determine the context of control in organisations and determine a number of characteristics that lend themselves to define a typology. On the other hand Boland (1979) and Orlukowski (1991) reveal how control is applied in the context of information management.
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