

## Chapter 8

# Outsourcing Performance

For the vendor an IT outsourcing relationship is successful if it generates profit for the company and if it strengthens the company's value proposition in terms of complementary competencies such as IT personnel development, methodology development and dissemination, and customer relationship management (Levina & Ross, 2003). For the client an IT outsourcing relationship is successful if it generates profit for the company and if it contributes to achievement of outsourcing objectives as exemplified by Lee and Kim (1999). Managing successful IT outsourcing relationships means to us that source firm and sourcing firm both achieve their objectives in a joint effort. Achieving objectives is a matter of outsourcing outcome.

In this chapter we start by presenting the vendor's value proposition because outsourcing outcomes are dependent on the vendor's ability to create value for both parties in the relationship. Satisfaction based on successful exploration and exploitation of the vendor value proposition plays an important role in building other important assets for the client company. The following two sections in this chapter discuss outsourcing opportunities and threats in a client perspective. Next, we present a method for developing quantitative performance measurements. Although decisions to outsource should be a part of the overall business strategy, control and objective measurement of service quality is important for

any company as this may influence the overall relationship. At the end of this chapter, we take a look at how to measure the success of IT outsourcing relationships.

### VENDOR VALUE PROPOSITION

The value generation potential of an outsourcing relationship consists of three factors: client characteristics, the vendor-client relationship, and vendor characteristics. A key client characteristic is an understanding of how to manage resources that a firm does not own. A key in the vendor-client relationship is formal (contractual) aspect of the relationship. The third factor shaping the outsourcing value proposition is the vendor's own capabilities. From an outsourcing vendor's perspective, there are many potential opportunities and benefits for the client. These opportunities and benefits can be derived from the IT outsourcing vendor's value proposition. Important vendor characteristics include capabilities such as technical competence, understanding of the customer's business, and relationship management. Our presentation and discussion in the following text of this third factor in terms of vendor value proposition is based on a research article by Levina and Ross (2003).

To date, most research on information technology outsourcing concludes that firms decide to outsource IT services because they believe that outside vendors possess production cost advantages. Yet it is not clear whether vendors can provide production cost advantages, particularly to large firms who may be able to replicate vendors' production cost advantages in-house. Mixed outsourcing success in the past decade calls for a closer examination of the IT outsourcing vendor's value proposition. The concepts of *complementarities* and *competencies* explain that outsourcing vendors can increase productivity and reduce costs on client projects by applying a set of complementary application management competencies. This is the vendor value proposition.

The concept of complementarity posits that firms can improve productivity by engaging in complementary activities where benefits from doing more of one activity increase if the firm is also doing more of the other activity. This concept of complementarity has been used in studies of manufacturing to show that modern manufacturing approaches work as a system, rather than as a set of independent factors. Those firms that invest simultaneously in several complementary activities perform better than those firms that increase the level of some of these activities, but not others. In fact, literature on complementarity argues that firms that increase one factor without also increasing complementary factors may be worse off than firms that keep the factors at the same lower level.

An outsourcing vendor may develop different competencies. In the case study by Levina and Ross (2003), the vendor developed a set of three competencies to respond to client needs and market demands: personnel development, methodology development and dissemination, and customer relationship management:

- *IT personnel development* addressed existing IT labor market constraints by the vendor in ways that the client had not. The vendor replaced experienced, high-cost client staff with mostly lower-cost, junior programmers and then developed their skills through training, mentoring, and team-based project work. Junior staff valued the professional growth while their mentors often relished opportunities to watch somebody take off. As a professional services firm, the vendor viewed maintenance work as a first step in a career development path, which involved rotating

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