Relational Trauma: Evidence of a Winner's Curse in IT Outsourcing.

Thomas **KERN**[1]
Department of Information and Decision Sciences, F1-16
ERASMUS UNIVERSITY ROTTERDAM
Burg Oudlaan 50, P.O. Box 1738
3000 DR Rotterdam, The Netherlands
Tel +31 (0)10 – 4081908
Fax +31 0(10) - 4089010
tkern@fac.fbk.eur.nl

Leslie P. **WILLCOCKS**
Templeton College
University of Oxford
Kennington, Oxford OX1 5NY
United Kingdom
Leslie.willcocks@templeton.co.uk

Eric van **HECK**
Department of Information and Decision Sciences
ERASMUS UNIVERSITY ROTTERDAM
Eheck@fac.fbk.eur.nl

[1] Address for correspondence

Authors Biography

<u>THOMAS KERN</u> is assistant professor for information management at the Rotterdam School of Management. He received his MSc (Economics) in information systems management from the London School of Economics and Political Science and his DPhil in the same area from Christ Church, University of Oxford. He is also a research affiliate with the Oxford Institute of Information Management at Templeton College. He was the 1996-1998 Lloyds of London Tercentenary Foundation Business Scholar and received together with Dr. Leslie Willcocks, Templeton College, a best paper prize at the 5th European Conference on Information Systems in 1997. He has published papers at the *European and International Conference on Information Systems and in the European Journal of Information Systems, Journal of Information Systems, and Journal of Global Information Management.*

<u>LESLIE P. WILLCOCKS</u> is Fellow in the Oxford Institute of Information Management, Templeton College, University of Oxford, Professor of Information Systems at Erasmus University, Rotterdam and Editor-in-Chief of the Journal of Information Technology. His doctorate is from the University of Cambridge, United Kingdom. Leslie has an international reputation for his work on Information Management, evaluation and IT outsourcing, and is a frequent keynote speaker at practitioner and academic conferences throughout the world. Previously he worked in accounting, management consulting and executive education for twelve years with Touche Ross and several smaller firms, and headed a research centre at City University Business School, London. He is co-author of 14 books, including: *A Business Guide To IT Outsourcing* (Business Intelligence, 1995); *Beyond The IT Productivity Paradox: Assessment Issues* (Wiley, 1998); *Strategic Sourcing of Information Systems* (Wiley, 1997); *Managing IT As A Strategic Resource* (McGraw Hill, 1997); and *New Strategies In IT Outsourcing* (Business Intelligence, 1998). He has published over 130 refereed papers in journals including Harvard Business Review, Sloan Management Review, MIS Quarterly, Long Range Planning and Journal of Management Studies. He is retained as adviser by major corporations and government institutions in USA, Europe and Australia.

<u>ERIC van HECK</u> is an Associate Professor at the department of Decision & Information Sciences, Rotterdam School of Management, Erasmus University Rotterdam. His main research interests are EDI Systems, IT-enabled Business Network Redesign, and Electronic Markets. He is a specialist in Electronic Auctions. He is (co-)author/editor of 12 books. His articles have been published in, for example, *Communications of the ACM*, *Information Systems Research*, and *WirtschaftsInformatik*. He is a member of the Association for Computing Machinery (ACM), the Association of Information Systems (AIS), the Computer Society within the Institute of Electrical and Electronics Engineers (IEEE), and the Institute for Operations Research and the Management Sciences (INFORMS). Previously, he worked for Cap Gemini Netherlands, Wageningen Agricultural University, and Tilburg University. He was a visiting scholar at the Leonard N. Stern School of Business at New York University. Email: e.heck@fac.fbk.eur.nl

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ABSTRACT

IT outsourcing's adoption by some of the largest international corporations has seen outsourcing become a key component of the Information Management agenda. However, the process of evaluating, selecting and subsequently contracting out or selling the organization's IT assets, people and/or activities to a third party supplier raises significant concern in light of the inherent 'Winner's Curse' that may arise when the supplier overpromises on what can be delivered for the contract price. This paper presents a unique longitudinal outsourcing case study that explicates the often abstruse Winner's Curse, its effect on post-contract management and the relationship and how it was alleviated by agreeing to mutually renegotiate the terms of the deal. Building on auction and IT outsourcing theory this paper provides both a model of IT outsourcing processes and a Winner's Curse typology for understanding IT outsourcing ventures. The findings of the study emphasize that a Winner's Curse in outsourcing, which may not be evident to either party during negotiations, will imply additional costs for both parties in form of increased management time and resources, may result in service slippage and high dissatisfaction levels and possibly demand service level renegotiations; may lead to relational loggerheads; and ultimately may result in early contract termination. To avoid experiencing such a relational trauma as a consequence of a Winner's Curse, this paper identifies a number of lessons that client companies should consider before signing-up with a supplier.

Keywords:

IT Management, IT Outsourcing Relationships, Auction Theory, Winner's Curse

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[2] An earlier version of the paper was presented at the Academy of Management conference in Toronto, August 2000

1. Introduction

Information technology (IT) outsourcing is the practice of contracting out or selling the organization's IT assets, people and/or activities to a third party supplier, who in exchange provides and manages assets and services for monetary returns over an agreed time period (Loh & Venkatraman 1992; Lacity & Hirschheim 1993). Outsourcing continues to experience a phenomenal adoption rate, especially in North America, Europe and more recently Australia, reaching an expected market size of $140bn by 2001 (IDC 1998). Its maturing as a viable management option has assured IT outsourcing's acceptance as an integral component of today's information management agenda (Feeny & Willcocks 1998; Rockart, Earl, *et al.* 1996). This agenda in many circumstances deems it prudent to compare the performance of the in-house IT services against those available in the market (Willcocks, Fitzgerald et al. 1996). A common outcome of such benchmarking is the uncovering of significant benefits, subsequently leading organizations to utilize external IT service suppliers.

Selecting the right supplier poses though substantial challenges. The difficulty lies here in choosing those evaluation criteria that satisfy the client organization's objectives for outsourcing - commonly those benefits that the internal IS organization is not able to deliver, but that the supplier(s) can offer. The common criteria have been identified as financial, business, technical, strategic or political benefits (DiRomualdo & Gurbaxani, 1998; Lacity & Willcocks, 1998). Financial is the most common benefit sought, which has supposedly led to dramatic cost savings of between 10 to 40%, has improved cost control and clarity, enabled organisations to change from a fixed cost structure to a variable one, and provided substantial cash flow improvements (see Apte, *et al.* 1997;

Hurst & Hanessian, 1995; Willcocks, Lacity, *et al.* 1995). Financial benefits, especially cost savings, are, however, often bloated by vendors for sales purposes (see Saunders, *et al.* 1997; Lacity & Willcocks, 1998). Business, strategic and/or political benefits have involved new business start-ups, process re-engineering, a refocus on the client's core competencies, assisting in managing mergers or globalization, and diminishing the often political debates about new IT projects (McLellan et al., 1998; Sobol and Apte, 1998). The core competencies argument is often quoted as a fundamental advantage (Prahalad & Hamel, 1990). Thirdly, technical benefits have involved, for example, easy access to expertise, improved services, new technologies and technological innovation (Currie & Willcocks, 1997). Once again, clients often found that no real technical benefits materialised either in access to personnel, expertise or innovation (Currie & Willcocks, 1997; Ketler & Walstrom, 1993). Yet although, the general lure of ridding oneself selectively or totally of the 'bottomless IT investment pit' and instead pay a fixed monthly sum for IT services is the major comparison measure for selecting a supplier (Ang & Straub, 1998; Lacity & Willcocks, 1998), we do not fail to recognise that, as those researchers and others have shown, organizations typically outsource for a selected mix of the above reasons.

However a client's focus on cost savings can drive supplier organizations into the corner of making service delivery promises that are initially calculated on a slim or even nil profit margin (Willcocks, Lacity, & Kern, 2000). They may do so, for example, because they are short of business due to recession, decreased competitiveness or are a new entrant into the IT services market; they are keen to enter a new market segment; they want to shut out competitors; they have a strategic intent to dominate certain market segments; and/or they believe that they can recoup the investment and broaden margins later. It is precisely in such circumstances that the danger of a ‘Winner’s Curse’ arises, as suppliers make bidding promises to ensure they win the contract, but inherently already know, or subsequently discover that they are unable to recover their tendering, business and operational costs, at least in the near future (Kern, 1999; Kern & Willcocks, 2000).

Instead they hope, as our research has shown (see Kern, 1999; Lacity & Willcocks, 2000) that they can recover their costs by, for example, identifying service areas that are in need of particular attention and responsible for low service performance, and/or areas of immediate service provision excluded from the contract but needed operationally, so meriting excess fees. In addition, suppliers will attempt to offer additional services from their portfolio of technology capabilities, service management and consultancy services over the life of the contract. Since supplier account management will need to concentrate disproportionately on recovering costs, and may well be under pressure from its senior managers to make stipulated margins in unfavourable circumstances, it is more than likely that trade-offs will occur that disadvantage the client. For example, case studies demonstrate that decreasing costs to the supplier can result in decreases in service quality and additional costs for the client (Kern, 1999; Lacity and Hirschheim, 1993). A supplier’s disproportionate concern for containment of its costs can lead to inflexibility in the interpretation of the letter and spirit of the contract, which can also lead to adversarial relationships (Currie and Willcocks, 1998). Thus operational performance and the client-supplier relationship will receive less attention and suffer (Kern, 1999). As a consequence, we suggest that in ‘Winner Curse’ situations suppliers may jeopardize the success and effectiveness of the operations and outsourcing relationship as their focus settles primarily on recovering their costs, and not on developing and maintaining the relationship and mutual objectives. A supplier would thus undertake opportunistic behaviour, seeking to reduce its own operational costs, often at the expense of the client.

This paper presents a unique detailed outsourcing case study illustrating the relational trauma a client organization experienced as a direct consequence of what auction theory has coined the Winner's Curse. The winner's curse occurs when the winner of an auction/tendering event systematically bids above the actual value of the business and thereby systematically incurs losses for the benefit of winning the deal. In IT outsourcing terms, it occurs when a supplier deliberately or unconsciously over-promises on the contract bid, and the bid is subsequently accepted. In a field still relatively under-theorised (see Willcocks & Lacity, 1998 review), studying IT outsourcing from this different perspective makes a distinctive contribution to our understanding of outsourcing supplier practice and its potential dangers. For managers, the paper is useful for drawing attention to this practice, but also emphasizing that, as in most outsourcing deals, client organizations need to have a carefully selected management team that actively develops, maintains and manages the deal and relationship, to be able to avoid or, if belatedly recognised, at least alleviate the damaging outcomes inherent in the Winner's curse.

The remainder of the paper is structured as follows. The first section reviews auction theory and the outsourcing evaluation literature, with the objective of identifying a number of key criteria that define the ‘Winner’s Curse’ situation in outsourcing. This is followed by a detailed description of the longitudinal case study research method, which centred on a multinational corporation based as a subsidiary in the United Kingdom. Following a detailed case description we explore the case by use of the identified criteria, before providing some insights into how client organizations can avoid the winner’s curse, and guidelines for cases where they find themselves already operationally tramelled in such a scenario.

2. Selecting the Supplier

Given the significance and impact of outsourcing on the performance of IT and the operations of the client organization, it is clearly vital that an appropriate supplier partner is selected (cf. Ruber, 1995), that acts and operates as a effective replacement for the sourced services. In fact, the right supplier choice has been shown by others to be paramount to the success of the overall outsourcing venture (Klepper and Jones, 1998; Lacity, Willcocks *et al.* 1995;1996). The criteria that generally inform the selection process is a richly researched area in outsourcing (see De Looff, 1995 & 1997; Lacity & Hirschheim, 1993). Factors commonly influencing and defining the selection process focus on the organization’s IT objectives, internal requirements, and benefits of outsourcing (Willcocks and Fitzgerald, 1994), yet we actually know very little about the consequences of a wrong selection, and its impact on post-contract management, the outsourcing relationship, and financial and organizational outcomes. It is here that this paper seeks to make a major contribution.

The selection process begins in earnest with the short-listing of relevant suppliers. Michell & Fitzgerald (1997) identified an open short-list process, in which clients advertise for suppliers to apply, and a closed short-list process, in which suppliers are directly approached by clients. Identifying and creating a short-list commonly involves issuing a request for information (RFI) to suppliers first, before selecting those most suitable to invite to bid (cf. Cross, 1995; Huber, 1993; White and James, 1996). With the issue of an RFI the client outlines its objectives, services, assets, transfers, and anything else of relevance to its outsourcing intention, and requests in return certain information from the supplier as to their likely approach to addressing their proposal, its capabilities, experience, references, and associated information (Cross, 1995; Halvey & Murphy, 1995; Huber, 1993; Michell & Fitzgerald, 1997). Those short-listed are subsequently invited to tender (ITT) or issued a request for proposal (RFP). Depending on the company's approach, the tender or proposal is the means by which a supplier is selected, or is used to enter into detailed dialogue and information exchanges to further narrow down the short-list before making a final selection (Cross, 1995; Michell & Fitzgerald, 1997). Both selection approaches tend to be preceded by the client's detailed evaluation, although findings suggest that some clients choose suppliers more on subsequent qualitative rather than pre-quantitative criteria (Michell & Fitzgerald, 1997), thus probably making a 'Winner's Curse' scenario more likely. Other findings of poor pre-evaluations of in-house costs and services by client organizations also illustrate how the over-promising by the supplier can be initially accepted as potential improvements (Willcocks, Fitzgerald et al., 1996). The selection and bidding process is a costly undertaking for both parties in terms of time, effort and resources involved (Alpar & Saharia, 1995; Cross, 1995). Moreover, it often involves bidders competing for the client’s IT service business in a setting that has strong similarities to an auction scenario.

2.1. The Auction Approach

Auction theory is an interesting and elegant application of game theory. It has been a particularly productive area of economic theory in terms of generating empirically testable predictions. One of the basic theorems in auction theory is known as the *revenue equivalence theorem*, which dates back to Vickrey (1961). He distinguishes four different basic auction formats: (i) English auction (increasing bids), (ii) Dutch auction (decreasing bids), (iii) first-price/sealed-bid auction, (iv) second-price/sealed-bid auction. Comparing the four different basic auction formats, Vickrey shows that in a simple model of consumer preferences the expected revenue to be collected by the auctioneer will be the same no matter which of the four mechanisms is chosen. Davis and Holt (1993) and Rothkopf and Harstad (1994) critically analyze auction markets from an economic point of view. Davis and Holt show the potential of experimental economics in relation to auctions and the gaps between the existing theory and the reality of auctions. They describe the contexts in which auctions arise, review the “mainstream” theory of single, and isolated auctions and discuss the important work involved in the enrichment of this theory. For researchers, they recommend paying particular attention to the process of modelling auctions and their subsequent impact on the deal. In this paper we follow their recommendation by applying the core notions of auction theory to the bidding process of outsourcing ventures. In particular we focus on the impact or aftereffects of an auction, one of which has been termed the ‘Winner’s curse’.

2.2. Winner's Curse

One of the more intriguing phenomena in auctioning is the winner's curse. The winner's curse occurs if the winner of an auction systematically bids above the actual value of the objects and thereby systematically incur losses. Acceptance of a bid in general is an informative event, and the failure to incorporate such contingent information into the bidding strategy can lead to excessive bids and subsequent losses for both parties. Persistent overbidding in auctions/tendering has been observed in laboratory experiments. Kagel and Levin (1986) for example report that losses due to overbidding are more common in auctions with large number of bidders, then in small numbers, but losses are likely to occur in both settings. Losses however, can be minimized with awareness and previous experience of auctions.

Lind and Plott (1991) further illustrated that:

- the winner's curse observed by Kagel & Levin (1984, 1986) was not a consequence of their laboratory experimental procedures (so real-life validity);
- the winner's curse might diminish in size but does never completely dissipate over time in a venture;
- the winner's curse is a general phenomenon exhibited by most bidders and in most settings; and
- theories of "sub-optimal" behavior (for example, Lind & Plott (1991) propose a so-called naive model of bidding that is based on the hypothesis that people do not behave strategically. They only bid to the expected value as if the situation were a simple second-price auction of a lottery and not one in which strategies might be

important) advanced as explanations of the phenomenon do not explain the data. Nor does the completely rational approach explain the phenomenon, as it does not exist in such scenarios at all. The best explanation available is that: ‘bidders want to win’.

The ‘winner’s curse’ phenomenon is said to occur frequently in the bidding, for example, for natural resources such as mineral rights or oil leases, where the value of the resource is uncertain, and firms only have an estimate of the value. Capen et al. (1971) provides particular supportive evidence for the winner’s curse in the oil lease industry, illustrating bidding in a dyadic context between a supplier and provider.

3. The Reality of a Winner’s curse in IT outsourcing

The outsourcing selection and bidding process has strong similarities to an auction situation, where various suppliers may be asked to make an offering for a proposed IT business, even though the exact value and service requirements can often not be clearly determined. In BP Exploration’s undertaking in 1992, six suppliers were eventually asked to bid for the offered services in circumstances where the exact future service requirements where not certain (see Cross, 1995). Decisive criteria for winning such bids tends to be costs, value added benefits, technology, expertise, capabilities and reputation or prestige of bidders (see Cross, 1995; Davis & Applegate 1995; Willcocks & Kern, 1998). The difficulty in such bidding circumstances is to select those supplier partners that offer the best deal, and here the focus tends to be not least on what cost efficiencies suppliers can deliver (Ang and Straub, 1998; Lacity and Willcocks, 1998). The assumption here is that suppliers have sufficient economies of scale, and improved

IT management practices, to be able to deliver improved services for a cheaper price, and that the resulting savings are those that the client will benefit from.

A danger that has become more apparent over the years to researchers studying IT outsourcing experiences, is the often large disparity between what suppliers initially tout in their proposals and what at the end of the day is delivered. In fact, some companies and government institutions have found outsourcing services to provide few measurable improvements or additional benefits (Kern, 1999; Lacity and Willcocks, 1998); and in the late 1990s some have even subsequently terminated contracts early (for example American Express, East Midlands Electricity, Sears UK). These and similar cases seem to suggest that suppliers can be overly keen to win a particular deal for possible reasons of prestige, size, partnering, costs, and long-term business opportunities. To reiterate, the resulting bid offering suppliers may make in such situations are calculated at cost leaving a very small margin upon which they could make a profit. Suppliers in turn may enter into a deal realising that in the short-term they may operate a venture merely at cost, but hope for the future, that additional business may arise upon which they can make money. In addition, suppliers often have to bid on the basis of incomplete information, as the overall IT environment of an organization is often to highly integrated to objectively evaluate the actual service costs and technical requirements. There are, in turn, strong similarities to the natural resource industry where determining the value is near impossible before bidding.

The resulting danger is what happens when suppliers out-bid themselves and find it impossible to continue with the deal as it is priced and structured. This is, of course, only one of many possible scenarios. Figure 1 illustrates the main possibilities relevant to this paper.

Figure 1 about here

Figure 1: The Winner's Curse and Other Scenarios in IT Outsourcing

We assume that due to the supplier's resulting mis-calculations the operationalisation of the contract and the outsourcing relationship will severely suffer in such a situation, as the supplier will be under pressure to ensure it makes its costs and possibly a margin. The effect may well be diminished services, lower number of supplier staff and less experienced staff actually in charge of the deal. The effect on the relationship may be catastrophic to the extent that the supplier is forced to terminate the deal or to ask the client to renegotiate the contract on price to ensure viability of the deal. In any event, the client may well be faced with a winner's curse (see Figure 1), resulting in significant additional costs and the need for increased management input to alleviate the frustrations of users and staff. In the end, the question arises whether outsourcing remains viable for the client, or whether a significant return to in-house sourcing defines a better option.

Of course evidence of such circumstances is rarely publicised and explicit, but does exist and may increase over time as the growing competitive pressure on suppliers due to the ever augmenting outsourcing market will push them to compete increasingly on prices and service deliverables. This paper provides a first hand account of a longitudinal winner's curse scenario, showing not only the short-term but also long-term consequences for the outsourcing venture.

4. Research Approach

The issue of a winner's curse was investigated in a distinctive outsourcing context. The deal was signed in 1994 by an international organization that operates in the oil industry. The case was chosen because 1) it represents an IT outsourcing deal that encountered significant problems due to the initial bidding and selection process; 2) it is a five year deal where initial investment made early termination costly and inappropriate. Therefore, the relationship was maintained and needed further careful development to reflect both client-supplier party's interests, and 3) we could gain substantial access to major participants and stakeholders of both client and supplier managers throughout the 1997-98 period thus allowing us to conduct a longitudinal study of the whole contract term.

4.1. Case Selection

Moreover, the selection of the cases was informed by our interpretive stance in doing case research (Lee, 1991; Walsham, 1995). The interpretive tradition does not reflect on how typical or representative a case may be, but rather on its potential explanatory power (Smith, 1990). Stake (1994) distinguishes between three purposes for studying specific cases: intrinsic, instrumental and collective. The intrinsic case study is undertaken because one wants better understanding of this particular case. The instrumental case study is carried out to provide insight into an issue or refinement of theory.

> "The case is of secondary interest; it plays a supportive role, facilitating our understanding of something else. The choice of case is made because it is expected to advance our understanding of that other interest. Because we simultaneously have several interests, often changing, there is no line distinguishing intrinsic case study from instrumental; rather, a zone of combined purpose separates them" (Stake, 1994, p.237).

The third type is a collective case study where researchers study a number of cases jointly in order to inquire into a particular phenomenon, population or general condition. This study clearly does not involve a collective case study, but an instrumental study. In turn, the approach taken to undertaking such case is perfectly summarised by the above quote from Stake (1994). Moreover, because the ESSO case has paradigmatic characteristics in terms of its outsourcing undertaking and provides a broad base of vendor selection, bidding and relationship practice, we suggest that a case of the company would be of interest and of real value to investigate.

4.2. Research process

Table 1 summarises the participants for the case research. Where possible we tried to interview the corresponding client-supplier manager. The account and vendor managers were however responsible for the whole deal and thus interfaced with most managers handling the deal.

Client Managers	Length	Supplier Managers	Length
CIO	50 min	CEO	60 min
IS Vendor Manager A*	90 min	Account Manager*	90 min
IS Vendor Manger B*	90 min	Customer Service Manager A*	90 min
Application Support Manager	60 min	Customer Service Manager B	60 min
Operations Support Manger	60 min	Technical infrastructure manager	60 min

*Interviewed twice over a seven month period

Table 1 - Managers Interviewed for the Outsourcing deal

Some respondents were interviewed multiple times across the seven month research period. Interviews varied from 50 minutes to 90 minutes in length and were conducted using a semi-structured questionnaire with many open-ended questions. Questions focused initially on understanding the reasons for outsourcing with a particular supplier, the tendering and evaluation process, the contract and implementation. It soon became clear, though, that ongoing operational issues were of greater importance, in particular the recent relational problems encountered with one particular supplier. Subsequent questions concentrated on the outsourcing relationship, with particular interest in understanding how the outsourcing relationship was developed, managed and maintained. A number of key questions raised in the interviews is listed in the appendix. All interviewees were assured anonymity to promote open discussions. Interviews proceeded from an unstructured to a structured format, with a common protocol. The use of a common protocol ensured not only collection of multiple views on the issues at stake, but also verified and validated responses from the various participants.

4.3. Data collection and data analysis

Interviews were then transcribed, and the text confirmed with the relevant respondents. We then developed a higher level of abstraction and interpretation by going through numerous iteration cycles of interpretation and understanding (Boland, 1991; Parkhe, 1993) and by following up questions with additional interactions with client or supplier managers we were able to develop a comprehensive story. Additionally we sought supporting documentation in order to construct the case history. This included annual reports, internal financial documents and presentations, details and summaries of outsourcing contracts, and some internal memos and reports. Combined the various data sources were compiled into case research databases. By using multiple data sources we tried to address issues of construct validity and reliability as noted by (Yin, 1984) in qualitative research. These sources and procedures allowed us to develop a qualitative, interpretative approach to case study construction (Walsham, 1995). So constructed, the case history will now be detailed in the next section. To guarantee the request for anonymity all names have been changed.

The case study shows in detail how an IToutsourcing arrangement developed into a Winner's Curse first for the supplier, then also the client company, how other scenarios could have developed as illustrated in Figure 1, but how, and by what means, the relationship was converted eventually into a 'No Curse' arrangement.

5. Relational trauma – a longitudinal outsourcing case study

In 1994 CLIENTCO signed a five year, five million pound ($US 7m.), selective IT outsourcing deal with Supplier A for legacy application support services. CLIENTCO's clarity in both objectives and contract focused the arrangements, but did not prove sufficient to ensure relational effectiveness and success. In fact, the first few years were riddled with difficulties, especially for the supplier, whose erroneous bid calculations caused serious service level problems and relational pressures. These eventually led to a serious breakdown in the outsourcing relationship.

5.1 Context and Overview

CLIENTCO is an affiliate of one of the largest petroleum companies in the world. It is an 'integrated' oil company combining the 'upstream' activities of oil exploration and production with the 'downstream' activities of refining, research, distribution and sales.

The increasing pressure from the mother company for operational efficiency drove CLIENTCO to expand the number of areas outsourced over the years and by 1998

CLIENTCO had contracts with five suppliers. CLIENTCO adopted early on an incremental approach of outsourcing essentially only the most obvious commodity IT services, with contracts running for a predetermined five year period:

> **“we talk about 5 suppliers, they are all key to us. We have chosen people who we believe can perform in those areas of the market that we want to use. I don't believe when you see all those wonderful outsourcing deals that there are too many people out there who can do the whole show” (Supplier Manager, CLIENTCO).**

Table 1 below lists CLIENTCO’s outsourcing and in-sourcing arrangements in 1998.

Supplier	Start	Outsourcing Scope, i.e. Service(s)	Size (per annum)
Insourcing	>1980	Networking, telecommunications & desktop computing	Approx. £14 million
Supplier A	**1994**	**Legacy application support**	**£1 million**
Supplier B	1986	Software development	£2-4 million
Supplier C	1991	Client server development support	£0.5 million
Supplier D	1986	Process work	£0.5 million
Supplier E	1996	Invoice production & mail	£0.5 million

Table 1 – CLIENTCO’s Outsourcing contracts

A number of reasons influenced CLIENTCO’s choice of a selective outsourcing strategy. Firstly, they found that no single supplier could handle all of their requirements to the level of standard required. Secondly, their careful selection of small niche suppliers ensured that CLIENTCO’s business was of strategic significance to the supplier, which in effect assured greater attention and control. Thirdly, they chose suppliers with whom they could work and who closely matched CLIENTCO’s culture. This aspect was a key parameter in the selection process.

The objectives pursued with outsourcing were clearly those of acquiring specific services, expertise and technology for a good price. In more recent years costs had become a greater issue for senior management. Every year management expected the operation costs to decrease. However, IT management was quick to point out that cost and services had to be kept in balance:

> **"Senior management's intention with outsourcing is to drive down the costs by a 5-10 per cent on IT services per annum. This has been the case for the department for the past 7 years. The problem with this being that new costs do arise, for example, with issues such as the Year 2000 date change" (Supplier Manager, CLIENTCO).**

5.2. Supplier A's Selection

SUPPLIER A was specifically asked to present a competitive bid against SUPPLIER B (who at the time were contracted to deliver application support services), following the end of B's contract period. SUPPLIER B at the time was the preferred supplier, having supplied CLIENTCO with IT services for the previous seven years, but they were also perceived as expensive. Consequently, SUPPLIER A was able to make a lower price offer, undercutting SUPPLIER B to such an extent that it became worthwhile for CLIENTCO to switch:

> **"they [SUPPLIER B] did it on a day-rate basis and they were the company that moved us the furthest forward in terms of proactively showing us how to do applications support and development better. But, at a cost. This was a Rolls-Royce service" (Senior Manager, CLIENTCO).**

SUPPLIER A's strong price offer, fuelled by its keenness to acquire business from a 'Blue Chip' company like CLIENTCO, gave SUPPLIER A the impetus to outdo SUPPLIER B:

> **"The reason we won the bid in the first place is because we were cheaper" (Customer Service Manager, Supplier A).**

However, the low margin calculation SUPPLIER A made was to cause much strain in the initial years and consequentially raised questions in CLIENTCO over whether cost-saving offers procured through a competitive benchmarking or tender process should not be scrutinised more closely before actually contracting with the competing bidder.

SUPPLIER A was to provide key application support services for approximately 130 systems that were still operating on CLIENTCO's mainframes in 1998. This included a scheduling service, helpdesk service, and an operations and processing service from the data centre. These 130 systems had to be operational 24 hours a day. In addition, SUPPLIER A was also contracted to supply CLIENTCO with relevant IT specialists.

5.3. The Contract

In 1994 CLIENTCO signed a five year, fixed cost contract with Supplier A for the provision of legacy application support services. The contract was structured into two core parts: on the one hand, a core service had to be supplied continuously according to service level agreements; on the other, an enhancement service was required that varied according to CLIENTCO's changing requirements. A failure to provide the core services at any time could diminish the potential bonus payments normally paid on the satisfactory delivery of services:

"we do have rewards based on performance, but it's a very low amount of money and it's not really that important in our profitability" (Customer Service Manager, Supplier A).

Pricing of the service provisions was also split into two parts. Core services were priced on a fixed monthly call fee of £49,000 (sterling) for all legacy application and system services. All add-on change requests, i.e. Computer Work Control Forms (CWCF), varied according to agreed and accepted prices. However, on average CLIENTCO spent an additional £45,000 a month on CWCFs:

"[…] the changes we actually pay are fixed price amounts. They estimate and then they do those changes for a fixed price" (Operations Support Manager for CLIENTCO).

Overall CLIENTCO was paying approximately £94,000 (approx. $US 160,000) a month in total according to 1997 negotiated prices.

Generally, core service prices were calculated according to an agreed headcount number. In 1997 the core service fee was based on 10 people providing the service every day of the week including holidays and sick leave. This flat fee was paid regardless of whether the work is carried out with more or less people:

"if we provide that service with 8 people that's good management on our behalf because we've provided the service with less people. If it takes us 12 people then we are making a loss because we can't do it, so we've got to manage it down" (Customer Service Manager, SUPPLIER A).

On the CWCF side, if Supplier A hoped to make a profit they had to perform better than their own cost estimates. Of course Supplier A could calculate its estimates so they always performed better, and CLIENTCO might find it difficult to counter check these calculations since no open book arrangement existed:

> **"we don't actually tell them how long it took to do something because obviously that's giving away our profitability then and we don't do that as a company" (Customer Service Manager, Supplier A).**

Nevertheless, the contract assured CLIENTCO an annual cost reduction in the flat rate charges for the core services and CWCFs:

> **"it's reduced by £20,000 per year next year and a further £10,000 the following year. [For] the CWCF work it is quite easy because the less work we get the less people we need. As the CWCF work comes down we just take people out of the team, but there's a minimum of £300,000 a year that CLIENTCO guarantees us. So if the work dropped below that level then we would still get £300,000 a year from CLIENTCO" (Customer Service Manager, Supplier A).**

The effect of shrinking the amount of work implied that the 1997/8 service provisions would become redundant at some point in the future. The planned time frame for phasing out the mainframe legacy system was 2004, at which point most applications would be operational on a client/server. Therefore the money Supplier A was making in 1997-98 would tail off over the next seven years. As a result this put pressure on Supplier A's managers to identify new areas of business:

“we need to manage Supplier A into a position where the mainframe work shrinks but other areas of work increase” (Customer Service Manager, Supplier A)

5. 4. Post-Contract Management

Transition period – Taking over from SUPPLIER B (1994-1996)

The transition period for Supplier A started in mid-1994. It focused on taking over existing service arrangements from SUPPLIER B and applying some of their expertise to provide the promised reductions in costs. Operationalisation of the contract, according to CLIENTCO, was a straightforward matter of delivering what the service level agreement specified. In accordance with CLIENTCO managers’ experience with other procurement arrangements, any deviation from the contract would raise questions and often led to conflicts:

“Originally when we took the contract on, there was a take-on team at CLIENTCO and that was made up originally of quite a lot of strong characters who demanded and expected a service from Supplier A. When that service wasn't provided they would want to know why, and not how can we help - it was why is this service not here. And it was very one way” (Customer Service Manager, Supplier A).

One difficulty for SUPPLIER A was of course that they were taking over from an existing contractor, i.e. SUPPLIER B, used to CLIENTCO’s idiosyncrasies and expectations. For SUPPLIER A it was a new environment. There was no one they could initially rely on to help operationalise the contract, especially not SUPPLIER B, the competitor, who had lost the business to Supplier A. Surprisingly, CLIENTCO’s managers were initially not aware of these difficulties. Only in retrospect did they recognise the correlation between their idiosyncrasies and SUPPLIER A's problems (a result of our discussion):

> **"It was a difficult time because they didn't know how we worked, we weren't saying to them, 'here's 5 of our best people, they are going to sit and work with you', because we didn't have 5 people to work with them. Because the business had already been contracted" (Senior Manager, CLIENTCO).**

However, at the time CLIENTCO's strict adherence to the contract was informed by their policy and experience with procuring services. Conforming to its policy, CLIENTCO had spent considerable time and effort to formulate a detailed contract and service level agreement, that then had to be delivered on. Respondents elaborated in reference to the clarity of the contract:

> **"there's nothing grey in our contracts, they are black and white, they are not open to interpretation" (Supplier Manager, CLIENTCO).**

> **"we've used it [the contract] as a base and we've often referred back to it in the past […]" (Customer Service Manager, Supplier A).**

In turn, all managers involved were aware of what SUPPLIER A was required to deliver and little further clarification was necessary. In fact, the specificity of requirements was high; this is exemplified by the rating adopted to emphasise the criticality of each separate service SUPPLIER A was to provide:

> **"it's all laid down in here [the contract]. The systems are all defined as being either critical, highly critical, or low criticality. They are graded according to how critical**

they are to CLIENTCO and the business. And depending on whether they are critical or less critical it defines how many hours you can wait before you get a problem fixed." (Application Support Manager, Supplier A).

"However there are certain systems which are deemed critical to the operation. We've got certain on-line systems that must be kept running and we've got our batch schedules of course which run overnight and we deem that to be critical" (Operations Support Manager, CLIENTCO).

The service level agreement (SLA) detail simplified the payment system as well. All payments were effectively dependent on the achievement of the stipulated services. Non-accomplishment inherently invoked conflict and more importantly eventuated in the loss of any bonuses:

"CLIENTCO offers a bonus scheme which essentially means if the service is running very well you are entitled to be paid a bonus; and various specific system bonuses as well. The converse is true, if there's been a problem on that system which is due to us, being inept then they might say no I'm sorry you've lost the chance to own your bonus this month" (Application Support Manager, Supplier A).

The incentive scheme acted as a motivator for SUPPLIER A to perform and deliver the specified services. Additionally, it also meant close scrutiny of SUPPLIER A's performance to determine whether services had been delivered to CLIENTCO's standard.

Essentially there were three main measures according to the contract: down time, the number of change requests, and the amount of time spent on specific aspects of the core services. The core service levels and their prices were annually renegotiated and updated, in an effort to ensure the costs were continually reduced, and the legacy services slowly phased out.

In late 1995, SUPPLIER A introduced an additional customer perception rating (CPR) method to monitor the degree of customer satisfaction with their service performance and operations. CPR was intended to provide the subjective perspective to the hard measures of the service performance reports. It was to be undertaken on a monthly basis and involved scoring the perceptions on a scale from 0 (lowest) to 6 (highest):

> **"Something that we do regularly at our monthly meetings, each team leader will ask for a perception rating from the customer and that's scored between 0-6. Each score means something different. I have to report back to my management team every month on the average customer perception ratings. So obviously we've got to keep that perception up" (Customer Service Manager, Supplier A).**

Early measures using the CPR method revealed a very low average score - a reflection of Supplier A's transition difficulties and a sign of things to come:

> **"When we started doing the perception rating about 18 months ago we scored 2.7 which was our average score, and that was taken from 6 or 7 business lines" (Customer Service Manager, Supplier A).**

In parallel to operationalising the service provision of the contract, SUPPLIER A was to continue rationalising and consolidating service delivery at CLIENTCO's sites and eventually move the service delivery and technology off-site to their headquarters in Birmingham. Rationalisation also involved altering the paper-based change request system to an online system. This was a fundamental improvement to the otherwise lengthy authorisation process of collecting signatures.

The transition period revealed CLIENTCO's strong corporate culture, to which SUPPLIER A would need to adjust. CLIENTCO in fact had the tendency to impose its culture on any supplier or supplier who wished to do business with them. In the period of consideration their culture had a strong focus on security, safety and control. In part this was traceable to CLIENTCO's parent company, but it also emerged from the nature of their business. A respondent explained how SUPPLIER A experienced this culture:

> **"CLIENTCO are very, very safety conscious. Obviously with them being a multinational company with a number of environmental and safety issues in the past like the EXXON Valdez oil disaster, they are extremely safety conscious. To their public face and to all their suppliers they put safety above everything else, […] even off-site on our own site, we have to do things in our office that the rest of Supplier A don't have to adhere to" (Customer Service Manager, Supplier A).**

Working with CLIENTCO was thus seriously complicated by their security, safety and control driven culture. This culture not only influenced the selection of individuals, but also affected all operations in or with CLIENTCO. In many situations one perceivable effect of CLIENTCO's culture was a concern for control:

“We are not a very hands-off organization. We like to influence everything, we want to be involved. We [also] have very stringent controls. […] But they are a [mother company] driven thing, so we aren't going to change them overnight. We've got piles of this stuff on controls. We spend a fortune every year with different departments being audited and things like that. […] It doesn't matter what we buy, we say we are buying a managed service and we've got to influence it, we want to get in there and control it. And we are fairly demanding” (Vendor Manager, CLIENTCO).

And these controls of course increase the costs:

“We've had a number of suppliers tell us that our controls potentially add 25% to the cost” (Vendor Manager, CLIENTCO).

Even more discernible was the impact of CLIENTCO’s culture on SUPPLIER A’s operation. Indeed, during the transition period (late 1994) it put a serious strain on both the relationship and operations:

“we had an original room that we earmarked for the CLIENTCO office and it was rejected by CLIENTCO because there were wells in the roof and the floor for the heating which someone could crawl under. […] Obviously as a supplier we have to stick to that and get involved in the safety and security issues” (Customer Service Manager, Supplier A).

Of course, these early problems of operationalising the contract complicated matters. Even by late 1998 in some cases SUPPLIER A’s managers working on the CLIENTCO account were still affected by the cultural impact; they continued to be perceived as ‘outsiders’ in their own offices. By early 1995 some of the operational and cultural problems had been alleviated, but overall service levels had dipped to an all time low, and relations were not developing as had been expected:

> **"trust was at a low because the service wasn't being provided to an adequate level and it just spiralled really. In order to turn it around we had to turn that spiral round and bring the trust back up by providing a good service" (Customer Service Manager, CLIENTCO).**

The effects of poor service performance were widespread, and hampered the development of the relationship. In accordance with CLIENTCO's control culture, managers were seeking to find the source of these difficulties. Blame was later to be apportioned to both CLIENTCO's and SUPPLIER A's operation managers handling the deal, and these were subsequently replaced.

These changes were of course very costly for both SUPPLIER A and CLIENTCO. However, this change in structure was critical for continuation and later it was perceived to be a defining moment in the turn around of the relationship. Part of the newly appointed relationship managers' remit was to ensure SUPPLIER A's structure and hence managers closely matched the client's expectations of a good interface and contact point. In this respect, CLIENTCO relationship managers became much more involved in all personnel arrangements, in and the alignment of SUPPLIER A's structure with that of CLIENTCO's.

The decision to formalise the structure was also influenced by the growing amount of time managers spent on the relationship rather than just focusing on the business requirements. It became indicative that IT outsourcing success was correlated with relationship management:

"The contract takes up 25% of our time and the rest of it takes 75%" (Vendor Manager, CLIENTCO).

However, effective relationship management depended on well-working management processes. CLIENTCO took the management procedures and processes from its previous dealings with SUPPLIER B and applied them to the operations with SUPPLIER A. It soon became evident that these did not work with SUPPLIER A. Consequently, during the far-reaching changes to the management structure in 1995-96 several of these management processes also had to be addressed.

The advantage of having a defined interaction structure then enabled CLIENTCO to formalise its management processes, outlining particular meetings at which Supplier A's performance would be reviewed and according to which payments were then made and bonuses granted. These meetings were key to CLIENTCO's control agenda, and gave both senior, operations and functional managers an opportunity to closely monitor SUPPLIER A's performance. In addition, they provided the possibility for voicing any concerns or problems that had arisen and drew senior management's attention to them. The evolving management process included adhoc meetings, and formalised inter-organisational quarterly, monthly and weekly meetings at different levels.

5. 4. Contract Renegotiation (1996)

Towards the end of 1995 it had become clear to SUPPLIER A that they were no longer able to deliver the services as originally priced and agreed. For the first one and a half years they had only made losses, and the contract was in fact costing them significant amounts of money. In consequence services were suffering, and both sides were highly dissatisfied with the arrangements. One respondent noted, referring to the initial set-up:

> **"when we very first started with the contract with CLIENTCO, Supplier A wasn't making much money, and in fact we lost a lot of money initially. Working down at Leatherhead and paying enormous amounts in travel costs, that was a main issue. And also we weren't delivering the service very well so other issues came into it. A bleak time and we weren't making money either." (Applications Support Manager, Supplier A).**

As a result SUPPLIER A was forced to re-evaluate the contract and its business with CLIENTCO. In part, they had to admit to themselves that some of the problems they were encountering, especially the lack of profit, was a result of their erroneous calculations and assumptions about CLIENTCO's business. However this only became apparent to SUPPLIER A during the actual operationalisation of the contract:

> **"when Supplier A first came into the frame with us they were very much used to dealing with public utilities and councils and things like that and they found us very strange. They came in, they took our business and they made some assumptions that we were organised like a council or a utility. We had high overheads all those sorts of things. We had excess resources working in that area. But we didn't. We'd already**

done all that work. They were a little bit naive to start off with" (Vendor Manager, CLIENTCO).

Consequently, in mid 1996 SUPPLIER A was left with few options but to confront CLIENTCO with their partially self-inflicted problem and request an early contract renegotiation. Essentially they had two real options for resolving the situation: either renegotiate or terminate the contract early:

"Supplier A came to us a couple of years ago and said look we've got a problem here, […] we cannot provide that resource any longer at that price" (Vendor Manager, CLIENTCO).

CLIENTCO's response was favourable, revealing a sympathy and understanding of SUPPLIER A's situation. The stated position was that they were not interested in causing SUPPLIER A a loss and wanted both parties to mutually benefit from the deal. Hence CLIENTCO's management agreed to revisit and evaluate the contract in light of SUPPLIER A's specific problems:

"CLIENTCO didn't want Supplier A to find themselves financially embarrassed and unable to carry on with the work, so they agreed to sit down and look at what was going on and try to help address it." (Applications Support Manager, Supplier A).

Interestingly, when CLIENTCO revisited the originally negotiated contract they were not surprised to find terms and price scales that essentially prohibited SUPPLIER A from making an adequate return on their costs. Reflecting on the original state of the contract one respondent emphasised:

“the contract that was put together was appalling. It did not take into account the availability of additional programmers as needed and the very significant price rises in the market. This thing wasn’t tied to KPI’s (Key Performance Indicators), it wasn't fair, they just couldn't deliver the services for us on it, so we had to go in and make some changes” (Vendor Manager, CLIENTCO).

The procedures adopted for the renegotiation cycle were simple. Whilst the ongoing service delivery was continuing as specified in the initial contract, a team on Supplier A’s side was formed which negotiated the specific changes with CLIENTCO’s Contracts and Materials department and the CLIENTCO Vendor Managers. The ensuing review and renegotiation re-aligned, for example, the contract to the present and actual service demands, and also uncovered a number of stipulated terms that were unenforceable in business terms:

“There was a review on how much they were paying for core services because we were doing a lot more core work than we were being paid for at the beginning […] but also there just seemed to be a lot of unnecessary stuff in the contract which we were never going to try and do. It didn’t seem to make business sense to do it. So that was taken out” (Applications Support Manager, Supplier A).

Once a section had been renegotiated and finalised, the changes were then taken on board straight away by SUPPLIER A’s account team and CLIENTCO’s operational managers. This meant direct implementation and operationalisation of the new terms. At times, the renegotiation phase was a trying time and relations suffered, but it was an essential process for SUPPLIER A to be able to continue with the outsourcing venture.

The outcomes of the renegotiation were felt to be positive experiences for both parties. At least it ensured mutual benefit from the deal for the future:

> **“I think to a certain extent we've both ended up walking away from that saying yes we are happy with the result. They are not getting everything they wanted, and we are not getting everything that we wanted” (Vendor Manager, CLIENTCO).**

> **“Now we have actually got the contract negotiations through and we’ve got a better understanding of the contract. We are actually making a satisfactory return on sales. It's not as good as a lot of customers that we have, but it's satisfactory” (Customer Service Manager, Supplier A).**

> **“CLIENTCO weren’t trying to make a lot of money out of the deal they had with us and perhaps risk bankrupting Supplier A. So we both worked together to come up with a better and comfortable contract on both sides. CLIENTCO win, we win, there’s a win:win situation” (Application Support Manager, Supplier A).**

Since the renegotiation, core service levels went to par, then above. The high level of contentment with the resulting arrangements led both parties to formulate an additional informal partnership agreement in early 1997.

5.5. Post-Contract Renegotiation (1997-beyond)

The successful outcome of the renegotiation phase put the relationship back on track. In the following months a number of changes and improvements became apparent. In particular the following aspects received significant attention:

- agreeing to an informal partnership;
- development of a trusting and open relationship;
- value added benefits for both SUPPLIER A and CLIENTCO;

In line with developments in the relationship and the service performance improvements, both parties agreed to formulate an informal partnership agreement. This agreement covered a number of principles about working together. It embodied no legal commitments whatsoever and was in essence rhetorical:

> **"It's an informal thing but it's been written by both sides. We have a partnership agreement with them rather than just do this only and only this [contract]. But I don't think it's actually officially recorded anywhere. It's one of those things that Supplier A and CLIENTCO do mention a few times, we are trying very hard to work with CLIENTCO not against them" (Application Support Manager, Supplier A).**

However, the underlying objective of the informal agreement was to foster a commitment that SUPPLIER A's managers would inform CLIENTCO of any planned changes that may effect the relationship. In a sense, it was an extended promise to cooperate and collaborate more closely:

"I think it's just Supplier A liked to build relationships with their main customers and relationship does mean that there might be a contract that we have to deliver, but it means also we will try to be more helpful and open with our customers so they know what we are doing. […] But CLIENTCO equally says that they are happy with this, they want to work in a partnership with Supplier A" (Application Support Manager, Supplier A)

The impact of this informal agreement was manifold. Respondents indicated that it basically resulted in a more cooperative and trusting relationship. CLIENTCO's managers have consciously worked on fostering such an operating environment because they wanted to ensure (as agreed to in the partnership approach) that they were always aware of any difficulties or problems:

"I trust them to speak to me if ever they need anything or want to tell me anything. I think I've more or less achieved, that they will phone if they've got the slightest need to talk. I also want to make sure it's a very informal relationship. That's developed quite nicely, they don't feel inhibited, they will call if they need to" (Operations Manager, CLIENTCO).

"If you haven't got the right people in the right positions then you are never going to get an open and trusting relationship to start off with. I think you've got to demonstrate your willingness to be open. You've got to demonstrate a manner of handling things. It's taken us some time to get there with a number of our suppliers" (Vendor Manager, CLIENTCO).

“What I did initially with Supplier A was just go in, hear what their problems were and sort a few of the quick ones out, so that they start to trust you a little bit. And demonstrate also that I had credibility within our organization and that I could make things happen” (Vendor Manager, CLIENTCO).

The impact of CLIENTCO’s efforts to foster such an environment improved relations considerably and also stirred a strong sense of loyalty on Supplier A’s side. One respondent explained, referring to the relationship:

“we do tend to feel we are in a way CLIENTCO employees. The team is very dedicated to CLIENTCO as it should be. […] we feel really very beholden to CLIENTCO and we have a lot of loyalty to them. Which is perhaps unusual. […] But we do all feel very committed to making sure that we do a very good job, a fair job” (Application Support Manager, Supplier A).

In fact, SUPPLIER A’s strong loyalty evolved to define an ethical undertone in its operations with CLIENTCO. To maintain the positive behaviours and attitudes that had evolved between SUPPLIER A and CLIENTCO, managers from both parties took a step further to develop a team spirit. Senior managers from CLIENTCO initiated this:

“we encourage team building exercises not at our sorts of level but across the piece. One of the things that we hope to do this year, we did a little bit last year, was some cross team building kind of stuff, so that we can get the likes of SUPPLIER B and Supplier A and whatever playing basketball together or go-karting together or whatever” (Vendor Manager, CLIENTCO).

It was hoped that these activities would contribute to the successful operation of the account, by furthering openness and bridging any culture gap.

Nevertheless, the benefits of this new openness and closer cooperation were felt to be of mutual advantage. For example, in SUPPLIER A's case the developments not only provided new opportunities for business with the IT department but also with other customers in CLIENTCO:

> **"They were asked recently to bid for a piece of work for another company, our Chemicals company, and they bid for that. To have it included as part of the main contract […]" (Vendor Manager, CLIENTCO).**

Another benefit for SUPPLIER A was CLIENTCO's IT/IS group's willingness and openness to discuss their future developments and long-term strategy. In a sense CLIENTCO was giving SUPPLIER A an early opportunity to bid for new and upcoming business:

> **"So the open relationship is quite good from our point of view as it gives us an opportunity to know in advance what we are going to bid for and to do preparation for that. So the partnership thing is an excellent idea. And only by being open can we provide the best service to CLIENTCO anyway and provide those opportunities and see what else we can do" (Customer Service Manager, Supplier A).**

On the other hand the benefits for CLIENTCO were access to technology, expertise and skill resources, enabling them to implement projects faster and move the business forward:

"There have been occasions where I can say I've allowed the supplier to move us forward faster because it's their business because they understand it. And that's what we saw them for. And they moved us forward in certain areas that we potentially recognised or wanted to do. And it's achieved faster results […]. And that's all great and that's the benefit" (Vendor Manager, CLIENTCO).

More importantly CLIENTCO began actively to seek value added by offering an additional bonus award if SUPPLIER A could show they had implemented any new ideas or innovations that added value or benefited CLIENTCO's operation.

Strong signs that the relationship and hence operations had improved became apparent in early 1997. By this time SUPPLIER A had adapted to CLIENTCO's management procedures and requirements and the relationship was working well. Service levels were in line with CLIENTCO's demands and in some cases even above stipulated services. SUPPLIER A's achievements above requirements were duly rewarded with bonus payments:

"If they manage to achieve that bonus to be awarded for a certain number of consecutive months in one period there are bonuses as well that are added. It's quite an incentive to be given that bonus for consecutive months. And just recently I think they went for 7 consecutive months where the batch bonus was paid which was quite an achievement. Because that's a long time to go, a whole month without anything happening" (Operations Manager, CLIENTCO).

SUPPLIER A’s customer perception rating reflected the overall improvement of the services and the relationship. By mid-1997 they were achieving a customer rating of 4.5 on a scale from 0-6:

> **“we are currently on 4.5 which is really good. It's higher than the average of Supplier A so the perception has gone up” (Customer Service Manager, Supplier A).**

This progression continued across 1998 and into 1999, up to the renewal date for the contract.

6. Analysis and Discussion

The case highlighted the difficulties of a competitive take-over bid and the resulting complexities the supplier faces when picking up service provision where a previous long-term deal with another supplier left off. It also emphasised the lack of attention both parties had given to the management structure and the resulting breakdown of the relationship. However, the greatest impact on the relationship were SUPPLIER A’s false assumptions and hence erroneous calculations concerning CLIENTCO’s operations, which forced them to request an early renegotiation.

The deal CLIENTCO had negotiated was strongly inclined in its favour, but the relationship as such was ‘cursed’. The deal as agreed, gave SUPPLIER A few possibilities to recover their bidding expenses and negotiation costs. In fact, SUPPLIER A found that the venture would make a net loss to operationalise, as they had evidently mis-calculated their initial bid offer. It is interesting to examine how SUPPLIER A could have made such an erroneous cost calculation when competitively bidding for CLIENTCO’s business. The assumption proposed by the managers at CLIENTCO seemed quite plausible - that SUPPLIER A had made assumptions at the outset about CLIENTCO's high resource base costs and operational inefficiencies, and then was unprepared to find that CLIENTCO for the past years had been on a drive to minimise these and similar costs, rationalise, standardise and downsize operations where possible. However, there is another plausible explanation, which in other cases such as the Inland Revenue (Willcocks & Kern, 1998) and British Aerospace (Currie & Willcocks, 1997) is also evident, that SUPPLIER A needed to contract with CLIENTCO to gain credibility, prestige and references by working with a major Blue Chip organization. To SUPPLIER A, essentially a small niche supplier, such a deal can hold wide spread benefits beyond solely making a margin on that contract, especially when bidding against others for subsequent contracts elsewhere.

Nevertheless, the consequence of the miscalculations cost SUPPLIER A dearly in the initial one and half years, to such a degree that they were left with no other option but to ask for a early renegotiation. At this stage, CLIENTCO could have responded by emphasising that SUPPLIER A needed to honour the contract or pay a termination fee, but they were not interested in going down a track of complete relational failure and possible high media publicity, and instead decided to renegotiate the contract. This renegotiation proved in subsequent months beneficial for both parties, as services improved considerably and SUPPLIER A was beginning to make a marginal return. The case emphasises that a balance needs to be struck between service levels and costs, and ensuring the supplier makes a return. In a one-sided venture, the supplier has to try to cover its costs in any way possible, which is likely to effect services and relational operations adversely. In addition, in situations of competitive bid circumstances the client generally has to ensure that the supplier is fully aware of the extent of the service requirements, and the client may have to spend more time on evaluating the bid proposals to avoid having to invest in costly renegotiations after such a short period of operation.

6.1. Operational and Relational Impact of the Winner's Curse

Significant impacts on post-contract management and relational operations were identified in areas of contract achievement, management structure, relationship atmosphere (i.e. behavioural factors), and operational efficiency.

Contract Achievement

Unexpectedly for CLIENTCO, supplier service levels plummeted in the transition period and remained below target for a number of months. Service levels dipped substantially as the supplier began adjusting and implementing its service routines to cater for the specifics of the systems and applications. During the transition the client's users group generally expects that the supplier will come in and dramatically improve services, but often these expectations are not achieved and rather take an unexpected downturn. CLIENTCO's case is no exception here and emphasises again the need for careful expectation management. One respondent further explained in reference to the initial adjust period:

> **"The specific stage when the trust went down is when we started, and it's extremely hard to provide a service whatever the level of personnel is when you don't understand the systems. Obviously systems are very different within different companies. Technology is the same and ideas of how systems work are the same but the actual specifics are very different. So when you come in cold**

and start to provide the service from nothing then the user will see a dip in their service from the previous supplier to you" (Customer Service Manager, SUPPLIER A).

However contract achievement was made to certain extent impossible, since SUPPLIER A had made a number of assumptions about CLIENTCO's operations and requirements that, actually, did not apply; especially in terms of rationalisation and standardisation. It is plausible to assume that SUPPLIER A were not fully aware of the systems and applications they were to take over and more importantly possibly lacked some of the competencies and resources to actually deliver CLIENTCO's service levels. The degree of miscalculation made by SUPPLIER A seemed to corroborate this fact, as did the lengthy period for the actual consolidation and eventually transfer of the systems to SUPPLIER A's headquarters in Birmingham. In turn operations, but also the relationship, suffered as service performance continued to drop.

Management Structure

Even though selective outsourcing is not commonly associated with detailed *relationship* management considerations - due to nature and contractual clarity of what is mostly outsourced – in CLIENTCO's case active relationship management became critical. The evidence suggests that due to the winner's curse scenario in the deal, the supplier was proabably not willing to resource the venture with their most experienced managers - which as a small niche supplier it needed as a sales team to attract new business. In turn during the first year the existing account manager found it very difficult to pick-up from the previous supplier and turn around the relationship. His/her incompetence of succeeding in managing the relationship, led instead to loggerheads with the client's manager, who expected a similar experienced account manager as from the previous supplier. CLIENTCO in turn was forced to request a new manager, but also agreed to replace their account manager and appoint in addition two fulltime relationship managers. CLIENTCO realised, it seemed, that SUPPLIER A needed more active management. CLIENTCO response by appointing two relationship managers was a decisive step to saving and turning around the venture. Two respondents noted, in reference to the structural changes:

> **"In fact at the very beginning I don't think Linda and Mac were in place. I know Linda worked very hard to build up the relationship. That was probably the turning point actually when we decided that supplier management was a critical aspect of the thing" (Operations Manager, CLIENTCO).**

> **"And then a new team was put in and that involved Linda in order to help the relationship grow and that was a very distinct change of direction from CLIENTCO. They saw that we couldn't provide the service at that level because we weren't getting any help from CLIENTCO and there was a one-way argument really. By changing the management team, and it was quite a big sweeping change of the management team[…]. And since then the contract has gone from strength to strength and the relationship has gone from strength to strength" (Customer Service Manager, SUPPLIER A).**

The impact of a soured relationship, and consequently having to change the management team at such an early point, was very dramatic. In many ways it meant starting all over again to develop and build the relationship. For SUPPLIER A though these changes meant improved cooperation and support to adjust to CLIENTCO's idiosyncrasies. In fact, it is evident that the cultural and operational differences between the two parties, presented quite a number of challenges for SUPPLIER A. In many ways, their lack of experience of working with large private sector organizations, became evident in their adjustment difficulties in terms of management and operations.

Relationship Atmosphere (Behavioural factors)

The case seemed to highlight a relational development from a strict contract controlled environment to a more trusting and cooperative environment. It is in the nature of the way CLIENTCO apparently operate that they generally endeavour to control operations with a supplier closely. One respondent explained, referring to CLIENTCO's culture for managing suppliers:

> **"We do have a difficulty with our lords and masters, or shareholder in the States and the people that are actually part of this organization, because we are now the European operations or regional operations department […]. I guess their view very much is real men don't get involved in these sorts of supplier management type issues. As far as they are concerned a supplier is a supplier, and we've gone out and asked them to provide X and if they don't provide X then we are going to hit them over the head until they do provide X" (Vendor Manager, CLIENTCO).**

This is clearly influenced by their extensive experience with procurement arrangements that they adopted a power wielding approach. In retrospect management by contract and the expectation to deliver according to contract seems to reflect this. However, in this situation the control approach failed and led to the breakdown of relations, because what SUPPLIER A needed initially was some guidance in understanding CLIENTCO's operations. It was important that parties worked together to clarify the requirements and idiosyncrasies of CLIENTCO and this was clearly missing. The result was evident in the amount of conflict between account managers. Effects were disastrous for both parties. Service levels were low and SUPPLIER A was losing money.

Improvements came with the introduction of the vendor managers who seemed to be interested in helping and cooperating to ensure both parties mutually benefited from the venture. In fact, CLIENTCO's managers now quite deliberately focused their initial efforts on resolving SUPPLIER A's problems with CLIENTCO and began to rebuild trust. Cooperation between the parties was to become fundamental and it is plausible that only in this kind of context did SUPPLIER A gather sufficient momentum to actually approach CLIENTCO to request an early contract renegotiation. The developments following the renegotiation were remarkable considering that the relations had broken down, yet literally 18 months later parties had informally agreed to a partnership and managers from all levels were engaged in team building exercises. The environment fostered by cooperation and working through problem issues was one of openness and trust, yet the contract was still governing the relationship. Through-out these developments what seemed to matter was CLIENTCO's realisation that both parties had to mutually benefit from the venture and hence their willingness to change the contract and replace people on their side to foster and maintain the relationship. The impact of such fairness stirred a loyalty in SUPPLIER A's managers to CLIENTCO, that saw them deliver regularly in subsequent years services above stipulated terms.

Operational Efficiency

The lack of a reciprocal profit for SUPPLIER A contributed to deficient services levels for CLIENTCO. Only through early renegotiation in 1996 was this alleviated, which of course introduced considerable extra costs for both parties in terms of time and resources to renegotiate and subsequently develop the relationship. This raises questions over whether CLIENTCO truly made a cost saving that year and in general for that venture. We can assume that no matter how long renegotiations of the contract take it will be at significant costs to both parties.

Nevertheless, the renegotiation process assured that both parties make a return on the venture and saved SUPPLIER A from having to terminate the contract which undoubtedly would have been disastrous in terms of costs for both parties. As a matter of fact, the renegotiation helped improve relations to such an extent that other value added benefits have emerged since from the venture not only for CLIENTCO, but also for SUPPLIER A, and in the long-term may even improve CLIENTCO's operational efficiency.

The Winner's Curse – Management Implications

The case findings identified a number of issues that were responsible in part for the 'winner's curse' which a client organization can influence in order to avoid or at least minimise the impact of a 'winner's curse' (see Figure 2 below). In line with general outsourcing practice these considerations would filter into a client organization's evaluation, selection and negotiation strategy. The objective has to be control of the impact on post-contract management and the relationship.

CAUSES	OUTCOMES
a) **Information**	
• Insufficient information	
• Misinformation	INFORMATION IMPACTEDNESS
• Wrong assumptions	
b) **Bidding**	
• Misaligned bid offer	
• Bidding to win, no matter	ABOVE BASELINE COST
• Under-estimate of resources and capabilities required	NO POSSIBLE PROFIT MARGIN
• Under-estimate of rigidity of contract	
c) Operating	
• Over-estimate of extra work and excess fees available	REVENUE ENHANCEMENT TACTICS CURTAILED.
• Under-estimate of control and tightness of client contract management	OPPORTUNISTIC BEHAVIOUR MINIMISED.

Figure 2 – Supplier Perspective on 'Winner's Curse'

In the case, it was evident that SUPPLIER A suffered from having insufficient information to make an adequate assessment of CLIENT A's requirements. The problem clearly was that SUPPLIER A was under time pressure to make an offer for a set of services that for the past seven years had been delivered by SUPPLIER B. The existing supplier knew exactly what the service provisions would entail, whereas SUPPLIER A had to rely on information only partly made available by the client and the direct competitor. The resulting assumptions underpinning the SUPPLIER A's bid was based on incomplete, incorrect and outdated information. In terms of transaction cost theory, there is likely to have been an information asymmetry, resulting in specific knowledge concerning service specifications being fragmented and the free flow of information hampered leading to information impactedness (Williamson, 1975). Client organizations in turn have to ensure that no such information impactedness exists, at least, in terms of their detailed service requirements. The danger, as highlighted in this case, is missed service and technology operations that should have been part of the supplier's bid and for which the supplier has not calculated any resources.

A mis-aligned bid will entail either a) termination, b) supplier's opportunistic behaviour (potentially damaging the client), c) the supplier accepting the loss and supplying the agreed service for strategic reasons, or d) renegotiation. In the case SUPPLIER A could not achieve b) at a profit, did not want c) so offered a) or d). Clearly the client could have played a more active role in evaluating the bid suppliers make, especially in one-to-one competitive bidding circumstances, to prevent possible miscalculations of the baseline costs. Interestingly, the client culture of cost efficiency and tight control was perceived as a protection, but ultimately backfired to produce undesired results. Client organizations should ensure that suppliers have a reasonable profit margin in their deal, or else the focus on the supplier's operations will be solely on where it can recover its bidding costs and begin to make a margin. Otherwise, as partly happened in the case, a supplier will seek to save on resources and employ inexperienced managers that diminish client users satisfaction levels.

Although, the case did not provide direct evidence, there was an issue that SUPPLIER A was confronted with a legacy system where it did not have the skills and resources to effectively handle the service and system requirements of CLIENT A. A potentially dangerous situation, as the supplier may have to recruit resources and the capabilities from the market before it can provide the actual services. Again the client should take an active role in determining whether the supplier is sufficiently resourced in terms of capabilities and skills to handle the deal.

For the client organization some lessons would seem to be:

- Ensure accurate evaluation of services and performance required
- Communicate these in detail to the bidders
- Carefully evaluate supplier ability to deliver on service and staff promises
- Carefully evaluate supplier's bid against own estimates of what it should be
- Maintain initial tight control but work flexibly where contract and service metrics are outrunning market prices
- Check market prices regularly and build price recalculations into contract
- Allow the supplier a reasonable profit
- Develop relationship mechanisms to create information flows and understanding of each other's commercial position and operational requirements.

The bidding phase is often a one-sided event, and may actually demand a more active participation of the client. At least in terms of assessing the suppliers overall resource potential, capabilities, skills, information access, bid offer and cost calculations. Intervening early on may prevent the experience of a winner's curse for both parties and subsequent adverse impact on the relationship.

7. Conclusion

The danger of suppliers bidding to win irrespective of calculating for a profit margin in outsourcing, was shown to have strong similarities to what auction theory identifies as a Winner's curse. In the context of outsourcing, this was shown in particular to entail promises that the supplier is subsequently not able to keep, due to the lack of any benefits or profit margins in the deal. The resulting impact on the post-contract management phase and the relationship was shown to be traumatic, to the extent that the operations and the relationship seriously suffered.

Indeed, both CLIENTCO & SUPPLIER A's experiences illustrated clearly that even though a relationship may be based on a high level of contractual clarity outlining explicitly the suppliers responsibilities, relationship management became absolutely critical to ensure not only successful service delivery, but also continuation of the deal. Only through active relationship management and ensuring both parties acquire mutual benefits from the venture was CLIENTCO and SUPPLIER A able to save and turn around this relationship to a point where parties found further value in agreeing informally to a trust-based partnership.

The Winner's curse in turn poses considerable pressures for an outsourcing venture and the relationship, to the extent that re-negotiation or even early termination becomes the best option. Active relationship management by competent relationship managers who can facilitate a successful and mutual turn around of the venture in these contexts takes on a new meaning. Regardless though of whether the venture and relationship is saved, significant costs will arise for both parties, raising general doubts over the financial viability of the deal.

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Appendix

Key interview research questions from protocol used with client managers:

1. What is your understanding of why your company actually outsourced?
2. Could describe and explain the supplier evaluation and selection process? Why [supplier]?
3. Could you describe the contract negotiation process?
4. What arrangements was [company] looking for? How long is the contract? What was outsourced? People transferred?
5. How is the contract structured? What are the costs?
6. How did you handle the transition period? How did you find the supplier handled the transition period? What problems did you encounter?
7. What role do you play in managing the relationship? Could you describe the state of the relationship with [supplier]? What are the operational difficulties? Perceptions, opinions, attitude!
8. What role does the contract have in the relationship? Did you have to refer, enforce it, or use it anyway in the relationship so far?
9. Current state of the relationship? Recent developments? What problems, issues, or conflicts have arisen?
10. How do you perceive the supplier's operations? Has [supplier] been able to provide you with value added benefits? Examples?
11. Are you achieving your expectations and outsourcing intentions (in terms of finance and services)? Why not?
12. What are the upcoming challenges for you and the relationship?

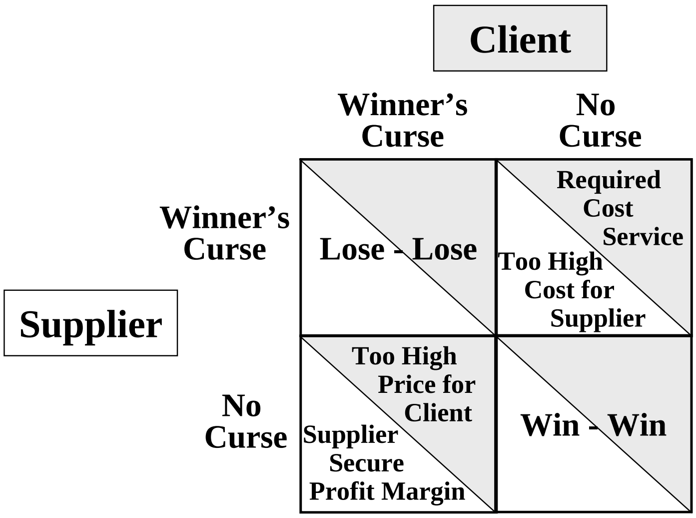

Figure 1: The Winner's Curse and Other Scenarios in IT Outsourcing