TOWARD A DEEPER UNDERSTANDING OF INFORMATION SYSTEM OUTSOURCING GOVERNANCE IN TRANSITION ECONOMIES

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By

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CERTIFICATE OF ORIGINALITY

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Abstract

Managing an information system (IS) outsourcing relationship is regarded as a critical success factor in commercial practice. However, there is limited academic research on how an IS outsourcing relationship is governed to ensure its success and maintain productive relationships. In particular, it is challenging for companies to achieve such feat in China due to the institutional instability of its transition economies. In this context, we draw upon institutional theory to develop a model examining relationships among governance mechanisms, IS outsourcing success, and relational continuity expectation. Results of a survey from 105 state-owned and 82 non-state-owned outsourcing projects show that the positive relationship between contractual governance and outsourcing success is stronger in state-owned firms than in non-state-owned ones. On the other hand, non-state-owned firms have a stronger relationship between relational governance and outsourcing success, and between outsourcing success and relational continuity.

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CHAPTER 1 INTRODUCTION

This chapter is divided into several parts: review of area background of information system (IS) outsourcing and governance, identification of a research gap by rendering opportunities for current study, development of research questions and objectives, report of research contributions, and illustration of the study organization.

1.1 Overview of the Study

Ever since Eastman Kodak announced its outsourcing contract with IBM, DEC, and Businessland in 1989, IS outsourcing has become a subject of intensive studies, especially at the organizational level (e.g., Apte et al., 1997, Barthelemy and Geyer, 2001, Lacity and Hirschheim, 1993a). In his review, Dibbern et al. (2004) proposed a conceptual framework that view outsourcing as an organizational decision process with five major issues: why to outsource (determinants of outsourcing decisions), what to outsource, which decision processes to take, how to implement sourcing decisions, and outcomes of sourcing decisions. Early research into the phenomenon focused on why organizations outsourced (e.g., Ang and Straub, 1998, Loh and Venkatraman, 1992, Poppo and Zenger, 1998), what functions should be outsourced (e.g., Teng et al., 1995, Grover et al., 1994a, 1994b), and which choice to make (e.g., Aug and Slaughter, 1998, Lacity and Willcocks, 1995, Lacity and Hirschheim, 1995). Recently, however, focuses have shifted to the management of outsourcing process/relationship (e.g., Han et al., 2007, Klepper, 1995, Lee and Kim, 1999) and topics related to outsourcing outcomes (e.g., Lee, 2001, Saunders et al., 1997). IS and various management literature have stressed the importance of developing a partnership-style environment with a service provider, with a number of models proposed for developing and sustaining outsourcing relationships between exchanging parties, namely, the client and the vendor (e.g., Grover et al., 1996, Lee and Kim, 1999). An interesting inquiry involved the management of a client-vendor relationship to ensure success and enhance the mutual commitment of exchanging parties. Furthermore, scholars suggest that analyses of firm behavior must take the nature of the institutional framework (Peng and Heath, 1996) into account. It is the intention of this study to contribute to the body of knowledge in this area through a survey-based approach that explores the governance of outsourcing relationships and the connection between outsourcing success and relational continuity expectations among institutional frameworks under specific transition economies.

1.2 Research Background

Outsourcing has emerged as a prevalent and transformational business practice (Handley and Benton Jr., 2009), and studies on it have been expanding and growing continuously (Rao et al., 1996, Tettelbach, 2000). Growth is not limited to volume; scope has emerged from traditional functions like data centers and systems operation to enterprise resource planning (ERP) integration and business process outsourcing (BPO). With the growth of complexity of outsourcing functions accelerating, new skills are needed by the client firm, most crucial of which is the ability to manage ongoing relationships with outside service vendors (Lacity and Willcocks, 1997).

However, firms have been slow to recognize the criticality of outsourcing governance. One report presented that at least 15 percent of total outsourcing contract value is at stake if outsourcing governance is not managed well (VantagePartners, 2007). Gartner, an information technology (IT) research and advisory firm, found that fewer than 30 percent of enterprises have formal sourcing strategies and appropriate outsourcing governance mechanisms in place. In a 2004 survey by the outsourcing advisory company EquaTerra, 42 percent of 130 chief information officers (CIOs) said they were dissatisfied with their outsourcing relationships (Cohen and Young, 2005). There is a growing realization that relationship is a crucial factor in the overall success or failure of an outsourcing arrangement. Research reports show that the issue of IS outsourcing relationship management are critical to both IS researchers and practitioners in order to ensure outsourcing success and continued relationships.

As an important global market, China has attracted unprecedented attention. IS outsourcing in the Chinese market has been tremendously growing, reportedly hitting $323 million for the first quarter of 2006 in the software outsourcing services market alone. International Data Corporation, an advisory firm, predicted that China will account for 24 percent of IT spending in Asia-Pacific by 2010 and become the largest IT services market in the region (Einhorn, 2006). However, past studies in this area were limited to outsourcing projects in Western developed markets with relatively stable institutional environments. Little is known about the relation of governance mechanisms to outsourcing success in transition economies, considering the significant institutional changes in moving from central planning to market competition (Li and Zhang, 2007). Therefore this study will focus on outsourcing governance and will identify interesting patterns among firms in emerging economies.

1.3 Motivations for the Study

Previous studies indicated that contractual and relational governance are the most examined governing mechanisms of interfirm relationships (e.g., Heide, 1994, Poppo and Zenger, 2002). Contractual governance is the written contractual and management-initiated mechanism designed to guide behavior toward desired objectives (e.g., Macneil, 1980, Poppo and Zenger, 2002, Goo et al., 2009). On the other hand, relational governance is an endogenous mechanism that can enhance exchange performance by embedding private and public information flows in a matrix of social ties rather than by resorting to a contract or its enforcement by a third party (e.g., Uzzi, 1999, Goo et al., 2009). Prior literature based on transaction cost economies (TCE) and social exchange theory (SET) identified direct relationship or combined relationship between contractual/relational governance and its outcomes, such as opportunism (e.g., Cavusgil et al., 2004), exchange performance (e.g., Ferguson et al., 2005), or relationship success (Vasylchenko, 2005).

However, there are inconsistent findings and views on the effectiveness of governance mechanisms and their relational outcomes. For example, some scholars are skeptical of the effectiveness of contractual governance and think it is unimportant (Larson, 1992). Strict adherence to the written contract may signal distrust between exchanging parties and preclude necessary flexibility (John, 1984, Macneil, 1980), while others deem contractual governance as a foundation for a successful relationship and regard it as necessary complement to relational governance. Researchers also have varying views on relational governance. Inconsistent arguments and findings indicate that the relationship between governing mechanisms and relational outcomes may be contingent on certain contexts, such as transactional uncertainty (Cannon et al., 2000) and legal environmental hostility (Cavusgil et al., 2004). Previous inconsistent research leaves some space for further examination of governance mechanisms under different contingent contexts.

Another limitation of past studies is its neglect of the crucial influence the institutional environment may have on the governance of relationship mechanisms. Institutional framework is defined as "the set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution" (Davis and North, 1976, p6). Researchers on institutional framework suggest that it interacts with both individual and organizations (North, 1990, Powell and DiMaggio, 1991, Scott, 1992). Specifically, institutional frameworks affect organizations by constraining which actions are acceptable and supportable (Aldrich and Fiol, 1994, Hillman and Keim, 1995). North (1990, p5) pointed that "both what organizations come into existence and how they evolve are fundamentally influenced by the institutional framework." Researchers have examined how institutional frameworks affect international competitiveness (Porter, 1990), stimulate economic development in the United States (Davis and North, 1971), and create competitive organizations in Japan (Hill, 1995). Given its influences on firm behavior, the relationship management that firms make is inherently affected by institutional framework. However, to the best of our knowledge, much of the literature does not discuss specific relationships between governance mechanisms and institutional framework. Free-marked-based institutional frameworks have been assumed by most writers. Due to the tremendous difference between the institutional framework and organization forms in the West and in the transition economies (Carroll, 1993, Lammers and Hickson, 1979), it would be necessary to discover how governance mechanisms will act in formerly planned economies.

1.4 Research Questions and Research Objectives

1.4.1. Research Questions

Based on the above analyses, the purpose of this study is to advance the understanding of the consequences of contractual and relational governance mechanisms using the institutional framework. In this study, three research questions on IS outsourcing governance are addressed:

- How are contractual and relational governance mechanisms related to IS outsourcing success and relational continuity expectation?
- How is the IS outsourcing success related to the relational continuity expectation?
- How does institutional context moderate the above relationships?

1.4.2. Research Objectives

The research seeks to provide a deeper understanding of governance mechanisms of outsourcing relationship in transitional economics. Objectives are threefold.

First, the study would examine the effectiveness of contractual and relational governance toward IS outsourcing success and relational continuity expectation in transition economics. Prior studies have found that both contractual and relational governance mechanisms are effective in enhancing exchange performance (e.g., Ferguson et al., 2005), relationship success (Vasylchenko, 2005), and deterring opportunism (e.g., Cavusgil et al., 2004). However, since most of these studies were conducted in Western countries and rarely in transition economies, we will investigate how effective both governance mechanisms are in enhancing outsourcing project performance in Chinese settings. The impact of institutional environment in Chinese transition economies on governance mechanisms will be considered. The finding will also be used to validate previous complement view on these two mechanisms in Chinese transitional economics.

Second, the study would also examine the link between IS outsourcing success and relational continuity expectation. Surprisingly, this vital relationship has not been investigated in IS literature. It is imperative to know if the current performance of outsourcing project would lead to a continuous relationship between the client and the vendor.

Third and most importantly, the study would identify how institutional frameworks interact with organizations governance in transitional economies. As discussed above, much of literature does not discuss specific relationships between governance mechanisms and institutional framework in spite of the influences of institutional framework on firm behavior. It would be necessary to investigate how governance mechanisms act in transition economies. Specifically, state-owned enterprises (SOEs) are separated from non-state-owed enterprises (non-SOEs) according to various institutional characteristics. The study will identify different patterns of governance mechanisms SOEs and non-SOEs use to achieve outsourcing success and relational continuity expectation.

1.5 Theoretical Contributions

The study has several main theoretical contributions to literature:

1) While most prior studies on governance mechanisms were guided by the rationale of transaction cost and social exchange, we turn to alternative theoretical perspective, and have found evidences that formal and informal constraints of institutional framework can effectively explain optimal choices of governance mechanisms in an outsourcing relationship;

2) Past studies have focused on firms in western countries with mature market economies (e.g., Grover et al., 1996, Cannon et al., 2000, Ferguson et al., 2005, Poppo and Zenger, 2002). This study contributes to the literature by empirically demonstrating how and under what conditions governance mechanisms are linked with outsourcing success and relational continuity in a transition economy;

3) Findings of the study also provide contingent explanations to controversial

observations on the effectiveness of governance mechanisms, indicating its utmost dependence on ownership types;

4) The study also provides a new perspective to explain the dominant influence of relational mechanisms compared to contractual mechanisms using institutional framework.

1.6 Study Organization

The thesis is divided into six chapters. Chapter 1 provides an introduction including research background, opportunities for study, research questions and objectives, hypotheses, research models, and theoretical contribution. Literature review is presented in Chapter 2. Prior studies on IS outsourcing, governance mechanisms and related theories, and institutional framework are reviewed to identify several research opportunities. In Chapter 3, 10 hypotheses are proposed using a research model based on previous governance literature and institutional framework. Methods in investigating the study are then illustrated in the Research Methodology section. Construction measurement, research design, and statistical analysis methods are discussed. In Chapter 5, data from the measurement and structural model are analyzed. In the last chapter, results are discussed and theoretical and managerial implications are presented. Limitation and future research are also indicated.

1.7 Chapter Summary

In sum, we begin by providing an overview of the thesis. Background introduces the reader into the field of outsourcing relationship management. By identifying some research gaps, the study is motivated to deeply understand governance mechanisms under institutional framework. Research objectives and contributions help the reader understand the potential improvement this study could make in the field of governance mechanisms. Previous studies on outsourcing and governance mechanism are reviewed in the following chapter.

CHAPTER 2 LITERATURE REVIEW

Chapter 2 begins with a definition of IS outsourcing, followed by a review of literature on outsourcing relationships, governance mechanisms and theoretical foundations, transaction cost theory, and social exchange theory. Limitations of previous studies on relationship governance are discussed next. Then, studies on IS outsourcing success and relational continuity expectation are illustrated. Finally, the literature on institutional framework in transitional economics is summarized.

2.1 IS Outsourcing Definition

IS outsourcing has been variously defined in the IS literature as:

- "… turning over to a vendor some or all of the IS functions …" (Apte et al., 1997, p. 289);
- "…the organizational decision to turn over part or all of an organization's IS functions to external service provider(s) in order for an organization to be able to achieve its goals" (Cheon et al., 1995, p. 209);
- "... the commissioning of a third party (or a number of third parties) to manage a client organization's IT assets, people and/or activities (or part thereof) to required results" (Fitzgerald and Willcocks, 1994, p. 92);
- "...the third party provision of IT products and services (Hancox and Hackney, 1999, p. 1);
- "...business practice in which a company contracts all or part of its information systems operations to one or more outside information service

suppliers" (Hu et al., 1997, p. 288);

- "... a decision taken by an organization to contract-out or sell the organization's IT assets, people, and/or activities to a third party vendor, who in exchange provides and manages assets and services for monetary returns over an agreed time period" (Kern, 1997 p. 37);
- "...the purchase of a good or service that was previously provided internally" (Lacity and Hirschheim, 1993b, p. 74);
- "...the significant contribution by external vendors in the physical and/or human resources associated with the entire or specific components of the IT infrastructure in the user organization" (Loh and Venkatraman, 1992a, p. 9)
- "...the handing over to a third party management of IT/IS assets, resources, and/or activities for required results" (Willcocks and Kern, 1998, p. 2).

Although there are many definitions, generally the idea is that the client firm turns over part or all of its IS functions to external service vendors due to certain technical reasons like focus on core business or lack of IT experts.

As briefly discussed in the Introduction, the literature identified five major outsourcing issues: why to outsource (determinants of decisions), what to outsource, which decision processes to take, how to implement sourcing decisions, and what outcomes of sourcing decisions are expected (Dibbern et al., 2004). In this research, we will focus on the literature on IS outsourcing relationship and success. We will examine IS outsourcing relationship from contractual and relational perspective in the following parts.

2.2 IS Outsourcing Relationship

IS outsourcing relationship has already received increased attention in literature (e.g., Kern and Willcocks, 2002, Lacity and Willcocks, 2001, McFarlan and Nolan, 1995). Two perspectives underlying most research are either related to the contract, or to the social relationship between the client and the vendor. Literature on the outsourcing relationship studies according to these two perspectives will be reviewed. Dibbern et al. (2004) and Ye's (2005) reviews on outsourcing studies are chosen in particular.

2.2.1 Contractual Issues in Outsourcing Relationships

As opposed to some studies that tended to ignore contractual issues, some researchers have realized the importance of the contract and regarded the contract as the ultimate foundation upon which the relationship is based (e.g., Clark et al 1995, Currie 1996). Those studies discussed some important issues on the contracts in the exchanging relationships during the outsourcing processes, such as how to structure a contract (e.g., Clark et al. 1995), when to choose certain types of contracts (e.g., loose versus tight, short-term versus long-term) (e.g., Currie and Willcocks 1998), how to interpret and management the contract (e.g., Currie 1996). The two new studies by Susarla et al. (2009) and Rustagi et al. (2008) discussed two new concepts, contract extendedness and amount of formal (contractual) control. However, since it is impossible to specify all of the outsourcing contingencies, and the associated vendor and client's obligations in a contract, social perspectives of the outsourcing relationships are often viewed as complementary to the contract by some of these studies (e.g., Clark et al. 1995, McFarlan and Nolan 1995). The following studies we reviewed are all related to contractual issues in more or less detail, however, this does not mean that they are not related to social perspective, since the two perspectives are highly related. All studies reviewed are listed in the Appendix A.

Lacity and Hirschheim (1993) conducted a series of in-depth interviews with multiple informants at fourteen Fortune 500 companies. Even though the outsourcing relationship usually does not contain any provisions for sharing risks and rewards, the authors found that the outsourcing relationship is often portrayed as a 'strategic partnership or alliance' instead of a contractual relationship. The authors also included a number of 'negotiation strategies' geared towards equalizing the balance of power between customers and vendors. The customer needs to improve its negotiating skills and position to reach parity with the vendor, because the vendor has the advantage for its experience and expertise in negotiating outsourcing contracts.

Currie and Willcocks (1998) distinguished four types of outsourcing arrangement: total outsourcing, multiple-supplier outsourcing, insourcing and a strategic alliance sourcing using case studies. These four types of outsourcing arrangements were placed in a framework by considering the client/supplier interdependency and scale of IT market use of each type. The form of client/supplier relationship and the 'attributes of a contract' can depend on other organizational dimensions (determinants) such as uncertainty. Hence, flexibility of the contract or the tightness of contractual definitions could be related to the uncertainty within an organization. The authors advocate that client firms should use short to medium term contracts to avoid "contract stranglehold".

Fitzgerald and Willcocks (1994) assume that strategic partnership exist in outsourcing relationships and examine the issues of contracts and partnerships. A framework for helping to identify and examine the interrelationship between contractual management, the required degree of contractual definition, and the characteristics of the area being outsourced (certainty or uncertainty) is developed. This framework is used to suggest that there are positions which are comfortable and positions that likely to lead to problems. In conclusion, the arguments imply that practitioners need to give more serious thought on these issues when entering into outsourcing deals, particular those concerning partnership.

Clark et al. (1995) developed a framework for the governance structure of contracts consisting of three dimensions: (1) length of the contract (2) governance cost and (3) governance mechanism. The authors match the governance mechanisms with the cost and the contractual attributes. With in-depth interviews of IS executives, Clark et al. found that critical factors in managing what they term an alliance (i.e., strategic partnership) were flexibility and governance mechanisms based on mutual awareness and understanding.

McFarlan and Nolan (1995), drawing on case research encompassing more than fourteen organizations over a four-year period, address several topics associated with 'vendor selection', structuring the outsourcing arrangement, and managing the relationship. Their analysis of the case material suggests that vital factors to successfully structuring an alliance are contract flexibility, and standards and control. While McFarlan and Nolan acknowledge the importance of the contract, they point out that contracts cannot anticipate every contingency. Thus the customer/vendor relationship becomes critical.

Currie's (1996) found that the most difficult issue faced by organizations in all sectors studied was structuring the contract. Four types of contracts were studied: (1) time and materials (2) fixed term, fixed price (3) mixture (4) contracted service levels. Her findings indicate both private and public sector organizations were looking to negotiate more fixed-term and fixed-price contracts, rather than flexible ones. Currie recommends short-term contracts, which may provide flexibility through the frequency of renewal.

Based on social exchange and contract theories, Kern (1997) developed a model that extended the structural determinants of an outsourcing arrangement from a focus solely on the contract to include the operationalization of the contract and the emergence of normative exchanges external to the contract. Using case studies from both customer and vendor perspective, He found that outsourcing success did not solely depend on the service levels. The relationship between clients and vendors was also important. He raised that research on best practices could focus on the relationships after the decision is made to outsource or it could focus on determining what to outsource.

Sharma (1997), based on the rationale of agency theory, investigated how to reduce the opportunistic behaviors of vendors. The answer is that the vendor is less likely to behave opportunistically in the following situations: (1) when the client demonstrates some level of trust in the vendor, and is actively involved in the coproduction of the service (vendor self-control); (2) when taking advantage of the client may harm its reputation (community control); (3) the vendor has an appropriate organizational control structure in place (bureaucratic control).

Marcolin and McLellan (1998) studied the conditions under which certain types of relationships should be used based on Fitzgerald and Willcocks (1994)'s framework. The study suggests that differences between the degree of uncertainty and contractual definition (loose or tight) will determine ideal combinations of strategic partnerships and buyer/seller relationships. The cases studies examined were placed in a three-dimensional framework, with contractual strictness, interpretation of strictness and uncertainty as defining dimensions. Each position in the framework was found to possess a prominent characteristic (e.g., when uncertainty exists, the contractual strictness is low, and the interpretation strictness is high, eventual conflicts occur). The paper shows the necessity to study the behavioral aspects associated with formal written contracts.

Willcocks and Kern (1998) employed a case study approach to investigate process and management issues related to the both contractual and informal issues of an outsourcing vendor and its client. They analyzed the case of Inland Revenue using two separate analytical frameworks. This paper explores three critical dimensions emerging from previous studies: what is outsourced; the contract; and the relationship dimension. The study explores two levels of a relationship: the contractual level, and the cooperative level (the cooperative level may be viewed as akin to a relationship or partnership). At the contractual level, a continuous exchange of information (i.e., communication) helps both sides fulfill their obligations, avoid conflicts, achieve expectations, and become satisfied. At the cooperative level, communication help to increase trust, avoid conflicts, facilitate solutions to problems, reduce uncertainty, manage expectations, and develop mutual goals and objectives and commitment. The overall conclusion drawn by Willcocks and Kern (1998) is that structuring the contract properly is necessary but not sufficient for outsourcing success. Effective interaction between the parties at the cooperative level appears to be necessary as well for a "strategic partnering" outsourcing arrangement to succeed.

Lee et al. (2000) reviewed the past studies, and identify the key research areas and their evolution that help to understand the outsourcing trend. The authors propose that the previous research can be represented in two stages: based on clients' view, the first stage is hierarchical relationship and win-lose strategy; the second stage based on the clients and the service providers' views, stresses equal relationship and win-win strategy. The authors introduce an integrative perspective that focuses on both stages as a way to understand the emergence of partnership-based outsourcing. They stressed that that contracts cannot provide for every contingency, and so an interactive relationship is necessary to attain the benefits associated with outsourcing, which should lead researchers to take a more social perspective, utilizing concepts such as trust and culture, as opposed to past and current reliance on economic-based theoretical perspectives.

Rustagi et al. (2008) defined the *amount of formal control* as the variety of mechanisms used by a client to exercise control over a vendor and the extent to which the mechanisms are used. The authors use literature on transaction cost economics and organizational control to build a model of the antecedents of the amount of formal control. They suggest that clients who have technical or relationship management knowledge, or have high levels of trust in their vendors, use formal control mechanisms to a lesser extent. Furthermore, task uncertainty was found to be positively associated with the amount of formal control, and the degree of core competency involved in the outsourced activity was not found to be related to the amount of formal control.

Susarla et al. (2009) examined holdup problems in outsourcing relationships with relationship-specific investments and contract incompleteness. The authors investigated whether contract extensiveness, which defines as the extent to which firms and vendors can foresee contingencies when designing contracts for outsourced IT services, can alleviate holdup. Task complexity is found difficult to draft extensive contracts. They then studied the role of nonprice contractual provisions, contract duration, and extendibility terms, which give firms an option to extend the contract to limit the chance of holdup.

2.2.2 Relational Issues in Outsourcing Relationships

All studies on social or relational issues of outsourcing examined and focused on one topic—partnership. Two different approaches can be identified in these studies (Dibber et al., 2004).

The *first* is to divide the development of an IS outsourcing relationship into sub-stages to facilitate examination of the relationship's evolution. The most representative study of this approach is Klepper (1995), who explored mechanisms for the development of outsourcing partnering relationship based on Dwyer et al.'s (1987) four-stage model.

A *second* approach is to concentrate on classifying factors present in partnership-type relationship. Contractual level is mostly ignored in this type of research (Dibber et al., 2004). Primarily based on social exchange theory, many researchers argued that partnership is the ideal type of relationship (e.g., Klepper, 1995, Mohr and Speckman, 1994), as it always results in a higher level of success (e.g., Grover et al., 1996, Lee and Kim, 1999, Lee, 2001). These studies identified the main attributes of partnership in order to understand its meaning (e.g., Grover et al., 1996, Lee and Kim, 1999). Factors that determine or impact these attributes were also identified (e.g., Lee, 1999, Mohr and Speckman, 1994). They also tried to understand the magnitude of how these determinants are actually impacted by management actions to influence relationships in a desired way. All studies reviewed are listed in Appendix A.

Mohr and Speckman (1994) studied the characteristics associated with partnership success. Their hypotheses agreed with results indicating that commitment, coordination and trust, communication quality and participation, and conflict resolution technique of joint problem solving are the primary antecedents of partnership success.

Klepper (1995) explored mechanisms for the development of long-term client-vendor relationships in outsourcing, which he called "partnering relationships." Based on transaction cost and social exchange theory, he assessed partnership models from IS and management literature. Some of these models explained the continuation of relationships while others the development of partnerships. He chose Dwyer et al.'s (1987) four sequential stage model of partnership development, namely, (1) awareness, (2) exploration, (3) expansion, and (4) commitment, to derive management actions in support of IS outsourcing partnering. The paper approached the development of partnership from the client firm's perspective using case studies. Analysis of the cases using the model structure enhanced the understanding of the dynamics leading to partnerships. The study indicated that in the exploration and expansion stages of partnership, expectations should clearly be communicated between potential partners, and fair bargaining and judicious exercise of power should be emphasized. The importance of established norms to guide partnership behavior should be recognized.

Grover et al. (1996) defined partnership by means of attributes of seller-buyer interactions. The measures for partnership were derived from the marketing field

(Anderson and Narus, 1990). They examined the relationships between degrees of outsourcing with outsourcing success and found that elements of partnership such as trust, cooperation, and communication are essential for outsourcing success. Length of relationship does not guarantee partnership. Like Klepper (1995), Grover et al. performed an organizational-level analysis. In their model, partnership was investigated as a variable mediating the relationship between the extents of outsourcing various IS functions and success of outsourcing.

Based on political perspective and social exchange theory, Lee and Kim (1999) took an extended view to examine factors influencing partnership. Instead of investigating partnership as a single element, they distinguished between the attributes and determinants of partnership quality. Trust, business understanding, benefit and risk sharing, conflict, and commitment are defined as attributes of partnership quality. On the other hand, the determinants of partnership quality were classified into three groups: dynamic factor (includes participation, joint action, communication quality, coordination, and information sharing), static factor (includes the ages of the relationships and mutual dependency), and contextual factors (includes culture and top management support). Results showed that participation, communication quality, information sharing, and top management support were positively related to partnership quality. The study also indicated that partnership quality may serve as a key predictor of outsourcing success.

Lee (2001) examined the relationship between knowledge sharing and outsourcing success. The effect of the ability of the service receiver to absorb the needed knowledge and to build a partnership on these relationships was modeled. Results indicated that knowledge sharing is significantly associated with the degree of attainment of outsourcing benefits; partnership quality plays a critical role as a mediator between knowledge sharing and outsourcing success.

Hancox and Hackney (1999) compared IS outsourcing in private sector organizations and public organizations in the UK. They found that due to suspicious perception on the vendors' profit motives, public organizations are more skeptical than private sector organizations about the concept of partnerships. They also found that the type of IS function being outsourced and the culture compatibility may be important factors in partnership-type relationships. This led Hancox and Hackney to comment that partnership-type relationships existed "as a collection of … intangibles."

2.2.3 Summary of Outsourcing Relationship Studies

There are three kinds of studies reviewed for outsourcing relationships according to research approaches. Dibbern et al. (2004), following various scholars (such as Galliers, 1991, Lee, 1991), divided outsourcing studies into several categories: empirical (positivist, interpretive, and descriptive) and non empirical (mathematical and conceptual).

Most of the outsourcing relationship studies reviewed were empirical, except Sharma (1997) and Lee (2000). According to Dibbern et al.'s (2004) review and Walsham's (1995) study, positivist studies predominated IS research in general. However, less than 25 percent of papers on outsourcing relationships can be rated as positivist, indicating that the theoretical maturity of explaining the building and management of relationships is still quite low (Dibbern et al., 2004).

Majority of papers with a positivist approach examine the social and psychological aspects of outsourcing relationship. Primarily based on social exchange theory, many researchers argue that a partnership is the ideal type. On the other hand, interpretive research tries to understand the phenomena of interest in its context. It highlights the structuring phase of outsourcing relationships and illustrates how the process of negotiating a contract begins to lay the foundation for ensuing exchanging relationship. The contract finds itself laying the ground rules for governance and structure that guide formal interactions between parties. Descriptive papers also emphasize on contract structuring and relationship building. The theme of these studies induces the notion that relationship issues are critical. However, researchers to this point have not always clearly delineated between different processes of building, structuring, and managing relationships.

Table 2.1 Major Theories Used in Outsourcing Research

Orientation	Theory	Focus	Resource	Main constructs
Strategic Management View	Resource Based	Internal slack resource	Physical capital. Human capital. Organizational capital.	1. Value. 2. Rareness. 3. Imperfect immutability. 4. Nonsubstitutablility.
	Resource Dependence	External resource (Uncertainty)	Land. Labor. Capital. Information. Products (Service).	1. Task dimensions. 2. Resource dimensions.
Economic View	Transaction Cost	Cost-efficiency (Economics of scale)	Production cost. Transaction cost.	1. Asset specificity. 2. Uncertainty. 3. Infrequency.
	Agency Cost	Principal-agent relationship (Contracts)	Monitoring cost. Bonding cost. Residual loss cost.	1. Uncertainty. 2. Risk aversion. 3. Programmability. 4. Measurability. 5. Length of relationship.
Social View	Power/ Politics	Power-structure relationship	Power, Politic.	1. Power (Authority, Resource acquisition, Dependency & low substitutability, Uncertainty absorption). 2. Politic (Selective use of decision criteria, Selective use of information, Use of outside, Experts, Building coalitions, Cooptation).
	Social exchange	Interaction processes	Trust , Culture.	1. Comparison level. 2. Comparison level for alternatives.

(Referred to Lee et al. 2002).

In sum, despite the fruitful theoretical and practical contributions of previous outsourcing relationship studies, limitations and spaces for further studies still abound. Previous studies were mostly grounded on the theories of transaction cost; social exchange or resource-based. Lee et al. (2002) summarized most major theories used in outsourcing research (Table 2.1). However, few studies have examined outsourcing relationships within the institutional framework, believed to have influential impacts on organization's strategic behavior (e.g., Peng and Heath, 1996). Another limitation in present studies is the lack of understanding about areas in transition economies. Since there are many similarities on outsourcing and governance mechanism studies, we will discuss the limitations of previous research on contractual and relational issues in detail later in this chapter.

2.3 Governance Mechanisms

2.3.1 Definition of Governance Mechanisms

Governance mechanisms in outsourcing relationships refer to the process and rules governing actions by the outsourcer firm (client) in a manner that promotes desirable outsourcee (vendor) behaviors (Choudlhury and Sabherwal, 2003). Domberger (1998) argued that governance is implemented by a client firm through various control mechanisms to influence vendor behavior in a manner that is consistent with achieving the client's objectives. Governance is believed essential to the stability of client-vendor relationships (Benton and Maloni, 2005, Carr and Pearson, 1999). In such relationships, elements of private incentive always thrive, resulting in the need for governance (Heide, 1994, Jap and Anderson, 2003, Provan and Skinner, 1989). Client firms are often uncertain about the fulfillment of their expectations and the cooperation of the vendor party during bargaining pressures. Researchers have identified several endogenous factors that drive conflict and underlie reasons for client-vendor partnerships governance. Such components include goal differences, ambiguous contracts, opportunistic behaviors, differences in operational routines, and unexpected market changes (Jap and Ganesan, 2000, Mohr and Spekman, 1994).

In the client-vendor relationships, governance is realized through both contractual and relational mechanisms (e.g., Cannon et al. 2000, Poppo and Zenger 2002).

2.3.2 Governance Mechanism Studies versus Outsourcing Relationship Studies

Contractual governance involves the use of a formalized, legally-binding agreement or a contract to govern interfirm relationships (Macneil, 1978), while relational governance is unwritten, worker-based mechanisms designed to influence interfirm behavior (Macneil, 1980).

Consistent with the two perspectives of outsourcing relationship, these two perspectives in governance mechanisms also appear in marketing (e.g., Cannon et al., 2000, Ferguson et al., 2005), strategic management (e.g., Hoetker and Mellewigt, 2009, Poppo and Zenger, 2002), operation management (e.g., Liu et al., 2008, Handley and Benton Jr., 2009), and business studies (e.g., Cai et al., 2008, Lee and Cavusgil, 2006), and sociology (e.g., Uzzi, 1999). Table 2.2 displayed the governance mechanism constructs appeared in the different areas.

Table 2.2 Governance Mechanisms in Various Fields

Areas	Governance Mechanisms		References
Marketing	Legal Bonds	Cooperative Norms	Cannon et al., 2000
Sociology	Economic embedded relationship	Socially embedded relationship	Uzzi, 1999
Organization Theory	Contractual coordination	Procedure coordination	Sobrero and Schrader, 1998
Strategic Management	Formal governance	Informal self-enforcing governance	Dyer and Singh, 1998
Operations Management	Contractual Completeness	Relationship Management	Handley and Benton Jr., 2009

Some similarities exist between outsourcing relationship and contractual/relational governance studies. For example, both of them identify two important perspectives in exchange relationship, contracts and relationship/partnership. Both find and stress the importance of client-vendor relationship or partnership.

Governance mechanism studies were reviewed separately from outsourcing relationship studies because of several differences.

First, most of the governance mechanisms studies have focused on the concept of "governance," "control," or "mechanisms," which stressed governing rules or control actions to influence relationships.

Second, while outsourcing relationships have concentrated on outsourcing contracts and partnership development, governance mechanisms studies have included both contractual and relational perspectives, and most of the time, even their relationships (substitutive versus complement).

Third, most of governance mechanisms studies are positivist surveys, while outsourcing relationships are more diverse in their approaches, being interpretive (e.g., Currie and Willcock, 1998, Hancox and Hackney, 1999), descriptive (e.g., Currie, 1996, MacFarlan and Nolan, 1995), and conceptual (e.g., Lee et al., 2000). A consistent theoretical foundation in outsourcing studies may not be found (descriptive studies are not theory-based), unlike in governance mechanisms studies where theoretical foundations of contractual and relational governance, TCT and SET respectively, may easily be identified.

Fourth, as listed above, governance mechanisms studies are being investigated in a wide range of research fields such as marketing, strategic and operation management, and logistic and business studies. They are not just limited to outsourcing relationships, and can verily apply to various client-vendor relationships, such as manufacturer-distributor dyads (e.g., Liu et al., 2008), strategic alliance (e.g., Hoetker and Mellewigt, 2009), international joint ventures (e.g., Luo, 2002), and marketing channels (e.g., Cavusgil et al., 2004, Lusch and Brown, 1996).

Last but not least, governance mechanism studies seem relatively newer than outsourcing relationship studies, at least among the ones we reviewed.

Despite their differences, these two fields of studies are highly correlated. In fact, some studies such as Goo et al. (2009) can be categorized as both. A review on TCT and SET, the theoretical foundations that influence contractual and relational governance, and their application in governance mechanisms will be initially taken.

2.3.3 Transaction Cost Theory

The theory of transaction cost maintains that making use of the market is costly (Coase, 1937) and that economic efficiency can be achieved through comparative analysis of production and transaction costs (Williamson, 1975, 1981, 1985). A firm's success depends on efficient management of transactions, here used as the analysis unit.

The theory is built on two fundamental behavioral assumptions: (1) limited rationality and (2) opportunistic behavior (Simon, 1957). According to the first assumption, it is possible to enter only into incomplete contracts, except when both parties are completely trustworthy (Williamson, 1975). However, the second assumption pointed out that in reality the parties behave opportunistically, that is, they cunningly take advantage of opportunities at the expense of others (Williamson, 1981). The danger of opportunistic behavior is further assumed to be less likely within a firm than in market coordination, since it can be prevented within a firm by means of the authority principle (hierarchy). The main theoretical argument of the theory is concerned with the conditions under which certain characteristics of the transaction or the object of the transaction would lead its internal, hybrid, or external governance. The choice of the governance structure to minimize the sum of production and transaction costs for a given transaction is the core issue investigated by TCT (Williamson, 1975, 1981, 1985).

However, analyzing these costs accurately is difficult in IT due to intangible factors. Williamson proposed a heuristic for estimating costs, depending upon three factors: the condition of asset specificity required to support the transaction, the degree and type of uncertainty surrounding the transaction, and the frequency of the transaction. Asset specificity defines the irreversibility of investments involved. It can be classified as physical or human capital investments. The construct uncertainty is applied to a variety of phenomena ranging from individual tasks to market conditions. Researchers found that uncertainty is negatively related to the ability to bind actors in a meaningful way to a specific course of action through contracts (Joskow, 1985, 1987).

Researchers pointed out that at the heart of TCT lies a simple efficiency principle: the choice and adequacy of governance devices is not only dependent on the possibilities for opportunistic behavior by an exchange party, but also on the cost of the governance device (Mellewigt et al., 2007). It seems that less complex contracts are more efficient than long, detailed, more complex ones because of fewer transaction costs. However, simpler contracts may result in greater relational risks, which may cause unsatisfactory cooperation or invoke the hazards of vested interests among exchanging parties. In comparison, when the parties to a transaction may be willing to accept less complex contracts to save transaction costs, a more complex contract becomes more attractive if the partner has an incentive to act opportunistically

(Mellewigt et al., 2007). This incentive is directly linked to assets. If firms make specific investments, they put themselves at the risk of value appropriation by potentially opportunistic partners (e.g., Poppo and Zenger, 1998, Williamson, 1991). Specific asset is of little value outside the relationship and the other party can seek to re-negotiate the terms of the transaction to his advantage by threatening to terminate the relationship. In short, to control against the risk of opportunism that may result from transaction hazards such as asset specificity, safeguards are designed into the contracts, which are manifested through more details and stipulations (e.g., Poppo and Zenger, 2002).

2.3.4 Social Exchange Theory

Social exchange theory also plays a prominent role in explaining exchange. The foundational premises of SET specify that exchange may involve both social and economic outcomes, which are compared to other exchange alternatives. Lambe et al. (2001) proposed that positive outcomes increase trust and commitment and, over time, norms that govern relationships. Thus, SET suggests an alternate form of governance with relationship and rejects the assumption of universal opportunism. Parties to relational exchange tend to rely more on trust, commitment, cooperation, satisfaction, and relational norms than strictly on written contracts (Heide and John, 1992). However, SET does not deny the existence of opportunism. In fact, the existence of opportunistic behavior helps to distinguish transactional relationships from TCT and relational exchange relationships from SET. SET explains why parties to such an exchange may choose to sever the relationship even if the economic benefits of a new, more social relationship are in danger of diminishing.

2.3.5 Contractual and Relational Governance Studies

Scholars whose research concentrates on relationship governance mechanisms (e.g., Anderson, 1985, Joskow, 1985) argued that contractual governance/coordination is a core construct of TCT (Williamson, 1975, 1981, 1985).

Contractual governance is derived from economic rationality and emphasizes governing interfirm relationships through monitoring and incentive-based structures (Liu et al., 2008, Williamson, 1985). It involves the use of a formalized, legally binding agreement or a contract to govern interfirm relationships (Macneil, 1978). Past literature has used various similar concepts such as contractual/contract-based governance (Ferguson et al. 2005; Lee and Cavusgil 2006), legal bonds (Cannon et al. 2000), legal contract (Cai et al. 2009), formal contracts (Cavusgil et al. 2004), contract (Liu et al. 2009), formal governance (Hoetker and Mellewigt 2009), contractual complexity (Poppo and Zenger 2002), and contractual completeness (Handley and Benton Jr. 2009). Therefore in the study, we prefer to regard these concepts as exchangeable.

According to TCE, a well-specified contract is viewed as the major instrument that balances the efficiency of the transaction and protects specific transaction investments from opportunistic behavior. Formal contract stipulates the rights and obligations of both parties to ensure that the terms of transactions will be enforceable (Ring and Van de Ven, 1992), and provides an efficient safeguard by which firms protect themselves from opportunism (Macneil, 1978, Williamson, 1985). It also explicitly states how various future situations will be handled (i.e., systems requirements, due dates, penalties for delay, etc.).

Recent studies have extended the literature of contractual governance by investigating detailed functions or specific agreements. Specifically, two fundamental functions of formal contracts are found: control and coordination (Mellewigt et al., 2007). Control provisions of contracts determine and influence what the parties should do to make the outcomes more predictable (Das and Teng, 1998, Poppo and Zenger, 2002). On the other hand, the establishment of coordinating provisions outlines mutual expectations and delineates roles, rules, programs, and procedures that enable joint endeavors to accomplish collective goals (Mayer and Argyres, 2004, Mellewigt et al., 2007).

Similarly, Goo et al. (2009) defined detailed formal contracts between two contracting organizations as service level agreements (SLA) and specified three characteristics and eleven elements out of SLA: foundation (including elements of service level objectives, process ownership, and service level contents), change (including elements of future demand management, anticipated change, planning of innovation, and feedback process), and governance (including elements of communication, measurement charter, conflict arbitration, enforcement).

On the other hand, relational governance is unwritten, worker-based mechanisms designed to influence interfirm behavior (Macneil, 1980). It is an endogenous mechanism that can enhance exchange performance by embedding private and public information flows in a matrix of social ties rather than by resorting to a contract or its enforcement by a third party such as courts (Uzzi, 1999). Hoetker and Mellewigt (2009) demonstrated that these mechanisms can include establishing teams, task forces, and committees (Grandori, 1997); direct managerial contact through trips, meetings, and even transfer of managers (Martinez and Jarillo, 1989); mechanisms for shared decision making (Saxton, 1997); and formal systems for conflict resolution relying on two-way communication and joint problem solving (Kale et al., 2000).

The theoretical foundation of relational mechanism lies in SET (Homans, 1961). Blau (1964, p91) defines social exchange as "voluntary actions of individuals that are motivated by the returns, which that they are expected to bring and typically do in fact from others". Thus social exchange, unlike economic exchange, stresses trust and reciprocal behaviors, rejects the assumption of universal opportunism, and suggests the relationship as an alternate form of governance. Accordingly, relational mechanisms focus on the roles of social interactions and socially embedded relations (Granovetter, 1985). Thus, in relational relationship, exchanging parties may rely more on trust, commitment, cooperation, satisfaction, and relational norms than written laws (Heide and John, 1992). These relational norms are the grounds for developing shared goals, flexibility, mutuality, toleration, and other social patterns that guide relationships (Black, 1998, Kaufmann and Stern, 1988). There is general agreement that these norms describe appropriate behavioral guidelines that enforce social obligation in the exchange (Heide, 1994, Heide and John, 1992), increasing the commitment of the parties to maintain a cooperative relationship (Seabright et al., 1992, Liu et al., 2008). Relational mechanisms induce norms of flexibility, solidarity, and information exchange. Flexibility enables firms to adapt to unforeseeable technological and market changes. Solidarity and information sharing facilitate problem solving.

In the following part, some governance mechanisms studies that are most related to our research will be reviewed. These studies are listed in Appendix A.

Poppo and Zenger (2002) investigated the relationship between contractual governance and relational governance, and proposed that the two complement each other. Using data from a sample of information service exchanges, they found empirical support for the proposition of complementarity. Their interdependence with each other also underlies their ability to generate improvements in exchange performance. Results concerning determinants (exchange hazards) of these choices show their distinct origins, which further augment their complementarity.

Ferguson et al. (2005) investigated the relative importance of contractual and relational governance on exchange performance and the influence of the boundary spanner on the implementation of these governance mechanisms and on exchange performance. They tested a model of governance of commercial banking exchanges using interview data with both parties to the exchange (the account manager as the bank's boundary spanner and the business client). Relational governance is found as the predominant governance mechanism associated with exchange performance. On the other hand, contractual governance is also positively associated to exchange performance, but to a much lesser extent. The closeness of the account manager to the client company in terms of information access is also positively associated to exchange performance. However, this is mediated through both contractual and relational governance mechanisms, with the latter being stronger.

Cannon et al. (2000) demonstrated the performance implications of governance structures involving contractual agreements and relational norms, individually and in combination (plural form) under varying conditions and forms of transactional uncertainty and relationship-specific adaptation. They found evidences to support their hypotheses on plural form thesis. The results also indicated that the increase of the relational content of a governance structure containing contractual agreements enhances performance when transactional uncertainty is high, but not when it is low.

Luo (2002) examined how contract, cooperation, and performance are associated with one another within international joint ventures (IJVs). Same with Poppo and Zenger (2002) who acknowledged that contract and cooperation are not substitutes but complements in relation to IJV performance. They proposed that contract provides an institutional framework guiding the course of cooperation, while cooperation overcomes the adaptive limits of contracts. Their analysis of 293 IJVs in a dynamic market demonstrates that contract completeness and cooperation drive IJV performance both independently and interactively. When contracts are more complete, cooperation contributes more to performance. Contract and cooperation differ in their quadratic effects such that the contribution of contract completeness to performance declines as completeness increases but the contribution of cooperation remains linear.

Sombrero and Schrader (1998) used a quantitative meta-analysis of 32 empirical studies on contractual and procedural coordination. Results showed that both dimensions are influenced by the same underlying constructs such as asset specificity and uncertainty in the goal and in the means; that they fulfill different but complementary roles in the governance of relationships; and that their systemic fit impacts the performance of relationships.

Mellewigt et al. (2007) highlighted the dual (controlling and coordinating) functions of formal contracts and identified the moderating role of trust. They provided a new focus to the current issue on the relationship between trust and contracts (substitutes or complements) that may help reconcile some divergent perspectives in the literature. They suggested that high trust positively weakens the relationship between control concerns and contractual complexity and positively reinforces the relationship between coordination concerns and contractual complexity.

Hoetker and Mellewigt (2009) investigated when formal and relational governance is superior to the other, a study used widely to coordinate resources and mitigate the risk of opportunistic behaviors. They used data on governance choices and subsequent performance of alliances in German telecommunications industry and find that the optimal configuration of formal and relational governance mechanisms depends on the assets involved in an alliance. Specifically, the results show that formal mechanisms are best suited to property-based assets while relational governance is best suited to knowledge-based assets. If a mismatch happens, it will harm the alliance performance.

Handley and Benton Jr. (2009) cited strategic evaluation, contractual completeness, and relationship management practices during outsourcing processes as the key performance drivers. Data from 198 sourcing executives and managers responsible for outsourcing initiatives were used to examine the influence of those outsourcing process factors on projected outsourcing results. Results indicated that outsourcing performance is significantly influenced by extensive strategic evaluation and proactive relationship management practices. Moreover, the impact of strategic evaluation on outsourcing performance is not direct, but is partially mediated by the relationship between the parties. As a mechanism, the link between contractual completeness and outsourcing success is not found significant.

Building on economic and social exchange theories, Liu et al. (2008) illustrated the different roles of transactional and relational mechanisms in hindering opportunism and improving relationship performance. Their results suggested that transactional mechanisms are more effective in restraining opportunism while relational mechanisms are more powerful in improving relationship performance. They also identified that performance is improved more significantly and opportunism is curbed more effectively when contracts and relational norms are used jointly. While outsourcing governance practices are widely examined in western countries, it is a study done in Chinese emerging contexts.

Cai et al.'s (2008) study dealt with quasi-integration governance mechanisms in the context of B2B buyer-seller relationships. Based on transaction cost analysis and resource dependence theory, the authors identified four key elements of quasi-integration: legal contract, joint problem solving, joint planning, and collaborative communication (the later three can collectively be seen as relational mechanisms). They also examined the relationships between interdependence and these four elements, and the links between the four elements and two exchange outcomes: supplier performance and buyer commitment. Empirical evidence derived from a study of 398 Chinese companies indicates that the four governance mechanisms are driven by inter-firm dependence, and legal contract serves as an important foundation of joint problem solving. Furthermore, they suggested that legal contract, joint planning, and collaborative communication positively affect supplier's performance, while joint problem solving and collaborative communication significantly enhance buyer's commitment to the relationship.

Lee and Cavusgil (2006) drew upon work in transaction cost economics and relational capital theory to examine the effect of governance structure on alliance performance. The analysis on 184 business alliances suggests that relational-based governance dominate the roles in enhancing alliance performance. Specifically, relational-based governance as opposed to contractual-based governance is more effective and influential in strengthening interfirm partnership, stabilizing the alliance, and facilitating knowledge transfer between alliance partners. The positive effects of relational-based governance are enhanced under high pressure of environmental turbulence.

Goo et al.'s (2009) field of work can be treated as typical IS outsourcing as well as governance mechanism study. Like Poppo and Zenger (2002), Luo (2002), and Lee and Cavusgil (2006), it also confirms that formal contracts and relational governance function as complements rather than substitutes. The authors demonstrated how specific characteristics of service level agreements (SLAs) impact relational governance in IT outsourcing relationships. They developed eleven contractual elements (foundation, change, and governance characteristics) and investigated their relationships with three relational governance attributes (relational norms, harmonious conflict resolution, and mutual dependence) and with relational outcomes (trust and commitment). Findings support the proposition that well-developed SLAs not only provide a way to effectively measure vender's performance, but also enable management of outsourcing engagements through the development of partnership-style relationships with high levels of trust and commitment. Moreover, results reinforce the fundamental proposition of overall complementarity between formal contracts and relational governance. However, the study also reveals that change characteristics of SLAs may act as a substitute for relational governance as these were found to dampen the level of trust and commitment through moderation effects.

Cavusgil et al. (2004) examined governance mechanisms in a cross-border context. They found that formal contracts, though negatively related to opportunism, do not have a significant effect on the alleviation of foreign distributor opportunism. Furthermore, the joint use of trust and formal contracts is not significantly associated with opportunism. Authors also pointed out trust and formal contracts' different purposes. Trust makes the relationship function while contracts institute and legitimize it. The study identified the influence of legal hostility on the governance of opportunism in the export market.

2.3.6 Relationship between Contractual and Relational Governance

The relationship of formal contracts and trust has been a matter of ongoing debates. A number of researchers have been concerned about the relationships of two perspectives of governance mechanisms, that is, whether they act as substitutes or as complementary mechanisms (e.g., Lee and Cavusgil, 2006, Luo, 2002, Poppo and Zenger, 2002).

On the one hand, relational governance mechanisms such as trust and contractual governance are seen as substitutes in negative relationship contracts (e.g., Macaulay, 1963), especially as relationship develops (Gulati, 1995, Ring and Van de Ven, 1994). There are two arguments why relational governance and formal contracts can be perceived as substitutes. *First,* relational governance eliminates the need for formal contracts and vice versa (Gulati, 1995). Relational mechanisms such as trust involve the expectation of reduced opportunistic behavior and thereby slow down the need for protective mechanisms (Ebers, 2003). If one party trusts the other, there is little need for contractually specifying obligations and responsibilities. Furthermore, relational mechanism reduces transaction costs by replacing contracts with informal self-enforcing mechanisms, making detailed contracting unnecessary or superfluous (Jarillo, 1988, Uzzi, 1997). *Second*, formal contracts directly hinder the formation of relational governance (Ghoshal and Moran, 1996, Macaulay, 1963). Macaulay argued that the use of elaborate contract indicates lack of trust and can turn cooperative relationship into an antagonistic horse trade. Lee and Cavusgil (2006) pointed that relational risk may rise if emphasized through the contract. Instead of reducing opportunistic behavior of either other party, contracts may lead otherwise (Klein 1996).

The logic for considering these two governance devices as complements, rather than as substitutes, appears to be equally compelling. Even more scholars believed that relational and contractual mechanisms are considered complements in a positive relationship. Researchers have noted that the combined power of formal contracts and relational governance may be much higher in terms of safeguarding assets (Baker et al., 1994, Mayer and Argyres, 2004). Liu et al. (2008) found that improvement of exchange performance is stronger when contractual and relational governance are used jointly than separately. *On one hand,* well-specified contracts narrow the domain and severity of risk to which an exchange is exposed and thereby encourage cooperation and trust. By regulating the awards and penalties that accompany severing relationship, contracts promote commitment and longevity in exchanges (Baker et al., 2002, Klein, 1996). Ferguson et al. (2005) believed that contracts can work as a foundation for cooperative relationship. Furthermore, researchers pointed out that the process of developing a comprehensive and complex contract itself requires both parties to engage in joint actions. *On the other hand,* formal contracts may support relational governance in reverse. The continuity and cooperation encouraged by relational governance may generate contractual refinements, as lessons learned during contract execution may be incorporated with mutual consent in contract revisions. This may further support greater cooperation in future periods

(Poppo and Zenger, 2002). Table 2.3 Demonstrate the two views on their relationships.

Table 2.3 Relationship between Contractual and Relational Governance

	Contractual Governance	Relational Governance	Reference
Substitute View	Contracts are incomplete, Preclude the necessary flexibility, Signify a transaction- oriented approach.	Self-enforcing safeguard More effective and less costly to both contracts.	e.g., Bernheim and Whinston, 1998, Grannovetter, 1995, Uzzi, 1997.
	Relational governance as substitutes for complex, explicit contracts.		
Complements Views	Reduce risk and uncertainty, Specify the roles and obligations.	Mutually oriented behaviour Create a social environment （or relational norms）	e.g., Cannon et al., 2000, Ferguson et al., 2005. Poppo and Zenger, 2002.
	Well-specified contracts may actually promote more cooperative, long-term, trusting exchange relationship		

2.3.7 Relative Strength of Contractual and Relational Governance

Scholars also examined the relative strength of these two mechanisms on the performance (Lee and Cavusgil, 2006, Liu et al., 2008). There is a consistent view that relational mechanisms are more effective in improving relationship performance than contractual governance, especially in uncertain environments (Lee and Cavusgil, 2006, Liu et al., 2008). Contractual governance spells out the rules and creates economic incentives and structure systems which stipulate mutual goals and expectations of both parties. However, the explicit rules and economic bondage the contracts define constrain a client or a vendor’s motivation to make unilateral and joint commitments that are outside the limits of a contract. This can be a substantial deficiency for the exchanging relationship in emerging markets (Liu et al., 2009) or in an environment with marketing uncertainty (Lee and Cavusgil, 2006) where many contingencies commonly arise after the contract is signed. Highly stipulated contracts may lead to strategic rigidity and demotivate a partner's initiatives for seeking new business opportunities (Bernheim and Whinston, 1998).

Nevertheless, relational governance may overcome the inflexibility disadvantages of contractual governance in turbulent environments. Based on mutual trust and commitment, relational mechanisms enforce obligations and promises between the parties through social process (Poppo and Zenger, 2002). Because environmental uncertainty increases the need to adapt to changes, forward planning processes via a priori agreements are replaced by mutual adjustment procedures (Lee and Cavusgil, 2006). Therefore, relational mechanisms furnish strategic flexibility and organizational agility and are believed to be more conducive to success in uncertain environment.

On the other hand, contractual governance is proposed to be more effective than relational governance in curbing opportunism (Liu et al., 2008). First, the contracts are superior to relational mechanisms in offering a formal framework through which to make joint decisions, govern collective actions, and solve possible conflicts (Poppo and Zenger, 2002), thus contracts are more effective in providing explicit descriptions and binding guidance that control behaviors. Second, the authors proposed that the level of contractual completeness is a good indicator of contracting parties' intention for ongoing cooperation. Third, relational mechanisms have some limitation on hindering opportunism. For instance, Jeffries and Reed (2000) argued that trust may be exploited by both partners, thus lowering their commitment to each other. Moreover, it seems that it will be more effective to constrain opportunism through contractual punishment than through social action (Jap and Ganesan, 2000).

2.4 Limitations of Previous Governance Studies

Although the "limitation of previous governance studies" is used in the title, actually, the limitations listed also apply to outsourcing studies. Though previous studies provided fruitful theoretical explanations on governance mechanisms and outsourcing relationships, several problems lie in current rationales on TCE and SET about governance of relationships.

First, inconsistent arguments exist in the literature on the TCE rationale for contractual mechanism. Some researchers posited that formal contracts are mechanisms that attempt to reduce risk and uncertainty in exchange relationships (Lusch and Brown, 1996), and important complements of relational mechanisms (Cannon et al., 2000). However, other scholars noted that contracts alone are incomplete and exchange parties are not able to state how potential situation should be handled by writing complete agreement that covers future contingencies (Williamson, 1975, Macneil, 1980). Many scholars are skeptical on how effective even the most careful crafted contracts can be (Macneil, 1980, Williamson, 1985, 1991). Some researchers even argued that formal contracts are rather unimportant and may actually undermine the formation of relational governance (Larson, 1992, Ghoshal and Morgan, 1996). Therefore, scholars complement the above drawbacks with the viewpoint from relational governance which stresses on exchange relationship based on reciprocal expectations and enhanced mutual adaptability.

Furthermore, researchers also do not agree on views concerning the effectiveness of contractual governance under the condition of uncertainty. According to the neoclassical contract law (Macneil, 1974), contracts are able to provide useful governance in exchange relationships even in the face of uncertainty and risk. However, the original transaction cost logic (Willismson, 1985) suggested that formal contracts are inefficient governance mechanisms in the face of uncertainty because firms are bounded in rationality and will find it impossible to contemplate all future contingencies. John (1984) also remarked that formal contract emphasizing control may signal distrust between exchange parties and may prompt opportunism in uncertain situations. Such inconsistent views lead to interesting studies that try to find contingencies under which contractual governance would be more effective. For example, Cannon et al. (2000) reported that contractual governance is ineffective in promoting supplier performance in exchanges involving a high level of transactional uncertainty. However, when transactional uncertainty is low, contracts can yield an effective means of governance resulting in enhanced performance. Findings provide one possible explanation that may elaborate inconsistency under uncertain situations.

Third, scholars do not have congruent views on the role of relational governance. Some scholars argue that relational governance is an effective self-enforcing mechanism and can restrain parties from acting opportunistically, resulting in enhanced relational outcomes (Brown et al., 2000). Others, however, present the dark side of relational mechanisms, suggesting that reliance on relational norms may weaken the efficiency of self-enforcing mechanisms (Wicks et al., 1999, Wuyts and Geyskens, 2005). For example, relational governance may impose considerable costs in terms of time and resource allocation (Das and Teng, 1998, Larson, 1992) since it depends on the repeated interaction of personnel across the firms. Particularly in face-to-face meetings, relational mechanisms often require managers and engineers to travel between firm locations. Furthermore, relational governance mechanisms can directly diminish performance. Relationships based on frequent interaction take on some aspects of internal supply that diminish incentives, such as second chances being given more frequently, an expectation of due process before termination, and an increase of negotiating unexpected cost (Hoetker and Mellewigt, 2009). In sum, the mixed evidence indicates that the role and strength of relational norms in governing interfirm relationship may also be different under different contingencies.

As a whole, we conclude that current literature leaves us some space for further improvement on the studies on governance of relationships:

Though recently the view that contractual and relational governance complement each other are generally accepted and agreed by most researchers (e.g., Luo, 2002, Poppo and Zenger, 2002, Goo et al., 2009), numerous inconsistent arguments and findings call for further reasonable explanations. One possible explanation may lie in the contingency contexts. Previous studies have found that the effectiveness of governance mechanism may be different under different transactional uncertainty (Cannon et al., 2000) and legal environment hostility (Cavusgil et al., 2004). However, other contingent contexts are yet to be found;

Most importantly, past studies have neglected the institutional environment that may have crucial influence on relationship governance mechanisms. Institutional theory is considered most relevant on interfirm studies in transition economies (Peng, 2003). North (1990, p5) pointed that: "both what organizations come into existence and how they evolve are fundamentally influenced by the institutional framework." However, to the best of our knowledge, few studies discuss the performance of governance mechanisms under the framework of the institutions. Therefore it would be necessary to investigate how governance mechanisms behave in transition economies (Carroll, 1993, Lammers and Hickson, 1979).

2.5 IS Outsourcing Success

2.5.1 Definition of IS Outsourcing Success

IS outsourcing success is precisely the main outcome aimed in the process. Studies on IS outsourcing focused on factors commensurate to success. Nonetheless, these factors are heavily dependent on one's concept of "success" or "outcomes" (Dibbern et al., 2004). Outsourcing outcomes can be classified into three types: (1) satisfaction, (2) expectations and their realization, and (3) performance (Dibbern et al., 2004).

We followed the Loh and Venkatraman (1992), Grover et al. (1996), Lee and Kim

(1999)'s studies by defining the outsourcing success as satisfaction with strategic, technological, and economic outsourcing benefits (e.g., Grover et al., 1996, Lee and Kim, 1999). In particular, success is evaluated as the extent to which vendor contributes to the following factors (Grover et al., 1996, p. 98): (1) focus on core business, (2) increasing IS competence, (3) increased access to skilled personnel, (4) economies of scale in human and technological resources, (5) control of IS expenses, (6) voidance of obsolescence risk, and (7) increased access to key information technologies.

Lee and Kim (1999) extended business success measures of Grover et al. (1996) by adding the perceptions of users. User perspective incorporated client satisfaction with outsourcing arrangement whereas business perspective included the above three sets of benefits. Saunders et al. (1997) and Goles (2001) agreed in using these same dimensions of benefits and added overall satisfaction to determine outsourcing success.

Overall, prior research on outsourcing success has focused on the type and extent of benefits and satisfaction that a client firm obtains from outsourcing arrangements.

2.5.2 Literature on IS Outsourcing Success

It is not surprising to find many overlaps in literature on the studies of outsourcing success with that of outsourcing relationships. Dibbern et al. (2004) demonstrated that there is an interdependence between "how" (outsourcing relationship studies) and "outcome" (outsourcing success studies) of outsourcing. We would like to stress on the latter using Dibbern et al.'s (2004) reviews.

By adopting TCT as the theoretical foundation, Wang (2002) analyzed the implications of transaction attributes on the consequences of outsourcing practice. The relationships among three exogenous variables (contractor reputation, asset specificity, and uncertainty) and two endogenous variables (post-contractual opportunism and outsourcing success) were investigated. The moderating effects of asset specificity on the relationships between uncertainty and endogenous variables were also examined. Authors conducted a survey on Taiwan companies with customized software outsourcing experiences. Results showed that reputation and uncertainty imposed predetermined effects on the contractor's post-contractual opportunism and outsourcing success, while asset specificity showed a negative effect on post-contractual opportunism and a positive effect on outsourcing success, disagreeing with typical predictions of TCT.

By means of psychological contract between customer and supplier project managers, Koh et al. (2004) intended to investigate the effect of client-vendor relationships on outsourcing success. They applied the concept of psychological contract to perceived mutual obligations, and to how such fulfillment of obligations can predict success. The results of content analysis showed that both customers and suppliers identified six obligations on both parties critical to success. Customers perceive supplier's obligations as accurate project scoping, clear authority structures, taking charge, effective human capital management, effective knowledge transfer, and effective interfirm teams. On the other hand, suppliers recognized customer obligations as clear specifications, prompt payment, close project monitoring, dedicated project staffing, knowledge sharing, and project ownership. The study indicated that fulfilled obligations predict success over and above the effects of contract type, duration, and size.

Han et al. (2007) investigated the effect of a firm's resource capabilities and interaction processes on the success of IT outsourcing. The causal structure of capability (IT, organizational relationship, and vendor management capabilities), process (information sharing, communication, and collaborative participation), and relationship (trust and commitment) in achieving outsourcing success were investigated. The integration of corporate IT resource and capability theories with social exchange theory distinguishes our research from that of others, who have generally treated these theories separately.

Grover et al. (1996) tested the direct relationship between the extent of outsourcing different IS functions and success with the moderating influence of service quality. The mediating role of partnership on the strength of relationship between the degree of outsourcing two functions (telecommunications management and systems operations) and success was confirmed. Results suggested that success is dependent on the character of IS functions being outsourced (i.e., which functions were outsourced). It also indicated the important role of partnership-style behavior of IS outsourcing with satisfactory outsourcing arrangement. The study demonstrated that when the independent variable is measured at the functional IS level, the fulfillment of individual task/functional level matters more than overall IS or organizational level performance in determining success.

Lee and Kim (1999) extended the business success measures of Grover et al. (1996) by adding the perceptions of users along with overall business success. User satisfaction was composed of (1) reliability, (2) relevancy, (3) timeliness, (4) accuracy, (5) currency, and (6) completeness of information. They tested the impact of different attributes of partnership quality on satisfaction with the vendor's IS services. Partnership quality is represented by the degree of trust, business understanding, benefit and risk sharing, commitment, and conflict. It showed that all factors of partnership quality except conflict significantly influenced outsourcing success. It is interesting to note that differences could be observed between the impacts of the particular partnership quality on user versus business satisfaction, which suggests that the perceived outcome and its influencing factors differ between the management and the user.

Saunders et al. (1997) used a case research approach to investigate the determinants of outsourcing success. Similar to the study of Grover et al. (1996) and Lee et al. (1999), economic, technological and strategic benefits, and overall satisfaction were used as measurement. Authors identified three influencing factors to outsourcing success: (1) nature of the contract (tight vs. loose), (2) perceptions toward the vendor (as a supplier vs. partner), and (3) the role of IS (commodity vs. core). Overall, the study stresses the importance of partnership arrangements and tight contracts.

In addition to the tightness of contractual definitions, Marcolin and McLellan (1998) examined outsourcing arrangements in two other dimensions, uncertainty and interpretation strictness. Their analysis of the data showed that although each contract could be defined as tight or detailed, it was the interpretation strictness that really mattered. Authors found that strategic partnerships (less detailed contracts, high uncertainty) were not better than buyer/seller relationships (tight contracts, low uncertainty) regarding overall satisfaction/success. In fact, buyer/seller relationships achieved greater satisfaction through more control and certainty in their relationships, and were better in avoiding conflict, achieving cost reductions, and developing trust. On the contrary, relationships with "looser" contracts showed a higher ability to transform their organizations (adjusting to uncertain environment) and to increase the level of trust over time, according to banks. Table 2.4 presents previous IS outsourcing success references.

Table 2.4 Determinants of Outsourcing Success

<table>
<tr><th colspan="4">Determinants of Outsourcing Success</th><th>Results</th><th>Authors</th></tr>
<tr><td>Level</td><td>Construct Focus</td><td colspan="2">Construct</td><td></td><td></td></tr>
<tr><td rowspan="5">Firm</td><td>Partnership</td><td colspan="2">Partnership quality (+)</td><td>S</td><td>Lee and Kim 1999</td></tr>
<tr><td rowspan="2">Contract</td><td colspan="2">Contract deepness (-)</td><td>PS</td><td>Marcolin and Mclellan 1998</td></tr>
<tr><td colspan="2">Interpretation strictness</td><td>PS</td><td>Marcolin and Mclellan 1998</td></tr>
<tr><td>Relationship management</td><td colspan="2">Post contract management (+)</td><td>PS</td><td>Marcolin and Mclellan 1998</td></tr>
<tr><td>Relationship attributes</td><td colspan="2">Buyer seller versus strategic partnership</td><td>PS</td><td>Marcolin and Mclellan 1998</td></tr>
<tr><td rowspan="7">IS Function</td><td rowspan="4">Characteristics of IS functions/ activities</td><td colspan="2">Technological uncertainty (+)</td><td>NS</td><td>Poppo and Zenger (1998)</td></tr>
<tr><td colspan="2">Measurement difficulty (-)</td><td>S</td><td>Poppo and Zenger (1998)</td></tr>
<tr><td colspan="2">Asset specificity (-)</td><td>S</td><td>Poppo and Zenger (1998)</td></tr>
<tr><td colspan="2">IS viewed as core competency (+)</td><td>S</td><td>Saunders et al. (1997)</td></tr>
<tr><td rowspan="3">Extent of outsourcing</td><td rowspan="3">Degree of outsourcing (+)</td><td>Overall IS</td><td>S</td><td rowspan="3">Grover et al. (1996)</td></tr>
<tr><td>Systems operation</td><td>S</td></tr>
<tr><td>Applications development</td><td>S</td></tr>
</table>

			End-user support	S	
			Systems planning and management	S	
			Telecommunications management and maintenance	S	
	Service quality	Service Quality SERVQUAL increases (+) (mediator) positive impact of outsourced IS functions on success:	Overall IS	NS	Grover et al. (1996)
			System operation	NS	
			Applications development	NS	
			End-user support	S	
			Systems planning and management	S	
			Telecommunications management and maintenance	NS	
	Partnership	Partnership attributes communication, trust, cooperation and satisfaction	Overall IS	S	Grover et al. (1996)
			System operation	S	
			Applications development	NS	
			End-user support	NS	

		increase (+) (mediator) positive impact of outsourced IS functions on success:	Systems planning and management	NS	
			Telecommunications management and maintenance	NS	
		Partnership arrangement (+)		S	Sauders et al. (1997)
	Contract	Tight contracts (+) – especially when applied to partnership relationships		S	Sauders et al. (1997)

(Referred to Dibbern et al. 2004)

PS=Partially Support, S=Support, NS=Not Support.

2.6 Relational Continuity Expectation

2.6.1 Definition of Relational Continuity Expectation

Relational continuity expectation refers to the desire of exchange parties to accomplish the long-term viability of their relationship (Jap and Anderson, 2003). It may indicate the degree to which an organization would be willing to engage in the mutual endeavors again (Jap, 2001). From the client's perspective, the client may not stop an ongoing outsourcing relationship, but it can choose to give up or continue its relationship with current vendor when a new project is on demand. Although relational continuity expectation is not a long-term performance outcome, compared to outsourcing success as a short-term performance consequence, it is important, for without it, the firms adopt a short time horizon, and refuse to engage in activities that do not pay off quickly and with certainty (Jap and Anderson, 2003, Williamson, 1993).

2.6.2 Literature on Relational Continuity Expectation

Heide and Miner (1992) described the perception of relational continuity as the shadow of the future, and highlighted the close relationship between expectations of future interaction and cooperative behavior. Future expecations are also found critical in determining the continuity of exchange in channel dyads (Anderson and Weitz, 1989). The literature on social exchange points to the role of future expectations in determining the long-term survival of the relationship. If the parties do not perceive that they will receive worthwhile benefits from the relationship in the future, they are likely to exit.

Jap (2001) investigated the willingness to collaborate in the futuer as one dimension of relationship quality. The author developed a conceptual framework that examines how the use of equity and equality sharing principles in conjunction with various resource and organizational conditions can be used to affect future collaboration, satisfaction, and outcome fairness. The study indicated that sharing principles can have a positive or negative effect on the relationship depending on the type of sharing principle used and the characteristics of the resources and organizations.

Jap and Anderson (2003) provided a longitudinal test of the ability of various relationship safeguards to preserve performance outcomes and future expectations given varying levels of ex post opportunism in the relationship. They found that given lower levels of opportunism, bilateral idiosyncratic investments and interpersonal trust enhance future expectations. However, at higher levels of opportunism, goal congruence becomes a more powerful safeguard, while interpersonal trust becomes less effective. Bilateral idiosyncratic investments continue to preserve performance outcomes and future expectations even at higher levels of opportunism.

Table 2.5 displays the studies of relational continuity expectation including the concepts, definition, antecedents and consequences. To the best of my knowledge, I have not found studies that examining the relationship between relational continuity and loyalty, however, it is reasonable to believe that relational continuity expectation will be associated with loyalty.

All in all, continuity expectation helps managers to know if their firms adopt a long time horizon and accept to engage in activities that do not pay off quickly and with uncertainty (Williamson, 1993). When participants expect that relationship will continue in the future, they will engage in processes and put up investments to enhance the relationship into the long run (Anderson and Weitz, 1989, Jap and Anderson, 2003).

Table 2.5 Studies of Relational Continuity Expectation.

Constructs	Definition	Antecedents	Conse-quences	Authors
Perceived continuity of relationship	Firm's perception of the likelihood that the relationships will continuity.	Trust, age of relationship, communications, power imbalance, stakes, negative reputations.	N/A	Anderson and Weitz (1989)
Intention to stay	Degree of which the firm would keep on working with current partners.	Satisfaction, affective and calculative commitment	N/A	Wetzels et al. (1998)
Extendedness of a relationship	Degree to which the parties anticipate that the relationship will continuity into future with an indeterminate end point	N/A	Level of buyer-seller cooperation.	Heide and Miller (1992)
Willingness to collaborate in the future	Defined as one component of relationship qualities indicating the desire of future collaboration.	Resources and organizational relationship conditions	N/A	Jap (2001)
Expectations of relational continuity	The long-term viability of the relationship.	Bilateral idiosyncratic investments, goal congruence, trust.	N/A	Jap and Anderson (2003)

2.7 Institutional Framework

2.7.1 Institutional Framework

Institutional framework has its roots both in sociology and economics (Scott, 1992). Economics demonstrates that the institutional framework of a society serves as constraints to regulate economic activities by providing the rules of the game (North 1981, 1990, Davis and North, 1971). The institutional framework is defined as "the set of fundamental political, social, and legal ground rules that establishes the basis for production, exchange and distribution" (Davis and North, 1971, p6). Institutions can even shape history by structuring political, social, and economic incentives in economic exchange. These structural constraints provide a stable structure to economic exchanges by limiting the choices of the individuals and organizations, thereby reducing uncertainty (North, 1990).

On the other hand, sociologists stress the legitimacy defining role that institutions take on and address shared beliefs that shape the way people in a society behave and can arise out of shared cultural and political systems (Powell and DiMaggio, 1991, Scott, 1987, 1992, Zucker, 1987).

We can see that sociological and economic approaches are complementary to each other (Scott, 1992), hence their usage in this study.

The institutional framework is made up of two constraints around individual and organizational behavior: formal constraints (contracts and political, judicial and economic rules) and informal constraints (codes of conduct, norms of behavior, and convention embedded in culture and ideology). Researchers have agreed that in situations where formal constraints fail, informal constraints will do (North, 1990, Powell, 1990, Scott, 1987, 1992, Zucker, 1987). Scott (1995) however, argues that institutions have three pillars at the most fundamental levels. First, the regulative pillar focus on formal rule systems and enforcement mechanisms sanctioned by the state (North, 1990). Second, the normative pillar defines legitimate means to pursue valued ends (Scott, 1995). Last but not least, the cognitive pillar refers to taken-for-granted beliefs and values that are imposed on, or internalized by social actors (DiMaggio and Powell, 1983). These three pillars of institutions provide three "related but distinguishable bases of legitimacy" (Scott, 1995, p47).

Researchers believe that both individuals and organizations are influenced by and interacted with institutional frameworks (North, 1990, Powell and DiMaggio, 1991, Scott, 1992). On one hand institutional frameworks influence individuals' decision making by signaling which choice is acceptable and determining which norms and behaviors are sociable. On the other hand, they also affect organizations by constraining which actions are acceptable and supportable within the framework (Aldrich and Fiol, 1994, Hillman and Keim, 1995). Institutions provide the rules of the game in which organizations act and compete. Specifically, North (1990, p5) pointed that "both what organizations come into existence and how they evolve are fundamentally influenced by the institutional framework. In turn, they influence how the institutional framework evolves."

Given the influence of institutional frameworks, researchers advocated that any analysis of firm behavior must take the nature of institutional framework into account (North, 1990, Oliver, 1991).

2.7.2 Institutional Studies and Governance Mechanisms

Previous studies have used institutional frameworks in various strategic management studies. For examples, Porter (1990) examined how the institutional framework in a country affects its international competitiveness. Davis and North (1971) focused on the role of institutional framework in the United States, which has stimulated its economic development. Hill (1995) also demonstrated how the institutional framework in Japan helps create its competitive organizations. Peng and Heath(1996) developed their firm growth model based on North's (1990) argument that it is the interaction between institutions and organizations that shapes economic activities. Peng (2003) examined how organizations make strategic choices during fundamental and comprehensive transitions using institutional framework. Based the rationale of institutional framework, Li and Zhang (2007) identified the moderating effects of ownership type between functional experiences and new venture performance. Peng et al. (2001) reviewed management and organizational research on Greater China, and tried to find leading individual and institutional contributions to the literature.

However, governance mechanisms, important strategic issues and behavior that would have much influences on organization performance, have been neglected by previous institutional studies. Much of the literature on governance mechanisms was developed in the West, and would not discuss the specific relationship between governance of client-vendor relationships and institutional frameworks. Free market-based institutional frameworks have been assumed by previous governance studies. This is unfortunate because chosen governance mechanisms are constrained and influenced by institutional frameworks. Given the tremendous amount of diversity between institutional frameworks and organizational forms in the West and in formerly planned economies (Carroll, 1993, Lammers and Hickson, 1979), institutional frameworks in Chinese transition economy will be explored.

2.8 Transition Economics

2.8.1 Transition Economies and Their Characteristics

China is experiencing planned-to-market-based economic transition that "changes fundamental managerial assumptions, criteria, and decision making, and represents a genuine transformation of the business" (Tan and Litschert, 1994, p3, Guthrie, 1997, Warner, 1987, 1992).

Table 2.6 displays certainty changes in the current transition from planned to market economy. First, SOEs and collective firms (Nee, 1992, Peng, 1997a, Peng and Heath, 1996, Peng and Luo, 2000) dominate planned economy. During the transition, however, private firms (e.g., Chang and MacMillan, 1991, Xin and Pearce, 1996), township and village enterprises (e.g., Walder, 1995, Jiang and Hall, 1996) and foreign-invested firms (Aldrich and Fiol, 1994), have come into existence and increased both in number and scope. Second, formal institutional forces in planned economy has focused on central planning and bureaucratic control, but lacked property rights legal system, strategic factor markets, and stable political structure in transition economy (e.g., Peng and Heath, 1996).

Table 2.6 Firm Types and Formal Constraints Change in the Transition

Planned Economies		**Transition to Market Economies**	
Former Formal Institutional Forces	• Central planning • Bureaucratic control	Current Formal Institutional Forces	• Lack of property rights based legal system • Lack of strategic factor markets • Unstable political structure
Former Firm Types	• State-owned firms • Collective firms	Current Firm Types	• State-owned firms • Collective firms • Private firms • Township and village enterprises • Foreign-invested firms

(Referred to Peng and Heath, 1996)

Specifically, China's transitional economy is characterized by weak capital market structures, poorly specified property rights, destabilized bureaucratic controls and tolerance over private ownership, and institutional instability, of which a lack of coherent business laws is an example (Brus and Laski, 1989, Fischer and Gelb, 1991). These characteristics make market exchanges uncertain and costly. The lack of an adequate legal framework to define and protect property rights has resulted in a sharp rise in opportunistic behavior (Boisot and Child, 1988, Puffer, 1994). Put another way, an economy geared toward market-based measures without adequate legal framework is bound to suffer opportunism and high transaction costs.

Because of a lack of market-supporting institutions, there exist “institutional voids” (Khanna and Palepu, 1997). In this way, managers and firms in China often have to perform basic functions by themselves, which might include obtaining market information, interpreting regulations, and enforcing contracts (Khanna and Palepu, 1997).

In this transition economy, different firms may have experienced different institutional supports and thus interacted with the institutional environments differently. Firms will be differentiated by the ownership types.

2.8.2 SOEs versus non-SOEs

The hallmark of transition economies is coexistence of non-state-owned and state-owned enterprises (SOEs). Most scholarly research differentiates firms in China according to their ownership types (Child, 1994, Lu, 1996).

As stylized firms, SOEs dominated mainland Chinese economy for a long time (Davies, 1995, Peng and Heath, 1996). Fundamentally different from Western firms that researchers typically encounter (Henley and Nyaw, 1986), SOEs in mainland China exhibit a number of strategic behaviors similar to their counterparts in the former Soviet Union and the pre-1989 Eastern Europe.

Table 2.7 has displayed some comparisons between SOEs and non-SOEs. SOEs have relatively easier access to government officials and have extensive bargaining between their managers and the government (Chen and Faure, 1995). SOEs may still be state-controlled in that their top managers are likely to be appointed by the state, their budgets soft (Boisot and Child, 1988, Lu, 1996), and their incentive structures not directly linked with performance. As a result, the notion of "competitive strategy" was very alien to most SOE managers, who tended to be political appointees with little motivation to perform (Tung, 1981).

In contrast, non-SOEs, such as private firms and foreign-invested firms, initially suffered from lack of legitimacy as new organizations (Aldrich and Fiol, 1994). Managers faced capital and budgetary constraints as state-owned banks favored SOEs. On a positive note, it disciplines the managers to perform better, and improve incentive structures. Moreover, in a country with uncertain property rights, the potential for threatening interference and expropriation from party and governmental officials is great (Nee, 1992, Xin and Pearce, 1996). Thus, non-SOE managers may be strongly motivated to search for ways to improve performance by developing social connections with government officials and other firms (Peng and Luo, 2000).

Table 2.7 Differences betweens SOEs and Non-SOEs in Chinese Transition Economy

	SOEs	Non-SOEs
Characteristics of Managers	• Extensive bargaining between their managers and the government • Lack of concern for efficiency and performance • The notion of "competitive strategy" was very alien to most SOE managers and tended to be political appointees	• Used to have fewer connections between their managers with government • Performance driven • More sensitive to the competitive market and deemed as more professional
Characteristics of Firms	• Have relatively easier access to government officials • More established and have longer time to connection building • Stronger institutional support • Soft budget	• Have fewer connections and contacts with government officials • Relatively new and have to build up connections from beginning • Weaker institutional support • Hard to get funds.

2.8.3 Institutional Framework and SOEs and Non-SOEs

As discussed, institutional framework influences organizations through the two constrains, formal and informal constraints (Xin and Pearce, 1996, Peng and Luo, 2000). On the other hand, the hallmark of transition economies is the coexistence of SOEs and non-SOEs. Previous studies found that SOEs and non-SOEs are salient in their differences of formal constrains and informal constrains (e.g., Peng and Heath 1996; Peng and Luo 2000). That is, SOEs in transition economies may have strong formal constraints compared to the non-SOEs, while non-SOEs may rely more on informal constrains than SOEs. Thus SOEs and non-SOEs in the same institutional environments will present differently through the two constraints. Therefore, in our study we may compare SOEs and non-SOEs for their governance mechanisms in the (institutional) transition economies.

During the transition to market economy, market-supporting institutions are scarce (Khanna and Palepu, 1997). Chinese transition economy is characterized by weak capital market structures, poorly specified property rights, and institutional instability. Under these circumstances, SOEs have structural advantages over non-SOEs. Since managers of SOEs are originally appointed by the government, their firms enjoy more institutional support and protection. In a country with uncertain property rights and great potential for threatening interference and expropriation from party and governmental officials (Nee, 1992, Xin and Pearce, 1996), non-SOEs may demonstrate more institutional stability because they have less connection with government than SOEs.

Studies have found that in an environment where formal institutional constraints such as laws and regulations are weak, informal institutional constraints, such as those embodied in the interpersonal ties cultivated by managers (guanxi in China), may play a more important role in facilitating economic exchanges and hence assert a more significant impact on firm performance (Peng and Heath, 1996).

Based on the argument and the fact that SOEs have more institutional support, scholars proposed that managers of non-SOEs may have more incentives to cultivate connections with people useful to business than managers of SOEs.

By developing guanxi as substitute for formal institutional protection, government ownership offered their counterparts by cultivating close personal relationships with people useful to business. Certainly, all Chinese managers would use guanxi, but non-SOEs managers would value these connections even more importantly to compensate for weak institutional support (Peng, 1997).

Another potential alternative explanation for the greater importance of personal connections to managers in non-SOEs is that: non-SOEs, especially private firms, are relatively new and small in a county that is still, at least nominally, communist. Their managers may cultivate connections to counteract liabilities of newness and smallness. Stinchcombe (1965) claimed that new firms generally face greater risks than older firms because of lack of external legitimacy. Empirical studies have tended to support the idea that newness is a liability for firms (e.g., Delacroix and Carroll 1983, Freeman et al. 1983).

Table 2.8 Institutional Influences on SOEs and non-SOEs

		SOEs	Non-SOEs
Informal Constraints	Incentives to build the relationships with government officials	Low	High
	Incentives to build the relationships with other firms	Medium	High
Formal Constraints	Level of institutional support	Strong	Weak
	Confidence on formal contracts	High	Low

(Referred to Peng and Luo, 2000)

Peng and Luo (2000) proposed that two types of relationships are especially important for firms in China: relationship with government officials and relationships with other firms. They compared SOEs and non-SOEs for their incentives to build the two types of relationships, and confirmed that since SOEs have higher level of institutional support and good relationships with government officials, non-SOEs may have more incentives to develop those two types of relationships to make up for weak institutional support. As shown in Table 2.8, formal and informal constraints of SOEs and non-SOEs are compared.

2.9 Chapter Summary

In this chapter, literature on outsourcing relationships, governance mechanisms and their theoretical foundations (i.e., transaction cost theory and social exchange theory), and outsourcing success and relational continuity expectation are reviewed. We recognized that though previous studies have provided fruitful theoretical foundations and explanations on relationship governance and management especially on outsourcing relationship and governance mechanisms, it still leaves us some space for further improvement. Therefore, based on these opportunities for a deeper understanding of governance mechanisms in a transition economy, we will examine how Chinese client firms would govern their outsourcing relationships under their specific institutional environment. In the next section, the research model and related hypotheses will be discussed.

CHAPTER 3 RESEARCH FRAMEWORK AND HYPOTHESES

Development of the research model is illustrated in several parts. First, the conceptual model is presented and illustrated. Second, the contractual mechanism is reviewed and its relationships with IS outsourcing success and relational continuity expectation are examined. Third, the relational mechanism and its relationships with both consequences are discussed. Fourth, the relationship between IS outsourcing success and relational continuity expectation are examined. Then, the relative strength of contractual governance and relational governance mechanism on two outcomes are investigated. These above mentioned relationships and seven related hypotheses are proposed and examined without differentiating firm types. However, based on the rationale of institutional framework, we proposed that some of the above relationships may be contingent on institutional environments, that is, different types of firms may have different relationship strengths. Specifically, the contingent effects of types of firm ownership (SOEs vs. Non-SOEs) on governance mechanisms, and on the relationship between outsourcing success and relational continuity expectation, are examined.

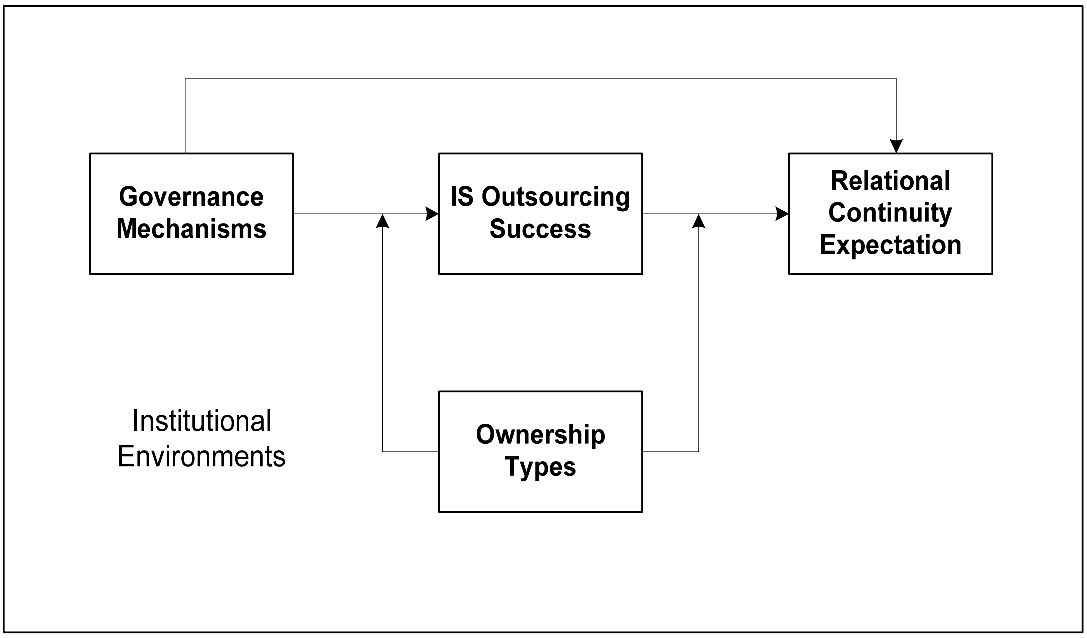

Figure 3.1 Research Framework

3.1 Overview of Research Framework

As discussed in the introduction section, the research dealt with management of the outsourcing relationships to ensure IS outsourcing success and relational continuity. Thus, our framework (Figure 3.1) focused on four main elements: two governance mechanisms (contractual governance and relational governance) and two outcomes (IS outsourcing success and relational continuity expectation).

In the conceptual research model, relationships among governance mechanisms (contractual and relational governance), project performance (IS outsourcing success), and relational performance (relational continuity expectation) under institutional environment are proposed and examined.

The research model presented that governance mechanisms are related to project and relational performance and that project performance may variably lead to relational feat. According to the rationale of transaction cost and social exchange, we first proposed that governance mechanisms positively relate to IS outsourcing success and relational continuity expectation, which was further discussed to test if the expectation of relationship loyalty is influenced by project performance.

Scholars confront the issue on which and when one governance mechanism is superior to the other (Liu et al., 2008). Addressing the question, the relative strength of two mechanisms on the outcomes under Chinese institutional framework is explored.

However, the most important hypotheses of the research model lie in the contingent values of types of firm ownership. Based on institutional framework, the differences between stylized (SOEs) and non-stylized firms (SOEs) are evaluated. Then we analyzed if optimal configuration of contractual and relational governance mechanisms in an outsourcing relationship is contingent on ownership type (SOE or non-SOE).

We have not hypothesized and tested possible moderation effect of ownership types on relationships between governance mechanisms and relational continuity expectation. The reasons lie in that : 1) it is not the main focus of this study and the relationships between governance mechanisms and relational continuity expectations may not be explained by institutional theory; 2) the rationale behind is not so clear as the relationships between governance mechanisms and outsourcing success; 3) relational continuity expectations are also influenced by success of current project, this further complicates the relationships.

In sum, the model investigated governance mechanisms in transitional economic setting. In the next section, detailed model development is illustrated beginning with contractual governance and its consequences.

3.2 Contractual Governance, IS Outsourcing and Relational Continuity Expectation

3.2.1 Contractual Governance and IS Outsourcing Success

IS outsourcing success refers to the overall organizational advantage obtained from IS outsourcing (e.g., Grover et al., 1996, Lee and Kim, 1999). Previous studies assessed outsourcing success in terms of attainment of 1) economic benefits (economies of scale in human and technological resources and control of IS expenses); 2) technological benefits (voidance of obsolescence risk and increased access to key information technologies); 3) strategic benefits (focusing on the core business and increased IS competence) (Loh andVenkatraman, 1991).

As we have discussed, contractual governance emphasizes the use of formalized, legal-binding agreement or contract to govern interfirm relationship (Macneil, 1978). It has been reported that formal contracts can effectively enhance exchange performance (Liu et al., 2008, Poppo and Zenger, 2002), alliance performance (Lee and Cavusgil, 2006), joint venture performance (Lee et al., 2003, Lee and Cavusgil, 2006), outsourcing exchange satisfaction (Vasylchenko 2005), among others.

Based on governance mechanism literature and theory of transaction cost, contractual governance is expected to have positive relationships with IS outsourcing success. Reasons include:

First, TCE assumes that due to threats of opportunism, interfirm exchange will result in contracts that clearly define terms and conditions, hoping to reduce the risks. By specifying rewards and punishment in the written agreement (Williamson, 1985), formal contracts can reduce the potential for undesired behavior, which is costly (Poppo and Zenger, 2002). though contract-based governance may involve large fixed transaction costs (including cost of drafting, interpreting, and implementing contract and corporate law), which the firm has to pay in doing business, it may reduce the marginal costs of enforcing an additional contract that is explicit, impersonal, and standardized (Li, 2005). A more comprehensive contract reduces the likelihood of opportunistic behavior and/or costly renegotiation (Barthelemy, 2003), thus providing both parties with mutual economic benefits.

Second, contractual governance serves two fundamental functions: control and coordination (Mellewigt et al., 2007). The control provisions of contracts determine and influence what the parties will do and make outcomes more predictable (Das and Teng, 1998, Poppo and Zenger, 2002).). It can furnish plans for the transaction and provide legal protections for both (Cannon and Perreault, 1999). Thus from the client's point of view, contracts serve to enforce the obligations of service vendor and help to optimize technological service to a certain level as defined.

Recent literature stressed the coordinating role of formal contracts in exchange relationship or alliance (Gulati, 1995, Ryall and Sampson, 2006, Sobrero and Schraber, 1998). The establishment of coordinating provisions outlines mutual expectations as well as delineates roles, rules, programs, and procedures that enable joint endeavors to accomplish collective goals (Mayer and Argyres, 2004, Mellewigt et al., 2007). By specifying clauses regarding delivery dates and information about system interactions, "better information flow between the parties to avoid coordination failures" is enabled (Mayer and Argyre, 2004, p404). Exchanging parties facilitate coordination through enhancing the predictability of each party's actions and structuring communication flows (Galbraith, 1977, Gulati and Sytch, 2005). Therefore, contracts serve to effectively pool and integrate resources, divide established labor, and channel specified communication. Only a contract can protect and facilitate exchanges, especially in IS outsourcing projects, and provide technological support to client firm.

Third, Goo et al. (2009) identified three characteristics of formal contracts. Among them, the foundation characteristics include provisions that specify key principles and agreements between the parties, key process owners and their roles and responsibilities, and target levels of product and service performance. The intent behind the provisions would help the service recipient and vendor to share common beliefs and understand objectives that initially created the relationship (Choudhury and Sabherwal, 2003, Koh et al. 2004). Thus the exchange relationship can build up on common goals and general commitments (Choudhury and Sabherwal, 2003). From the client's point of view, formal contracts facilitate the achievement of strategic goal and help the client to focus on the core business by formally specifying what service and expertise the vendor should provide.

To sum up, contractual governance is effective in achieving the three aspects of benefits of outsourcing projects essential to IS outsourcing success. This leads to our first hypothesis:

H1: Contractual governance positively influences IS outsourcing success.

3.2.2 Contractual Governance and Relational Continuity Expectation

Relational continuity expectation refers to the desire of exchange parties to accomplish long-term viability of their relationship (Jap and Anderson, 2003). Continuity expectation helps managers to know if their firms adopt a long time horizon, and accept to engage in activities that do not pay off quickly and with uncertainty (Williamson, 1993). When participant parties expect that the relationship will continue into the future, they will engage in processes and make investments to enhance the relationship into the long run (Anderson and Weitz, 1989, Jap and Anderson, 2003).

Contractual governance is expected to be beneficial to relational continuity expectation based on two reasons:

First, contractual governance may reduce opportunistic behaviors, anticipate future uncertainty, and protect the relationship. By placing limits on the actions of service vendor and enhancing monitoring, contractual governance mitigates potential opportunistic behavior, constraining subsequent ability of the vendor to extract additional rents from the client by failing to perform as agreed (Williamson, 1985). A legal contract may state how various situations will be handled (Lusch and Brown, 1996) and ensure that the terms of transactions will be enforceable (Ring and Van de Ven, 1992). Thus, through the establishment of contractual provisions which clearly articulate vendors' obligations, clarity is enhanced and uncertainty is reduced. Goo et al. (2009), demonstrated that the governance nature of contracts specifies ways to maintain relationships through a clear statement of measurements, penalty and incentives, exit options and responsibilities, and documented communication processes (including dispute resolutions).

Second, contractual governance may serve as a foundation for long-term and trusting relationships. The establishment of coordinating provisions outlines mutual expectations as well as delineates roles, rules, programs, and procedures that enable the joint endeavor to accomplish collective goals (Mayer and Argyres, 2004). Zucker (1986) pointed that contractual safeguards minimize costs arising from exchange hazards and help firms to build initial institutional trust. Thus, not only formal contracts are beneficial to short-term relationships by specifying the obligations and controlling undesired behavior, but also serve as a foundation for long-term and trusting relationship by coordinating future expectation (Ferguson et al., 2005). This leads to our second hypothesis:

H2: Contractual governance positively influences relational continuity expectation.

3.3 Relational Governance, IS Outsourcing Success and Relational Continuity Expectation

3.3.1 Relational Governance and IS outsourcing Success

Relational governance is an endogenous mechanism that can enhance exchange performance by embedding private and public information flows in a matrix of social ties rather than by resorting to contract or its enforcement by a third party, such as courts (Uzzi, 1999). The theoretical foundation of relational mechanism lies in SET (Homans, 1961, Blau, 1964, Emerson, 1972). Unlike economic exchange, social exchange stresses trust and reciprocal behaviors, rejects the assumption of universal opportunism and suggests relationship as an alternate form of governance.

Previous research has provided strong empirical evidence that relational governance leads to mitigation of opportunistic behavior (Achrol and Gundlach, 1999, Liu et al., 2008), net reduction of transaction cost (Artz, 1999), relational/exchange performance (Ferguson et al., 2005, Poppo and Zenger, 2002, Liu et al., 2008), trust and commitment (Goo et al., 2009), outsourcing performance (Handley and Benton, 2009), organizational performance (Cannon et al. 2000), and so on.

Thus, we expect that relational governance will also positively lead to IS outsourcing success.

First, according to SET, relational governance will formulate reciprocal expectations and enhance mutual adaptability. As discussed in literature chapter, relational exchanges promote norms of flexibility, solidarity, and information exchange. Flexibility refers to the joint expectation that both parties will be willing to make adaptations as circumstances change (Dwyer et al., 1987). Developing solidarity shifts the focus away from opportunistic behavior toward that which promotes a bilateral approach to problem solving, creating a commitment to joint action through mutual adjustment. Information exchange promotes cooperation and coordination and facilitates anticipation of each other's needs (Lusch and Brown, 1996).

Through the building of solidarity and information exchange norms, trust can be established and management and transaction cost can be reduced (Macaulay, 1963, Dore, 1983, Palay, 1984, Granovetter, 1985, 1992, Bradach and Eccles, 1989, Jones et al., 1997, Adler, 2001). Compared to formal contracts, governance emerging from values and agreed-upon processes found in social relationships (Macneil, 1978, 1980, Noordewier et al., 1990, Heide and John, 1992) may minimize transaction costs (Dyer 1996, Dyer and Singh, 1998). This benefits both parties with economic advantages.

Second, it is widely agreed that relational governance in interfirm cooperation encompasses relational norms and trust (Anderson and Narus, 1990, Heide and John, 1992, Luo, 2007). When trust and relational norms are developed, partners are more effective in improving communication, information flow, knowledge sharing, and solidarity (Brown et al., 1983, Hult et al., 2004). Research also demonstrates that mutual trust could foster learning and knowledge transferring (Lee and Cavusgil, 2006): (1) trust facilitates intensive interaction between individuals involved and aids in transfer and learning of complex and tacit know-how across the firms interface; (2) since knowledge exchange depends on the degree of openness and transparency between partners (Doz and Hamel, 1998) and suspicion decreases the willingness to share knowledge, mutual trust is important in reducing the fear of opportunistic behavior (Gulati, 1995, Zaheer et al., 1998) and reduce the protectionist constraint often imposed by partners (Kale et al., 2000); (3) mutual trust encourages partners to set up idiosyncratic knowledge-sharing routines to facilitate the learning of information and know-how (Dyer and Singh, 1998), and thus can accelerate knowledge transfer (Kale et al., 2000).

The mechanisms of relational exchange are believed to be beneficial to technological exchange and learning. Through this frequent information sharing, exchange partners could complete tasks, especially technical ones more effectively (Mohr and Speckman, 1994).

Third, from the client's view, as the relationship becomes more strategic, the types of information shared with the service vendor (long-term forecasts, information planning, and future product designs) often becomes more critical (Noordewier et al., 1990). This demands close collaboration and entails joint efforts. Common collaborative initiatives include joint problem resolution, continuous improvement (Cannon and Perreault, 1999, Heide and Miner, 1992), and mutual strategic planning (Dwyer et al., 1987, Helper et al., 2000). Thus, relational mechanisms furnish strategic flexibility and organizational agility, and are hence more conducive to success (Liu et al., 2008).

Therefore, relational mechanisms will positively influence outsourcing success. This leads to our third hypothesis:

H3: Relational governance positively influences IS outsourcing success.

3.3.2 Relational Governance and Relational Continuity Expectation

Relational norms generally direct the focus of a service provider to a long-term orientation. Norms of flexibility influence the development of stability in relationships as it encourages adjustments when disturbances due to technology and other environmental changes occur. Norms of solidarity shift the focus of each party from self-centered behaviors to behaviors that foster unity arising from common responsibilities and interests. The relational value of solidarity figures prominently in promoting exchange into the future. It ensures a "keep on with it" attitude such that each party desires to and is able to be involved with the other (Jap and Ganesan, 2000, Goo et al., 2009).

Heide and Miner (1992) highlighted the close relationship between expectations of future interaction and cooperative behavior. Poppo and Zenger (2002) asserted that the expectations of continuity that accompany relational mechanism generate incentives for specific investments. Literature on social exchange points to the role of future expectation in determining long-term survival of relationship. Relational mechanisms focus on the roles of social interactions and socially embedded relations (Granovetter, 1985). Thus in a relational relationship, exchanging parties may bank more on trust, commitment, cooperation, satisfaction, and relational norms than written laws (Heide and John, 1992). These relational norms are the grounds for developing shared goals, flexibility, mutuality, toleration, and other social patterns that guide relationships (Black, 1998, Kaufmann and Stern, 1988). There is general agreement that these norms describe appropriate behavioral guidelines that enforce social obligation in the exchange (Heide, 1994, Heide and John, 1992), which increase commitment of the parties to maintain cooperative relationship (Seabright et al., 1992, Liu et al., 2008). Therefore relational mechanisms could enhance relational continuity expectation based on trust and long-term commitment.This leads to another hypothesis:

H4: Relational governance positively influences relational continuity expectation.

3.4 IS Outsourcing Success and Relational Continuity Expectation

Ring and Van de Ven (1994) proposed that a decision to continue an interfirm relationship is based on an assessment of economic efficiency and fairness of past transactions. They suggested that the parties in a cooperative long-term relationship are motivated to seek both equity and efficiency outcomes. Exchanging parties will continue with or expand mutual commitments executed in an efficient and equitable manner. Fornell (1994) examined customer satisfaction on a continual basis and found that loyalty is caused by a combination of satisfaction and switching barriers. He found that companies are highly dependent on customer satisfaction for repeated business in those industries where switching barriers are less powerful. Accordingly, literature stressed the importance of current project success, which can be an important determinant of decisions for future collaboration. This leads to our fifth hypothesis:

H5: There is a positive relationship between IS outsourcing success and relational continuity expectation.

3.5 Institutional Framework and Governance Mechanisms

3.5.1 Institutional Framework

Institutional framework is defined as the set of fundamental political, social, and legal ground rules that establish the basis for production, exchange, and distribution (Davis and North, 1971, p.6). Studies found that where formal constraints fail, informal constraints will come into play (North, 1990, Powell, 1990, Scott, 1987, 1992, Zucker, 1987).

In China's transition economies, the most notable change in formal constraints is the weakening and replacement of central planning regime by more market-based transactions to facilitate economic exchange (Brus and Laski, 1989, Naughton, 1994). However, necessary formal constraints of current scheme are not yet fully developed (Clarke, 1991, Litwack, 1991). For instance, a well-defined property rights based legal system is not properly enforced and firms may be threatened by illegal use of their brands and products. As a result, informal constraints play a larger role in regulating economic exchanges during the transition (North, 1990) and have considerable influence over the behavior of individuals and firms.

3.5.2 Relative Strength of Governance Mechanisms

We propose that under a transition economy, relational governance may have higher impact on outsourcing success and relational continuity than contractual governance based on two reasons. First, in line with the above institutional framework, several studies stressed the importance of interpersonal connections among the top management in both vendor and client firms to firm performance, which can compensate insufficient formal infrastructure in emerging economies (Xin and Pearce, 1996, Peng and Luo, 2000). In emerging markets where institutional and legal systems (including commercial and contractual laws) are undergoing drastic development, legal institutional support is weak and firms would have to rely more on informal constraints. Liu et al. (2008) elaborated that contingencies commonly arise after contract signing. In this case, highly stipulated contracts may lead to rigidity, thus discouraging or delimiting partner's initiatives and commitments for seeking and gaining from new business opportunities.

Second, even in developed markets, contractual governance is not without its limits. Researchers posited that strict adherence to written contract may preclude the necessary flexibility in an exchange, and signify a transaction-oriented approach and an adversarial relationship (Gundlach and Achrol, 1993). On the other hand, relational governance in interfirm cooperation encompasses common values and trust, informational exchange, solidarity, and participation (Anderson and Naurs, 1990, Heide and John, 1992, Luo, 2007). In conclusion, relational governance is expected to play a greater role than contractual mechanism in governing established interfirm exchanges, enhancing outsourcing performance, and extending exchange relationship into long term collaboration. Consequently another two hypotheses are proposed:

H6: Contractual governance has weaker impact on IS outsourcing success than relational governance.

H7: Contractual governance has weaker impact on relational continuity expectation than relational governance.

3.5.3 Contingent Effects of Institutional Framework on Governance Mechanisms

The institutional framework could not only explain the relative effectiveness of contractual governance and relational governance on relational outcomes, but also can help to provide valuable rationality differentiating different firms' governing behaviors in emerging economies. Based on prior studies, we propose that governance mechanisms would be dependent on firm type in China's transition economies.

Literature shows that governance effectiveness of contractual and relational mechanisms is not context-free (Jap and Anderson, 2003). Researchers pointed out that firms are embedded in institutional contexts and may not have the same values for all firms. Peng and Luo (2000) found that diversity of Chinese organizations suggests that not all senior managers are interested in all types of ties (such as interpersonal ties with government officials and with managers of other firms) and that not all managerial ties are equally beneficial to a firm. As a result, theoretically, it is important to recognize heterogeneity among firms, which suggests the usefulness of taking a contingency perspective in trying to capture the influence of institutional framework.

SOEs and non-SOEs differ in their behaviors and performance (Peng and Luo, 2000). Founded by the government or its agencies, SOEs have lost a lot of privileges during the transition change, but have maintained relatively easier access to government officials compared to non-SOEs. Typical government-appointed senior managers from these established firms lack necessary concern for efficiency, with incentive structures not directly linked to performance due to "soft budget constraints" (Boisot and Child, 1988, Jensen and Meekling, 1976, Lu, 1996). In contrast, non-SOEs (private firms, foreign-invested firms, and collective firms) initially suffer from lack of legitimacy as new organizations (Aldrich and Fiol, 1994).

Previous studies have identified that the more uncertain the environment is, the more likely the informal interpersonal ties will be mobilized (Pfeffer and Salancik, 1978). Two kinds of relationship ties, namely relationships with government and relationship with other firms exist (Peng and Luo, 2000). They advocated that SOEs and non-SOEs have different initial relationships and thus their incentives to further build the relationship are different.

Legitimacy, support, and protection from the government agencies that have founded them naturally define SOEs. In contrast, non-SOEs suffer insufficient support and lack of market legitimacy, placing them in a relatively weak position within the institutional environment (Nee, 1992). As a result, senior managers from these established SOEs may endure longer time to develop relationship networks even among themselves, and thus may be less motivated to cultivate good relationship with other firms and government officials than managers of private firms (Jensen and Meekling, 1976). While top executives at non-SOE firms may have stronger urge to improve their relationship to compensate for their liability of newness. Such incentives may be especially powerful in a transition economy which lack formal institutional support for non-SOEs (Peng, 1997, Xin and Pearce, 1996). As contractual governance relies on legitimacy to take effect, non-SOEs will not expect much on the contracts to provide protection. One senior manager of an electronic SOE remarked that no firms in China would bring contractual dispute to court. However, if legal means is the only solution to ease conflict, his firm's connections with various government departments will elicit courtroom advantages. On the other hand, most non-SOE senior managers admitted that the effectiveness of formal contracts is very limited. Accordingly, non-SOEs will take more incentives to use relationship network (guanxi) to compensate for the weak support of formal institutions. We propose that:

H8: The positive relationship between contractual governance and IS outsourcing success will be stronger in SOEs than in non-SOEs.

H9: The positive relationship between relational governance and IS outsourcing success will be stronger in non-SOEs than in SOEs.

3.5.4 Contingent Effects of Institutional Framework on Relationship between Outsourcing Success and Relational Continuity Expectation

The relationship between outsourcing success and relational continuity expectation is also predicted to be different according to ownership types. Non-SOEs are found to have strong incentives to improve guanxi to better adapt to changing environment. Senior managers in these firms may have a strong desire to search for better performance, and their incentive structures is linked with it. They may not easily give up a cooperative relationship, especially a successful one. On the other hand, senior executives at SOEs, which may still likely to be appointed by the China government, may be less constrained by budgets, and their incentive structures are not directly aligned with performance (Jensen and Meekling, 1976, Peng and Luo, 1998). We propose then that the performance-driven attitude of non-SOEs will lead to a stronger relationship between outsourcing success and relational continuity than SOEs.

H10: The positive relationship between IS outsourcing success and relational continuity will be stronger in non-SOEs than in SOEs.

3.6 Control Variables

Several control variables that could influence outsourcing success and relational continuity expectation are examined. Two project characteristics that are often thought to influence outsourcing success, project type and project size was controlled following Koh et al. (2004). We also controlled three firm level characteristics that may affect relational continuity expectation: relationship age, firm size, and industry (Fugerson et al., 2005, Poppo and Zenger, 2002).

3.7 Chapter Summary

In this chapter, the research model was presented and hypotheses were proposed. The rationale behind the links among two governance mechanisms and two outcomes were discussed and explained. The contingent effects of firm types on the relationships between governance mechanisms and outsourcing success based on the theory of institutions were also demonstrated. In the next chapter, research methodology will be discussed.

CHAPTER 4 RESEARCH METHODOLOGY

This chapter describes the research design, methodology, and procedure. Setting, participants, unit analysis, data collection procedures, measures, and analytical strategies are highlighted. Scholars pointed that any particular data source or single research method may suffer from inherent limitation or bias. Disadvantages of single methodology are believed to be mitigated when multiple data sources or research methods are combined (Creswell, 1994). Due to the lack of existing understanding and the complexity of the phenomenon of interest, a multiple research method called triangulation was adopted (Creswell, 1994). Triangulation provides opportunities for researcher to seek convergence of results and to observe overlapping and different facets of a phenomenon that emerge from multiple sources (Creswell, 1994). Furthermore, triangulation adds scope and breadth to the study; hence the combination of case studies and survey research herein.

4. 1 Case Studies

A case study methodology was chosen for two reasons (Creswell, 1994, Yin, 1993, 1994). First, there have previously been few empirical studies on knowledge in governance mechanisms and outsourcing relationships in transition economy, and as Dibbern et al. (2004 p68) pointed out "… the theoretical maturity of explaining the building and management of relationships is still quite low." Second, since the proposal of alternative and complementary theoretical lens (i.e., institutional framework), there is a need to explore and describe outsourcing relationship governance in a deeper way and greater detail to provide preliminary evidence for the study.

Only four case studies were conducted due to the scale of phenomenon of interest and resource constraints. Theoretical sampling method for research design (an approach focusing efforts on theoretically useful cases that can highlight, replicate, and/or extend the theory) was used (Eisenhardt, 1989b).

In April 2008, four organizations in China that have been involved in outsourcing relationships for several years were selected for on-site interviews, with CIO (or vice general manager) and project manager as resource persons. Based on several open-ended questions (chosen from Table 4.1), each interview lasted for about 45 to 60 minutes, providing preliminary evidence to support proposed theory. Findings from the case studies are reported below based on three perspectives.

Table 4.1 Interview Questions

Related Construct	Interview Questions	Potential Respondents
General Descriptive	Please describe your role in your firm? To whom do you report to?	All
Contractual Governance	What kind of contract has been signed? 1.Contract Length, 2. Type (Time and materials; Fixed Price; Mixture; Contracted Service Level) What would you do with the future uncertainties? What do you think should include in the contractual governance of the relationship? How important is contractual governance to you?	Top IT executive and IT project manager of focal firm
Relational Governance	How this service vendor is selected? How long have you cooperated? How is the relationship developed? What do you think should include in the relational governance of the relationship? How important is relational governance to you?	Top IT executive and IT project manager of focal firm
IS Outsourcing Success	How do you define outsourcing success? Is this project success? Which kind of governance mechanisms is more important for outsourcing success? Why?	Top IT executive and IT project manager of focal firm
Relational Continuity Expectation	How do you define relational continuity expectation? Would you want to continue the cooperative relationship after the project? Why? Which kind of governance mechanisms is more important for relational continuity expectation? Why?	Top IT executive of focal firm
Institutional Framework in Transition Economies	How do you feel that the institutional environments' role in supporting your firm? How do you believe in the legal systems' role in protecting the rights of your firms?	Top IT executive of focal firm

Table 4.2 Interviewed Firms Information

Company Name	Types	Industries	Information Intensive (Yes/No)	Employees/ IT Employees	Outsourced Systems	Contracts	Length of Deal (Years)	Years of Relationship
Firm A	Private	Manufacturing	No.	3000/12	Manufacturing Support System	Time and Material; Short-term Contracts	2	2
Firm B	Share-holding	Wholesale	No.	350/4	Financial Management System	Service Level Contracts; Medium-Term Contracts	2	1.5
Firm C	SOEs	Banking	Yes	10000/80	Credit Card Management System	Fixed Term and Fixed Price; Long term Contracts	4	2
Firm D	SOEs	Manufacturing	No	5500/19	Enterprise Resource Planning System	Service Level Contracts; Long-term Contracts	5	3

Table 4.3 Governance Mechanisms and its Influences

Firm	Major Contractual Governance	Major Relational Governance	Importance of RG/CG to OS/RC [a]	Factors Leads to Outsourcing Success	Factors Leads to Relational Continuity Expectation
A	1. Service level; 2. Assets and Staff; 3. Pricing.	1. Establish of collaborative task groups; 2. Norms of conflict resolution; 3. Joint problem solving mechanisms; 4. Good communication.	CG to OS : 1[b] RG to OS : 5 CG to RC : 1 RG to RC : 2	1. Cooperative relationships with vendors; 2. Vendor's capabilities.	1. Strategic goals and plan; 2. IT Needs.
B	1. Service level or product; 2. Pricing; 3. Assets and staff transfers.	1. Social exchanges; 2. Good communications and information sharing; 3. Cooperation.	CG to OS : 2 RG to OS : 4 CG to RC : 2 RG to RC : 4	1. Selecting the appropriate vendor; 2. Relationship management of functional departments and the vendors; 3. Relationship management of IT departments and vendor staff.	1. Relationship; 2. Performance of previous outsourcing projects; 3. IT Needs.
C	1.Security issues; 2.Software patent ownership; 3.Financial matters and pricing; 4. Information exchanges; 5. Assessment and quality reports /documents.	1. Opening in information and knowledge sharing; 2. Trust and commitment; 3. Joint conflict solving.	CG to OS : 4 RG to OS : 4 CG to RC : 1 RG to RC : 2	1. IT vendor' capabilities; 2. Communications' between internal IT staff with IT vendor's staff; 3. Vendor performance control.	1. Strategic goals and plan; 2. IT departments capabilities; 3. Vendor capabilities.
D	1.Service exchanges; 2.Regular meetings; 3.Financial matters and pricing; 4. Quality reports; 5. Uncertainty control.	1. Cooperative attitudes; 2. Trust and commitment; 3. Good communications; 4. Joint problem resolution; 5. Mutual decision making.	CG to OS : 5 RG to OS : 4 CG to RC : 2 RG to RC : 4	1. Management and monitor vendor performance; 2. Communications and relationships with vendor's; 3. Cost control; 4. Uncertainty control.	1. Relationship; 2. Performance; 3. Strategic planning.

a. RG= Relational governance, CG=Contractual governance, OS=Outsourcing success, RC=Relational Continuity.

b. XX to XX: 1-5. The influence of XX to XX. 1-5 = From not at all important to very important.

4.1.1 Contractual Governance and its Influences on IS Outsourcing Success

Sources stated that contractual governance may include definitions of services levels or products quality, financial matters and pricing terms, regular cost reports, assets and/or staff transfer mechanisms, regular meetings and information exchanges, evaluation criteria or quality assessments reports, and awards or punishment terms. Firm D defined sub-staged contract, specifying how results of a previous stage affect contract of the next.

It seems that non-SOEs (firms A and B) do not deem contractual governance as important mechanism to project success, as opposed to SOEs firms. Reasons may lie in the institutional environments and previous experiences. Top IT manager of Firm B said:

> *"The contract works as a basis for the outsourcing relationship, it is necessary and important. We take it seriously and try to specify the detailed service level and functions, the awards and penalties. However, sometimes, I think the contract is just a piece of paper. You know where we are. Here in China the legal system is very immature and unhealthy. It is a place you really don't want to spend your time to go to the court. If you want to win a lawsuit, you have to cultivate relationships with the judges. Instead of wasting our time and money on the lawsuits, why not invest these energies on the relationships with the vendor.*
>
> *It is not the only reason. You know that the outsourcing projects are very complicated, and it is impossible to capture all the future contingencies and the working processes in the contract. So as for me, I will be serious with contracts, but the relationship is more important."*

Mr. Liang, the vice general manager of Firm A was even pessimistic toward contracts, recalling a "bitter memory" with a main distributor who owed the firm a large sum of money. After winning a costly lawsuit, they were disappointed at its enforcement, not being able to recover anything. The terrible experience made him comment:

> *"You'd better never conduct a suit in China, because you will never win.*

Only the court and the judge can win. You can find that all you get is a waste your time, efforts, and money."

For these reason, managers said that they pay more attention to vendor (partner) selection and relationship development.

On the other hand, all four SOEs managers are more positive toward contractual governance, treating it as important as relational governance. The CIO of Firm D even regarded contracts as the most important mechanism in business. According to Mr. Sun, a bank manager:

> *"We have various IT projects with different service vendors. Only one of our vendors is a US firm, others are all native companies. We have found out that the American firm emphasizes a lot on the standardization of the interaction process. Especially, they insisted that we document the requirements and needs of the outsourced software, the service level, etc. It is really hard for us at the beginning, because you know, for the accountant, the customer service staff, or even our IT staff, it is difficult to express the abstract idea in their head in an understandable way. It takes a lot of efforts to do, communications and discussions, among staff in various departments. But later on, we found that the cooperation appears to be very smooth and we are satisfied with their service.*
>
> *The native service providers act in a totally different style. Sometimes what we need is too abstract to be documented and defined. In these cases, the American firm will not accept our projects, while many native firms will accept. The native companies are more flexible and would like to help us to develop the systems under these uncertainties. However, sometimes what they deliver are too far away from what we expected. We asked them to change and revise. But they would argue that they developed all the functions exactly according to our directions. These will cause us a lot of trouble. Now we realize that the importance of documentation our request and standardization in the procedure. It will be a trend to be standardized. We will pay more attention to this process especially when collaborate with native vendors."*

The results are consistent with our argument on institutional framework. Managers of non-SOEs felt that they are not protected or supported by institutions, while managers of SOEs are more optimistic toward contracts.

4.1.2 Relational Governance and its Influences on Outsourcing Success

While managers seem inconsistent in their views on contractual governance, their notions on relationship are more identical. Most of them agreed on the importance of relationships toward outsourcing projects. Project managers of Firm B said:

> *"We found that although services were delivered according to agreement, in many cases they can't satisfy user requirement. Every transaction needs a contract, however, things that matters in outsourcing process are relationships and social exchanges which are difficult to track in a contract."*

Relational governance mechanisms could be summarized as: meetings of managers for shared decision making and goal sharing; personnel connections development and trust building through information/knowledge sharing; establishment of collaborative task groups and committees; norms of conflict resolution and joint problem solving mechanisms; and good communications at both the interpersonal, technical and business level. Among these, they emphasized information sharing, trust and commitment, cooperation, and conflict solving as most important to a successful client-vendor relationship.

They found that information exchanges involve both formal and informal mechanisms. IT project manager in Firm A defined information sharing and communication as key operational effectiveness measures in outsourcing relationships. Exchanges include contractually agreed mechanisms such as regular meetings and report exchanges (service performance reports, accounts, payment schedules, change requests) and informal exchanges such as day-to-day interactions and operations. CIO of Firm C shared his opinion on information sharing:

"It is better both parties can tell the other party what happened in its parts. There is no way to have a good relationship unless both parties are open with each other. Information sharing help you know the vendor more and ensure that you've got a supplier who tries hard to understand your tasks."

On the other hand, many of them stressed cooperation and joint problem solving based on trust and commitment. When a problem occurred in outsourcing projects, two parties should be working toward a common goal and if they don't trust each other they are going to miss whatever the contract says. Conjoint efforts should be focused on solving the problem instead of blaming the wrong party. Without co-operation, parties would surely evolve toward an adversarial relationship, and disputes or conflicts would be very difficult to resolve.

Most of managers mentioned that guanxi in China as a dominant force. According to Mr. Zhang, senior IT manager of Firm A:

"It is a tradition in China to stress guanxi, at home, at school and here at your work place. Everyone likes being respected, being treated good. You do others good, and they will do you good. I always encourage young fellows in my team to be good to the IT staff of vendors, be patient when answering their questions, tell them if you know what they want to know, only when what you say will harm our own firm. All my colleagues founds that the collaboration is very smooth and their service are satisfactory till now."

However, good relationship and guanxi do not grow overnight. Nearly all managers agree that relationship building is slow and tedious, not instant, beginning quite formally with detailed transactional exchange. During the process, through frequent information and knowledge sharing, two-way communications, and joint problem solving, trust and commitment will be established gradually.

Since managers of both SOEs and non-SOEs regard relationship as an important mechanism to outsourcing performance, and most rate the influence of relational governance on outsourcing success high, it would be hard to identify the real impact of firm types on relationships. Managers of non-SOEs do not give contracts the same value as relational governance. Understandably, non-SOEs may have more reasons to build and develop relationships with the vendor.

4.1.3 Governance Mechanisms and Relational Continuity Expectation

There are roughly two views on the relationship between governance mechanisms and relational continuity expectation. One opinion (held by managers in Firms A and C) is that both contractual and relational governance mechanisms are not important to relational continuity expectation, or at least do not have much direct impact on it. The CIO of Firm A said:

> *"As for the future collaboration, it is more related to our own plan and strategic development. For us, after installment of this production assistant system, we will have no needs for any other IT systems in recent years. So relationships with vendor, how successful or good performance of the vendor, are important, but only our plan will decide."*

On the other hand, IT executives in Firms B and D believe governance mechanisms, especially relational governance, will be an influential factor. They are consistent in the view that relationship rather than contracts are more related to continuous collaborations. They agree that good relationship and satisfactory outsourcing performance will make the exchange collaboration a pleasant experience, and the vendor who is more likely to become a partner will be chosen once a chance to co-operate is seen.

4.1.4 Case Studies Summary

The interviews with CIOs and managers of these four firms provided some preliminary evidence of the relationship among governance mechanisms, outsourcing success, and relational continuity expectation. First of all, though executives in SOEs and non-SOEs believe both contracts and relationships are necessary for an outsourcing exchange, it seems that they have different views on direct influences such mechanisms have on outsourcing success. SOE managers think contracts are important and outsourcing interaction process should be standardized, while non-SOE managers who have had bad experiences choose to neglect it and focus on relationship building and management. On the other hand, no strong support can be found that non-SOEs and SOEs regard relational governance differently, only that non-SOEs may have stronger urge to build relationships as it is their only effective choice. Last but not least, the case study also indicates that the link between governance mechanisms and relational continuity may relate to relationship rather than contracts. In the sections that follow, proposed research model is further tested using survey methodology.

4.2 Survey

A questionnaire survey method was also used for establishing generalizability. The use of statistical methods in analyzing data makes result of the study reliable and useful for many firms.

4.2.1 Questionnaire Design

A questionnaire was designed for data collection. As respondent-friendly questionnaire is critical in achieving high response rate, the steps suggested by researcher (Dillman, 1978) are as follow:

- Bilingual version in both English and Chinese to avoid language barrier;
- Careful design and pilot testing of the instruments;
- Careful wording of the cover letter.

Since most measurements were developed from western studies, it was necessary to seek comments from practitioners to verify that respondents would understand the items and that the questionnaire was appropriate in Chinese context. Three IS managers were interviewed and wordings and format refinements to the instrument were made based on their comments.

4.2.2 Unit Analysis and Respondents

IS outsourcing projects were used as unit of analysis for this study. Following previous studies in IS and strategic management (e.g., Grover et al., 1996, Koh et al., 2004, Poppo and Zenger, 2002), only top IS executives or chief information officers (CIOs) were required as participants. Only when multiple projects from a client firm were surveyed were project managers assigned to fill in the questionnaires. In such case, we asked top IS executives to make sure no two projects were with the same vendor.

4.2.3 Sampling Framework

Due to the difficulty of deriving samples representative of China as a whole (Roy et al., 2001), data collection was conducted in three areas: Shandong and Sichuan Province and Shanghai municipality. These areas were chosen first because of their geographic size and GDP rank (2007 top 10). Their location was also properly considered; Shandong is a northern province with coastal and inland cities, Sichuan is an inland province found in central southern China, while Shanghai is totally a coastal southern city. Third and most importantly, none of them belong to Special Economic Zone, where special government policies influence development of transition economies. Firms in these provinces are believed to be representatives of emerging economies.

We collaborated with three renowned universities in these areas for data collection. Colleagues and students in the three universities helped in distributing questionnaires to prospective respondents. Around 200 questionnaires were distributed in Shandong and Sichuan provinces and 150 in Shanghai municipality. With 249 questionnaires collected, response rate is around 46 percent. Among them, 187 from 171 firms are usable.

4.3 Non-Response Bias

We tested the non-response bias by the method suggested by Armstrong and Overton (1977). That is, the Chi-square of the measurement items of the responses from the first 25 percent of the respondents was compared with that of the final 25 percent. We also compared the possible differences in firm ownership type, firm size, industry sector, as well as project size and relationship longevity within these two groups of samples. Our results indicate no significant differences between these two groups on key measures and these demographic data. Therefore, non-response bias is considered not to be a problem for this study.

4.4 Common Method Bias

Since all data were perceptual and collected from a single source at the same time, common method bias might be a threat to the validity of our research. To test possibility of common method bias, Harman's one-factor test on questionnaire measurement items was used (Podsakoff and Organ, 1986). Resulting principal components factor analysis yielded four factors with eigenvalues greater than 1.0 and accounted for 64.8 percent variance. The first of these four factors accounted for 27.2 percent of total variance. We also followed the recommendation of Padsakoff et al. (2003) and the procedure used by Liang et al. (2007), adding a common method factor to PLS model. Indicators were associated reflectively with method factor. Then, we calculated each indicator’s variance explained by the principle elements and method factor. The results (Appendix B) demonstrate that the average substantively explained variance for indicators is 0.711, while the common method variance is only 0.004. Furthermore, most method factor loadings except CG1 are not significant. The above evidence suggests that the common method bias is not a significant issue in this study.

4. 5 Constructs Operationalization

Multi-item scales were used to operationalize variables except for control ones. These items were obtained largely from past research, modifying some to suit this study's context. All perceptual items were measured by seven-point Likert scale ranging from "strongly disagree" to "strongly agree."

4.5.1 Contractual Governance

Contractual governance is precisely and rigidly administering substantive and remedial rules of control. Previous studies measures contractual governance using different measurement constructs. Examples are contractual/contract-based governance (Ferguson et al., 2005, Lee and Cavusgil, 2006), legal bonds (Cannon et al., 2000), legal contract (Cai et al., 2008), formal contracts (Cavusgil et al., 2004), contract (Liu et al., 2008), and formal governance (Hoetker and Mellewigt, 2009). Poppo and Zenger (2002) measured it as contractual complexity with a one-factor measurement, while Handley and Benton (2009) measured it as contractual completeness with a six-item measurement.

In this study, three items to measure contractual governance obtained from Cannon et al. (2000) and Ferguson et al. (2005) were adopted: (1) Our relationship with the vendor is governed primarily by rules and regulations of contracts; (2) We have formal agreements that detail the obligations of both parties; (3) A satisfactory solution to a disagreement would be found, whether it is based on a formal agreement or not.

4.5.2 Relational Governance

Relational governance refers to an endogenous mechanism that can enhance exchange performance by embedding private and public information flows in a matrix of social ties rather than by resorting to contract. In this study, we view relational governance as a composite factor with the following underlying norms and dimensions: open communication and sharing of information, trust, dependence, and cooperation. The specification is consistent with previous studies (Anderson and Narus, 1990, Macneil, 1978, Poppo and Zenger, 2002).

Adapted from Poppo and Zenger (2002), three factors modified from these empirical studies were used to measure relational governance: (1) An extremely collaborative relationship exists with the vendor; (2) We share long- and short-term goals and plans with the vendor; and (3) The vendor can be relied on to keep promises.

4.5.3 IS Outsourcing Success

Success is one of the IS outsourcing outcomes, defined as the satisfaction with strategic, technological and economic outsourcing benefits (Dibbern et al., 2004). In particular, success was evaluated as the extent to which the vendor contributes to the following factors (Grover et al., 1996, p. 98): (1) focusing on core business; (2) increased IS competence; (3) increased access to skilled personnel; (4) economies of scale in human and technological resources; (5) controlling of IS expenses; (6) voidance of obsolescence risk; and (7) increased access to key information technologies. Lee and Kim (1999) extended the business success measures of Grover et al. (1996) by adding perceptions of the users along with overall business success. Generally, IS outsourcing success refers to outsourcing benefits from different aspects. In the current study, multiple-item perceptual scales taken from Grover et al. (1996) and Lee and

Kim (1999) were used.

4.5.4 Relational Continuity Expectation

Relational continuity expectation refers to the exchange parties' perspective of long-term viability of relationship. Three factors measure were adapted from Jap and Anderson (2003) and Jap (2001): (1) Our relationship with the vendor will last far into the future; (2) We and the vendor expect to continue working with each other on a long-term basis; (3) We and the vendor would welcome the possibility of additional collaboration in the future. Table 4.4 displayed the measurement items and references of the main constructs in the study.

Table 4.4 Measures of Main Constructs

Constructs	Measurement Items	References
Contractual Governance	• Our relationship with the vendor is governed primarily by rules and regulations of contracts. • We have formal agreements that detail the obligations of both parties. • We would find satisfactory solution to disagreement, whether it is based on agreement or not. (R)a	Cannon et al. (2000); Ferguson et al. (2005).
Relational Governance	• We have an extremely collaborative relationship with the vendor. • We share long- and short-term goals and plans with the vendor. • We can rely on the vendor to keep promises.	Poppo and Zenger (2002).
Outsourcing Success	We have • …been able to refocus on core business. • …increased our IS competence. • …increased the access to the skilled personnel. • …enhanced economies of scale in human resources. • …been able to control IS expenses. • …reduced the risk of technological obsolescence. • …increased our access to key information technologies.	Grover et al. (1996); Lee and Kim (1999).
Relational Continuity Expectation	• Our relationship with the vendor will last far into future. • We and the vendor expect to continue working with each other on a long-term basis. • We and the vendor would welcome the possibility of additional collaboration in the future.	Jap and Anderson (2003); Jap (2000).

4.5.5 Control Variables

All five control variables use single-item measures. Following Koh et al. (2004), only two types of outsourcing project were classified (0=non-systems-development projects, 1= systems-development projects). Project size was measured by the contract amount. Relationship age was measured by the number of months that exchanging parties have collaborated. Number of employees was used as the measure of firm size. Industry was measured using categories from 1-4 (1= Banking, 2= Manufacturing, 3= Service, 4= others).

4. 6 Instruments Validation

The validity and reliability of the measurement will be tested.

4.6.1 Reliability

Since multiple items were used to measure a unidimensional construct, that is, reliability of the measurement, it is important to establish the same set of items measured in the same way each time they are used under the same conditions with the same subjects. Reliability is the extent to which a set of variables is consistent in what it measures, or simply put, the internal consistency of scale items.

Cronbach's coefficient alpha and composite reliability was used as the measure of construct reliability. Cronbach's alpha is a direct function of both the number of items as well as their intercorrelation. It is calculated according to the following formula (Nunnaly 1978):

Cronbach's alpha $= (K/K\text{-}1) \times \{(S_T^2 - \sum S_I^2)/ S_T^2\}$

Where K= the number of items.

S_T^2 *= the total variance of the sum of the items*

S_I^2 *= the total variance of the an individual item*

On the other hand, composite reliability is a measure of internal consistency of the construct indicators and depicts the degree to which indicators indicate common latent construct. To calculate composite reliability, information on the indicator loadings and error variances are used from measurement models (Diamantopoulous and Siguaw, 2000). The formula for composite reliability is as follows (Diamantopoulous and Siguaw, 2000).

$$\rho_c = (\sum\lambda)^2 / [(\sum\lambda)^2 + (\sum\theta)]$$

where, λ represents the standardized indicator loadings;

θ is the indicator error variance, calculated as $1-(\lambda)^2$

In social science research, a Cronbach's alpha of .70 or higher is considered to indicate an acceptable level of internal consistency (Nunnaly, 1978). A commonly accepted threshold value for composite reliability is also 0.70.

Next, construct validity is examined. Survey instrument was checked for following types of validity: content and construct validity, which includes convergent and discriminant validity.

4.6.2 Content Validity

Content validity is the degree to which the instrument looks or appears to measure the intended content area regarding its representativeness or sampling adequacy.

Given most of the measurements of constructs used in this study were obtained from previous studies, content validity was tested using previous researchers' gauges. However, since those constructs, mostly developed in western countries, was used in a different environment setting, it was important to ensure that the measures of those constructs were correctly translated to Chinese and understandable by Chinese scholars and practitioners. Therefore, to assess content validity of the measurement, experts were asked to review instruments of pretest. Five Chinese IS managers and three Chinese IS scholars were interviewed and their comments were incorporated to refine the Chinese version of questionnaire and content validity.

4.6.3 Construct Validity

Construct validity testifies how well results obtained from the use of the measure fit the theories around which the test is designed. This is assessed through convergent and discriminant validity.

Convergent validity is the degree to which an operation is similar to (converges on) other operations that it theoretically should also be similar to. Convergent validity criteria require one single latent variable underlying a set of measurement items. To establish convergent validity, measures that should be related are in reality related.

Discriminant validity describes the degree to which operationalization is not similar to (diverges from) other operationalizations that it theoretically should not be similar to (Campbell and Fiske, 1959). A successful evaluation of discriminant validity shows that a test of concept is not highly correlated with other tests designed to theoretically measure different concepts. Discriminant and convergent validity are two good ways to measure construct validity.

Average variance extracted was proposed by Fornell and Larker (1981) as a measure of shared or common variance in a latent variable (LV), the amount of variance captured by LV in relation to its measurement error (Dillon and Goldstein, 1984). In different terms, AVE is a measure of the error-free variance of a set of items. It was indicated by Fornell and Larker (1981) that AVE can be used as measure of convergent and discriminant validity. The AVE formula for X with indicators x_1, x_2, ... , x_n is:

$AVE = \Sigma[\lambda i^2] Var(X) / \Sigma[\lambda i^2] Var(X) + \Sigma[Var(\varepsilon_i)]$

where λi is the loading of xi on X;

Var denotes variance;

ε_i is the measurement error of x_i, and Σ denotes a sum.

A rule for assessing discriminant validity requires that the square root of AVE be larger than all the inter-construct correlations (Chin, 1998). To further assess validity of measurement instruments, a cross loading table was also helpful. It requires that each item loading is higher on its principal construct than on the other constructs and the cross loading differences higher than the suggested threshold of 0.1 (Gefen and Straub, 2005).

4.7 Statistical Analysis

Data were coded and entered in the computer using the statistical package for SPSS 14.0 and PLS-Graph 3.5.

The model was tested by the statistical method of structural equation modelling (SEM). The component-based SEM software, partial least square (PLS), will be chosen to test the research model for several reasons. First of all, PLS is a robust second-generation multivariate technique that is recommended for causal-predictive analysis for highly complex predictive models (Chin, 1998,). The research model is complicated, hence suitable for PLS. Second, PLS makes no prior distributional assumption about the data and is a good approach for testing structural models when the sample size is limited. Hence, PLS is appropriate. Third, PLS estimation technique is simpler and faster in calculating parameter estimates and therefore has procedural advantages over a covariance-based method (Dibbern, 2004).

4.8 Chapter Summary

Using case studies and survey methods, this chapter illustrated how each of the two methods incorporated in this research were designed and developed. For survey methods, issues such as questionnaire design, unit analysis and respondents, sample framework, non-response bias, common method bias, construct operationalization, instrument validation, and statistical analysis were discussed. The next chapter will guide us to the analysis and results section.

CHAPTER 5 ANALYSIS AND RESULTS

This chapter reports data analysis results. First, measurement model, validity, and reliability of measurement were tested. Second, a full sample model was tested to examine the relationships of governance mechanisms and their effectiveness on outsourcing success and relational continuity expectation—the relative strength of governances' effect on the two outcomes. The structural model for SOEs and non-SOEs were compared to test hypotheses that the optimal configuration of contractual and relational governance mechanisms in outsourcing relationship is contingent on the types of ownership of firms. Last, we tested and analyzed the potential mediation effects for all SOEs and non-SOEs samples.

5.1Demography of the Respondents

Demography of samples is shown in Table 5.1.

The composition of respondents is satisfactory, as more than 80 percent are vice presidents, chief information officer, top executive IS managers, and project managers.

Table 5.1 Demography of Samples

	Full Sample[a] (n=187) %	SOEs[a] (n=105) %	Non-SOEs[a] (n=82) %
Respondents[b]			
VP, CIO or Top IS Executives	84.2	80.1	88.3
IS Project Managers	7.5	12.4	2.6
Others	6.0	7.5	9.1
Industry Sectors			
Commerce	30.2	25	19.7
Manufacturing	17.3	19.1	20.9
Service	41.3	45.4	49.5
Others	11.2	10.5	9.9
Firm Size (Number of employees)			
<200	25.5	24.8	26.4
200-499	34.2	34.3	34.1
500-2000	14.8	11.4	18.7
>2000	25.5	29.5	20.9
Relationship Longevity (Months)			
<12	23.5	22.9	24.2
12-24	18.9	13.3	25.3
25-60	46.4	46.7	46.2
>60	11.2	17.1	4.4
Project Size (Contract Amount: 10000US$)			
<10	42.3	50.5	33
10-100	46.9	36.2	59.3
>100	10.7	13.3	7.7

a. Figures are all percentage. b. VP=Vice president, CIO=Chief information officer.

5.2 The Measurement Model

5.2.1 Reliability

As discussed in Chapter 4, a Cronbach's alpha of .70 or higher is considered to indicate an acceptable level of internal consistency (Nunnaly, 1978). A commonly accepted threshold value for composite reliability is also 0.70. Values of Cronbach's alpha and composite reliability of all constructs pass the .70 threshold, indicating adequate reliability of construct measurement (Table 5.2).

Table 5.2 Composite Reliability and Cronbach's Alpha, AVE table.

Sample	Constructs	Composite Reliability	Cronbach's Alpha	AVE
Full Sample (n=182)	Contractual Governance (CG)	0.94	0.89	0.83
	Relational Governance (RG)	0.91	0.86	0.77
	IS Outsourcing Success (OS)	0.94	0.92	0.64
	Relational Continuity Expectation (RC)	0.93	0.90	0.82
SOEs (n=105)	Contractual Governance (CG)	0.93	0.89	0.82
	Relational Governance (RG)	0.92	0.86	0.78
	IS Outsourcing Success (OS)	0.95	0.93	0.65
	Relational Continuity Expectation (RC)	0.92	0.86	0.78
Non-SOEs (n=82)	Contractual Governance (CG)	0.94	0.88	0.83
	Relational Governance (RG)	0.90	0.85	0.75
	IS Outsourcing Success (OS)	0.94	0.91	0.64
	Relational Continuity Expectation (RC)	0.94	0.88	0.84

5.2.3 Construct Validity

For this study, measurement model was assessed separately for full sample and subgroups, for all constructs convergent validity was evaluated by examining item-construct-loading and average variance extracted (AVE). We noted that all reliability coefficients are above 0.7 and each AVE is above 0.5 (Table 5.2) for full, SOEs, and non-SOEs sample, indicating that measurements are reliable and the latent construct account for at least 50 percent of variance in the items. Loadings (ranging from 0.72 to 0.95) are in an acceptable range and t-values (ranging from 10.37 to 106.36) indicated that they are significant at the 0.001 level (Table 4).

A rule for assessing discriminant validity requires that the square root of AVE is larger than all inter-construct correlations (Chin, 1998). All constructs in the study met the requirements (Tables 5.3, 5.4, and 5.5).

To further assess the validity of our measurement instruments, a cross loading table (Appendix C) was constructed based on the procedure recommended by PLS (Gefen and Straub, 2005). It can be seen that each item loading is higher on its principal construct than on other constructs. The cross loading differences were higher than the suggested threshold of 0.1 (Gefen and Straub, 2005), except for one item in a non-SOE sample. Results collectively suggest good measurement properties for the full sample and both SOEs and non-SOEs.

Table 5.3 Factor Loadings for Full Sample (n=187)

Item	Loadings	T-stat
Contractual Governance (CG)		
Composite reliability = 0.94, Average variance extracted = 0.83		
CG1	0.93	79.46
CG2	0.94	72.00
CG3	0.85	31.54
Relational Governance (RG)		
Composite reliability = 0.91, Average variance extracted = 0.77		
RG1	0.92	76.78
RG2	0.90	48.02
RG3	0.80	25.87
Outsourcing Success (OS)		
Composite reliability = 0.94, Average variance extracted = 0.64		
OS1	0.76	15.98
OS2	0.80	19.29
OS3	0.79	20.62
OS4	0.80	24.86
OS5	0.77	18.89
OS6	0.79	23.70
OS7	0.79	23.41
OS8	0.79	19.14
OS9	0.93	52.25
Relational Continuity (RC)		
Composite reliability = 0.93, Average variance extracted = 0.82		
RC1	0.91	42.39
RC2	0.91	37.63
RC3	0.90	49.08

All t-statistic is significant at: *** $p<0.001$.

Table 5.4 Factor Loadings for SOE Sample (n=105)

Item	Loadings	T-stat
Contractual Governance (CG)		
Composite reliability = 0.93, Average variance extracted = 0.82		
CG1	0.91	38.00
CG2	0.94	54.82
CG3	0.86	25.33
Relational Governance (RG)		
Composite reliability = 0.92, Average variance extracted = 0.78		
RG1	0.92	48.59
RG2	0.91	45.13
RG3	0.82	20.78
Outsourcing Success (OS)		
Composite reliability = 0.95, Average variance extracted = 0.65		
OS1	0.75	10.37
OS2	0.78	13.25
OS3	0.83	19.82
OS4	0.80	16.08
OS5	0.77	14.03
OS6	0.77	14.90
OS7	0.81	17.37
OS8	0.78	13.85
OS9	0.93	37.81
Relational Continuity (RC)		
Composite reliability = 0.92, Average variance extracted = 0.78		
RC1	0.91	41.65
RC2	0.88	18.23
RC3	0.87	17.79

All t-statistic is significant at: *** $p<0.001$.

Table 5.5 Factor Loadings for Non-SOE Sample (n=82)

Item	Loadings	T-stat
Contractual Governance (CG)		
Composite reliability = 0.94, Average variance extracted = 0.83		
CG1	0.93	106.36
CG2	0.95	44.27
CG3	0.85	18.42
Relational Governance (RG)		
Composite reliability = 0.90, Average variance extracted = 0.75		
RG1	0.92	58.96
RG2	0.89	24.87
RG3	0.79	15.04
Outsourcing Success (OS)		
Composite reliability = 0.94, Average variance extracted = 0.64		
OS1	0.72	11.43
OS2	0.82	14.92
OS3	0.80	18.25
OS4	0.76	13.77
OS5	0.77	14.92
OS6	0.82	17.88
OS7	0.79	17.56
OS8	0.75	12.75
OS9	0.93	33.69
Relational Continuity (RC)		
Composite reliability = 0.94, Average variance extracted = 0.84		
RC1	0.90	32.26
RC2	0.91	36.74
RC3	0.89	30.14

All t-statistic is significant at: *** $p<0.001$.

Table 5.6 AVE and Correlation Table

Subgourp and Construct	Composite Reliability	Correlations of Constructs[a]			
Full Sample		1	2	3	4
1. Contractual Governance (CG)	0.94	**0.91**			
2. Relational Governance (RG)	0.91	0.54	**0.88**		
3. Outsourcing Success (OS)	0.94	0.49	0.63	**0.80**	
4. Relational Continuity Expectation (RC)	0.93	0.54	0.70	0.63	**0.91**
SOEs		1	2	3	4
1. Contractual Governance (CG)	0.93	**0.91**			
2. Relational Governance (RG)	0.92	0.54	**0.88**		
3. Outsourcing Success (OS)	0.95	0.50	0.59	**0.81**	
4. Relational Continuity Expectation (RC)	0.92	0.49	0.74	0.59	**0.88**
Non-SOEs		1	2	3	4
1. Contractual Governance (CG)	0.94	**0.91**			
2. Relational Governance (RG)	0.90	0.55	**0.87**		
3. Outsourcing Success (OS)	0.94	0.44	0.67	**0.80**	
4. Relational Continuity Expectation (RC)	0.94	0.60	0.66	0.69	**0.92**

a: Diagonal elements in the “correlation of constructs” matrix are the square root of AVE

5.3 Multicollinearity Checking

Further, there were several inter-construct correlations in Table 5.6 that were over the 0.60 criteria. This indicated that multicollinearity posed a potential problem for this research. Generally, the common rule of thumb for the presence of multicollinearity is that variance inflation factors (VIFs) are higher than 10 or tolerance values are less than 0.1 (Mason and Perreault, 1991). Our results show that the highest VIFs for full sample, SOEs, and non-SOEs were 1.87, 1.96, and 1.83, respectively, while the lowest tolerance values were 0.58, 0.68, and 0.62 respectively. Thus, multicollinearity did not appear to be a significant problem for our dataset.

5.4 The Structural Models

5.4.1 Full Sample Model

Structural model for the full sample was tested first. A bootstrap analysis was performed with 500 subsamples, with the sample size set equal to the full sample size (n=187). Figure 5.1 summarizes the results of PLS analysis. Since no control variables were significantly related to dependent variables, they are not presented in Figure 5.1. Chin (1998) described R^2 values of 0.67, 0.33, and 0.19 in PLS models as substantial, moderate, and weak, respectively. In our full model, the two governance mechanisms accounted for 43 percent and 57 percent of variances of outsourcing success and relational continuity expectation, respectively, indicating acceptable R^2 values.

As predicted, we can see that both contractual and relational governance are positively related to outsourcing success and relational continuity expectation. Thus, Hypotheses 1-4 are all supported. Hypothesis 5 proposed that there is a positive relationship between outsourcing success and relational continuity. Path coefficient between outsourcing success and relational continuity is 0.27 ($t=3.31$, $p<0.01$), upholding Hypothesis 5.

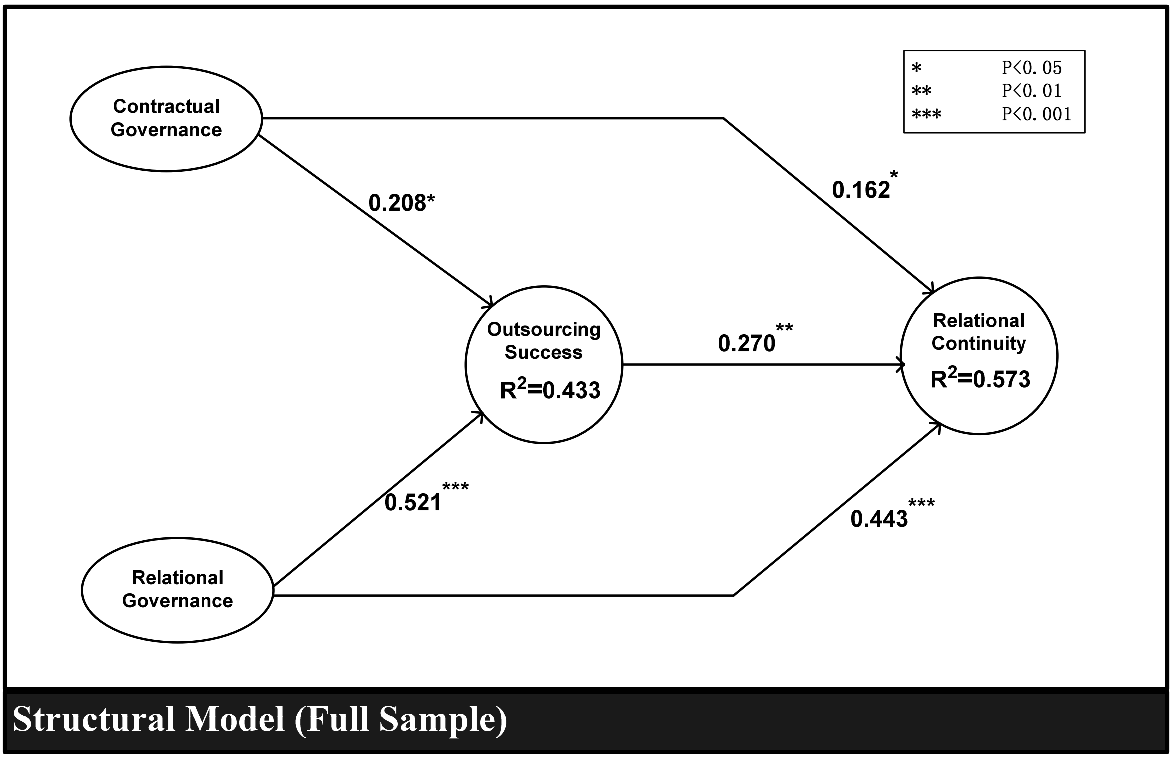

Figure 5.1 **Structural Model (Full Sample)**

As per Cohen and Cohen (1983), the equation to compare relative strengths of the associations between constructs is used:

$$T=(r_{xy} - r_{vy}) \cdot sqr((n-3)(1+r_{xv}))/sqr(2 \cdot (1-r^2_{xy} - r^2_{vy} - r^2_{xv} + 2\, r_{xy} \cdot r_{vy} \cdot r_{xv}))$$

Hypothesis 6 proposed that relational governance has a stronger impact on outsourcing success than contractual governance. With x=contractual governance, v=relational governance, y=outsourcing success, and n=187, the result shows that rxy = 0.49, rvy = 0.63, rxv =0.54, and T= - 1.73 ($p<0.05$, one-tailed test), which confirms Hypothesis 6. Hypothesis 7 proposed that the positive relationship between relational governance and relational continuity expectation is stronger than the positive relationship between contractual governance and relational continuity expectation. Similarly, x=contractual governance, v=relational governance, y=relational continuity, and n=187, we thus get results that show rxy= 0.54, rvy = 0.70, rxv =0.54, and T= - 2.16 at the 0.05 level, confirming that relational governance has stronger impact. Results of the testing of first seven hypotheses are displayed in Table 5.7.

Table 5.7 Hypotheses Testing Results

Hypotheses and Paths	T-stat	Hypotheses
H1: CG→OS	2.25*	Supported
H2: CG→RC	2.13*	Supported
H3: RG→OS	5.99**	Supported
H4: RG→SR	4.49**	Supported
H5: OS→RC	3.31**	Supported
H6: CG→OS < RG→OS	1.73*	Supported
H7: CG→RC > RG→RC	2.16*	Supported

Statistic is significant at: *p<0.05, **p<0.01.
a. CG=contractual governance; RG=relational governance; OS=outsourcing success; RC=relational continuity.
b. One-tailed tests were performed as the direction of differences was hypothesized.

5.4.2 Comparison Model for SOEs and Non-SOEs

The structural model for the groups of SOE and non-SOE was performed. Figure 5.2 shows the standardized path coefficients and the explained constructs variance. Only significant paths and control variables are displayed.

The model displays satisfactory R^2 values for both SOE and non-SOE group. Only one control variable (project size) is found having a significant relationship with dependent variables. Project size is negatively related to outsourcing success in SOE group.

Results show that the effectiveness of governance mechanisms on outsourcing success is significantly different among SOEs and non-SOEs. The most salient comparison lies in the relationship between contractual governance and outsourcing success. For the SOE group, the relationship is significant while in the non-SOE group it is not. Relational governance is significantly related to outsourcing success in both groups. This is also true for the relationship between outsourcing success and relational continuity, even though in SOE group, it is only marginally (at the level of 0.1) significant.

To test our hypothesis associated with different ownership type, we compared the coefficients of individual paths between two structural models. This analysis is similar to a test of the moderation effect of firm ownership types on path strength across groups. It is necessary to first assess whether latent variables were perceived in a similar fashion between SOE and non-SOE groups (Carte and Ressel, 2003).

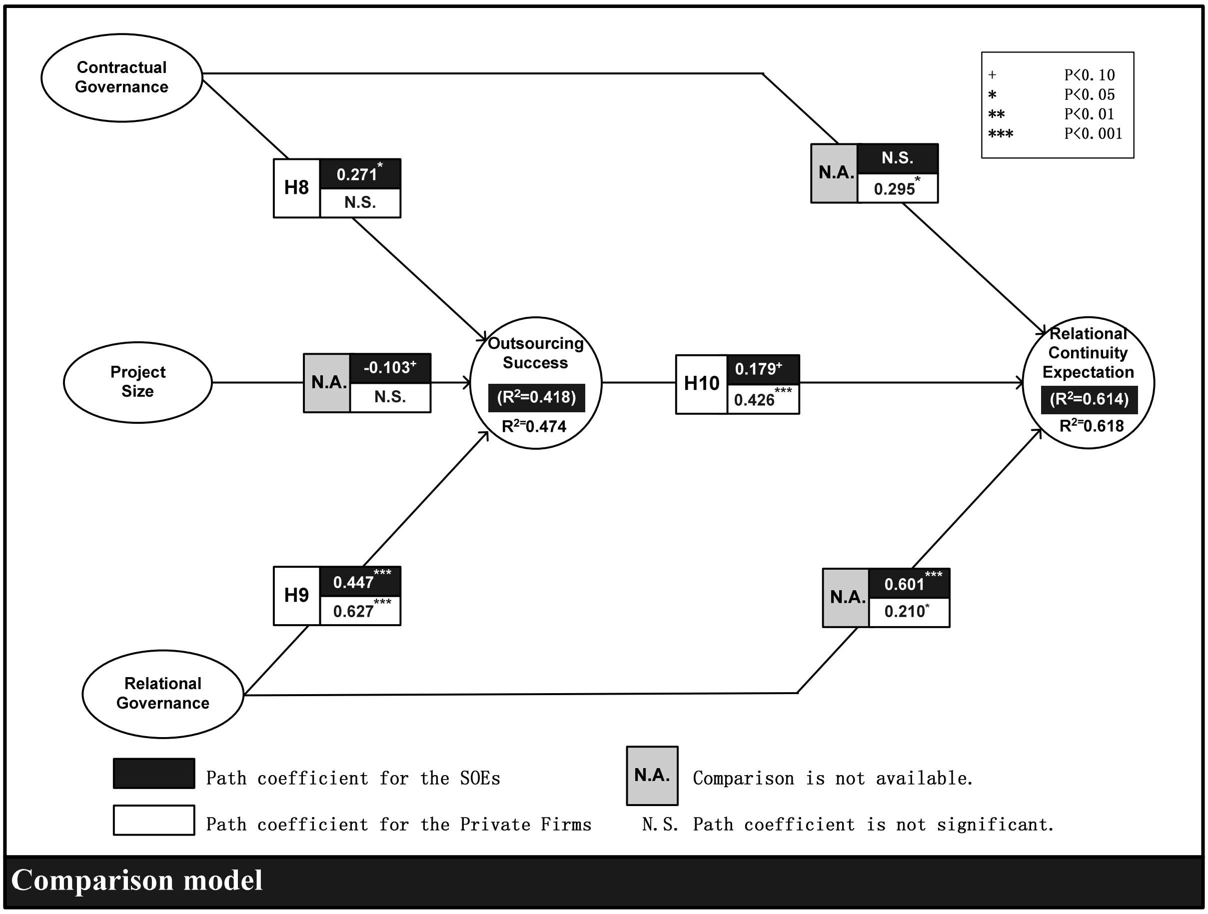

Figure 5.2 Comparison Model

Measurement Invariance Analysis

Multigroup measurement invariance analysis (Doll et al., 1998, Steenkamp and Baumgartner, 1998) was applied. Using AMOS 7.0, we performed configural and metric invariance analyses to evaluate measurement invariance across SOEs and non-SOEs. Configural invariance denotes that the patterns of item loadings are congeneric across groups (Doll et al., 1998, Steenkamp and Baumgartner, 1998), while metric invariance checks whether items have equal loadings between groups. If the change in chi-square between these two nested (configural and metric) models is non-significant (Byrne, 2006) or the CFI difference is below the 0.01 threshold (Cheung and Rensvold, 2002), then metric invariance is supported, permitting path coefficient comparison between groups.

The analytical procedure described above was followed to assess measurement invariance across groups. Configural invariance analysis revealed the pattern of item loadings to be congeneric across two groups. In terms of metric invariance, changes in chi-square were 12.23 (df=14, p=0.59), and the change in CFI was 0.002 for the nested model which confirms metric invariance.

Comparison Hypothesis Testing

Thus, hypotheses on group differences (H8-H10) could be tested by statistically comparing corresponding path coefficients in the structural models. This comparison was carried out following Chin et al. (1996) and Keil et al.'s (2000) procedure. T-statistics was calculated to evaluate the differences in path coefficients across models:

$T = (PC_1 - PC_2) / \{sqrt\,[(n_1 - 1) / (n_1 + n_2 + 2) \cdot SE_1^2 + (n_2 - 1) / (n_1 + n_2 + 2) \cdot SE_2^2\,] \cdot sqrt(1/n_1 + 1/n_2)\}$

Where T = *t-statistic with* $n_1 + n_2 + 2$ *degrees of freedom*

ni = *sample size of dataset for SOE (n=1) or Non-SOE group (n=2)*

SEi = *standard error of path in structural model for SOE (n=1) or Non-SOE group (n=2)*

PCi = *path coefficient in structural model for SOE (n=1) or Non-SOE group (n=2)*

Table 5.8 displayed the T-values of the comparison hypotheses. Hypothesis 8 proposes that the positive relationship between contractual governance and outsourcing success is stronger in SOEs than in non-SOEs. As PC1=0.27(SE1=0.08) and PC2=0.04(SE2=0.06), T=2.34 (p<0.01). Result confirms Hypothesis 8, indicating SOEs have more confidence in formal contracts than non-SOEs. Relational governance is significantly linked to outsourcing success in both groups, even though non-SOEs have a stronger impact with T value equals 1.31 (p<0.1). Thus, Hypothesis 9 is marginally supported.

We found that outsourcing success significantly leads to expectations of future collaboration in non-SOEs, while it is marginally significant in SOEs. Results identified a significant relationship difference between outsourcing success and relational continuity in SOEs and non-SOEs, indicating a support for Hypothesis 10.

Table 5.8 Path Comparisons

Hypotheses and Paths	SOEs		Non-SOEs	T-stat	Hypotheses
H8: CG → OS	$0.27^{**}(0.078)$	>	0.04(0.056) N.S.	2.34^{**}	Supported
H9: RG → OS	$0.45^{**}(0.102)$	<	$0.63^{**}(0.086)$	1.31^{+}	Marginally Supported
H10: OS → RC	$0.18^{+}(0.090)$	<	$0.43^{**}(0.110)$	1.76^{*}	Supported

Path coefficient is significant at: + p<0.1, *p<0.05, **p<0.01. N.S. Path coefficient is not significant.

a. CG=contractual governance; RG=relational governance; OS=outsourcing success; RC=relational continuity.

b. One-tailed tests were performed as the direction of differences was hypothesized.

5.5 Mediation Testing

Our proposed research models included potential mediation effects. Specifically, outsourcing success may mediate the impact of both contractual and relational governance on relational continuity expectation. Procedure for mediation analysis is based on path coefficients and standard errors of the direct paths between (i) independent and mediating variables (i.e., iv→m) and (ii) mediating and dependent variables (i.e., m→dv) (Baron and Kenny 1986). Results of the PLS analysis are used to calculate the extent to which a construct mediates the relationship between independent and dependent variables (Hoyle and Kenny, 1999). In this study, magnitude of the mediation effect between contractual governance (iv) and relational continuity (dv) mediated by outsourcing success (m) is the product of the standardized paths between iv and m and between m and dv. Standard deviation of the mediated path can be computed based on magnitudes and variance of the paths among iv, m, and dv. Results of path analyses in the model are shown in Table 5.9.

Table 5.9 Significance of Mediated Paths

Sample	Direct Effect	Mediated Path	Path Coefficient	Z Statistic
Full	CG→RC	CG→OS→RC	0.056	1.81*
	RG→RC	RG→OS→RC	0.141	2.82*
SOE	CG→RC	CG→OS→RC	0.049	1.73*
	RG→RC	RG→OS→RC	0.080	1.83*
Non-SOE	CG→RC	CG→OS→RC	0.017	0.70 (N.S.)
	RG→RC	RG→OS→RC	0.267	3.45**

Statistic is significant at: *p<0.05, **p<0.01.
a. CG=contractual governance; RG=relational governance; OS=outsourcing success; RC=relational continuity.
b. One-tailed tests were performed as the direction of differences was hypothesized.
c. The standard error of the mediated path is approximated based on the formula sqrt($b^2S_a^2 + a^2S_b^2 + S_a^2S_b^2$), where a and b and are the magnitudes of the paths between iv, m, and dv, and S_a and S_b are the standard deviations of a and b

Results showed that outsourcing success mediated both governance mechanisms and relational continuity in the full sample and in SOE sample, with z statistics 1.81, 2.82, 1.73, and 1.83 respectively. For non-SOE sample, outsourcing success only mediated relational governance and relational continuity with z-statistic 3.45. The mediation test suggests that outsourcing success mediates the relationship between relational governance and relational continuity expectations in all three samples. As for the contractual governance and relational continuity expectations, the meditating effects exist in full sample and SOE sample, but not in non-SOEs sample.

5.5 Chapter Summary

This chapter reports satisfactory data analysis results of the study. The testing of the measurement model indicates that all measures are validated and reliable, not only for the full sample, but also for SOE and non-SOE group samples. The impact of governance mechanisms on IS outsourcing and relational continuity expectation is confirmed in structure model testing. However, impacts are contingent on firm ownership types to achieve IS outsourcing success, confirming our hypotheses that the influence of relational governance on IS outsourcing success is stronger for non-SOEs than for SOEs. On the other hand, our hypothesis that the influence of contractual governance on IS outsourcing success is weaker for non-SOEs than for SOEs was also supported. Non-SOEs regard outsourcing success more seriously than SOEs, being crucial to relational continuity. On the whole, results confirmed our model and supported most of our hypotheses.

In the next chapter, the results will be summarized and our contribution to theory and practice demonstrated. Limitation and future research will also be discussed.

CHAPTER 6 DISCUSSION AND CONCLUSION

The final chapter is the Discussion and Conclusion section. First, we summarize the results of the study for all firms, SOEs, and non-SOEs. Second, implications for theory and practice are discussed. Lastly, we present the limitations and probability for future research.

6.1 Summary of Results

6.1.1 Overall Firms

Congruent to previous studies, contractual and relational governance are both considered important mechanisms. Results of this study leave little doubt as to the effectiveness of both contractual and relational governance on IS outsourcing success and relational continuity expectation. This also confirms the previous views that stress on how the two governance mechanisms complement each other (e.g., Poppo and Zenger, 2002, Goo et al., 2009) in a transitional environment.

However, comparison of the two mechanisms shows that relational governance has stronger effect on both outsourcing success and future relational continuity than that of contractual governance. Due to inherent complexity and uncertainty associated with outsourcing activities, a contract alone is not sufficient to align objectives and mitigate external sourcing risks. It is critical that firms behave in a cooperative and collaborative manner if they wish to extract full value from outsourcing engagements (Liu et al., 2008). This is consistent with the studies that emphasize the importance of cooperation, partnership, and strategic alliance (e.g., Mohr and Speckman, 1994, Klepper, 1995). The study indicates that Chinese firms rely heavily on informal constraints (relational mechanism) to manage their relationships. The findings are consistent with previous studies that stressed the importance of interpersonal ties (guanxi) in transition economies (Xin and Pearce, 1996, Peng and Luo, 2000).

The present study also confirms that outsourcing success enhances future relational continuity expectation. This agrees with marketing studies which advocate that success and efficiency of current project should be the important determinants of loyalty and the decision to continue interfirm relationship (Fornell, 1994).

Outsourcing success is also found to mediate the relationship between contractual/relational governance and future relational continuity. This shows that governance mechanisms affect relationship commitment through successful outsourcing projects. The finding further confirms the importance of good project performance to a long-term and continuous relationship (Ring and Van de Ven, 1994).

6.1.2 Contingency Effects of Ownership Types

This study also confirms the important influence of institutional contexts on firm behavior. It is shown that the effectiveness of governance mechanisms on outsourcing success changes with the type of ownership. SOEs that are closely connected with the government have more institutional support and more confidence in their contracts. On the other hand, non-SOEs have to rely on relational governance as a substitute for weak institutional supports.

Contingent relationship between outsourcing success and relational continuity expectation can also be attributed to the characteristics of transition economies. We found that success of outsourcing projects in non-SOEs (in contrast with what happens with SOEs) leads to a better chance of future collaboration. Results are consistent with previous studies that non-SOEs are more performance-driven than SOEs. Another plausible reason could be that SOEs, as the more established firms, may have more collaborative relationships than non-SOEs, which may reduce their dependence on current relationships.

Only a mediation effect of outsourcing success on the relationship between relational governance and relational continuity expectation is found when examined separately with firm ownership types. We could tell from the finding that for non-SOEs, relational governance influences future collaboration of exchanging parties through the performance of current outsourcing project. For non-SOE firms, therefore, a partnership governing mechanism and the performance of the outsourcing project are both important to build a continuous cooperative relationship.

6.2 Theoretical Contributions

6.2.1 Governance Mechanisms

First, while governance mechanisms' role in client-provider relationships has long been highlighted in literature, past studies have only focused on firms in the western countries with mature market economies (e.g., Grover et al., 1996, Cannon et al., 2000, Ferguson et al., 2005, Poppo and Zenger, 2002). However, literature has not provided enough evidence on how to govern outsourcing relationships in transition economy. This study contributes to this line of research by empirically demonstrating how and under what conditions governance mechanisms are linked with outsourcing success and relational continuity. Findings confirm the role of contractual and relational mechanisms in emerging economies. This articulates further past studies stressing both governing means as important mechanisms in enhancing relationship performance and long-term commitment (e.g., Ferguson et al., 2005, Goo et al., 2009).

Specifically, previous studies have used TCT to explain the role of contractual governance (e.g., Ferguson et al., 2005). However, some scholars have doubted the effectiveness of contract especially in uncertainty environment because contract cannot contemplate all future contingencies (e.g., Willismson 1985). Our study has found that the contract in the uncertainty environment such as institutional transition environments, actually depends on another important factor, ownership type. That is, for SOEs even in the uncertainty and risky transition period, they may still have confidence in their contracts, while for the non-SOEs, the contracts are regarded as not effective. On the other hand, researchers have used SET to explain the role of relational governance (e.g., Cannon et al., 2000). Our study is consistent with previous studies that stressing the importance of relationship or partnership (e.g., Klepper, 1995, Lee and Kim, 1999).

Second, while most prior studies were mainly guided by the rationale of transaction cost and social exchange to explain mechanisms of relationship management, we turned to an additional theoretical perspective and proposed that institutional frameworks influence the effectiveness of governance mechanisms. Our study finds support for the central tenets of TCT and SET while building important boundary conditions from institutional framework for their application in governance mechanisms. While TCT predicts that contractual governance has a positive relationship with outsourcing success, and SET predicts that relational governance has a positive relationship with outsourcing success. In transition economies, however, the institutional framework adds to the theory by building important boundary conditions. We advance that considering the nature of institutional environments involved in outsourcing projects allows more precise predictions about appropriate choice of governance mechanism, rather than just the level of potential opportunism.

Specifically, by differentiating diversity of institutional supports of SOEs and non-SOEs, non-SOEs may rely more on relational governance while contracts may be more effective for SOEs. Evidence has been found that the optimal choice of governance mechanisms in an outsourcing relationship depends on the type of ownership.

Third, we have found that the outsourcing success mediates the relationship between governance mechanisms and relational continuity. Outsourcing success is identified mediating the relationship between relational governance and relational continuity expectations in all three samples. As for the contractual governance and relational continuity expectations, the meditating effects exist in full sample and SOE sample, but not in non-SOEs sample. The findings indicate that governance mechanism impact the future relationships through the performance of current (or past) projects. The only exceptional is for non-SOEs. Contractual governance is directly associated with relational continuity, other than through outsourcing success. The reason may lie in that for non-SOEs contractual governance is not effective in achieving outsourcing success.

Four, findings of the present study provide possible explanations for controversial observations on the effectiveness of governance mechanisms. As discussed, previous studies have controversial conclusion and views on the mechanisms of contractual and relational governance toward relationship performance. The effectiveness of both mechanisms on opportunism and relational outcomes could be different with a change of uncertainty (Carson et al., 2006) and legal environment hostility (Cavusgil et al., 2004). The study extends the literature by indicating that making optimal combinations of governance mechanisms highly depend on outsourcing content and ownership type, a formerly overlooked contingency.

Last but not least, the study also indicates that relational governance is more effective in enhancing outsourcing success or building future continuous collaborations than contractual governance. Liu et al. (2008) also found that relational mechanisms are more effective than transactional mechanisms in improving relationship performance. However, other than using the traditional rational of transaction cost and social exchange, we explained the dominant influence of relational mechanisms using explanation on institutional framework. In emerging economies, Chinese firms lack the legitimate system that can provide institutional support, in contrast with their counterpart firms in western countries. Therefore, Chinese firms rely more on informal constraints (relational mechanism). This is in line with previous studies that stress the importance of interpersonal ties (guanxi) in transition economies (Xin and Pearce, 1996, Peng and Luo, 2000) and interfirm cooperation, partnership, and strategic alliance (e.g., Mohr and Speckman, 1994, Klepper, 1995, Lee and Kim, 1999).

6.2.2 Institutional Framework in Transition Economies

The findings also contribute to the literature on institutional framework in transition economies. To the best of our knowledge, this study is among the first to explain governance mechanisms using institutional framework. Based on previous research findings that informal constraints can act as substitutes for weak institutional supports in emerging economies, this study identifies that SOEs and non-SOEs in transition economies may govern their outsourcing relationship with the vendor differently. In line with institutional rationale, SOEs are found to rely more on formal contracts, while non-SOEs have more incentives to use relational mechanisms. SOEs are found to care less for outsourcing performance than non-SOEs. Results provide evidences on the solidness and completeness of institutional framework.

Furthermore, most studies in this area have focused on interpersonal ties among managers (e.g., Peng and Luo, 2000, Xin and Pearce, 1996) or political networking (Li and Zhang, 2007), which are seen from the perspective of informal constraints. We have adopted a broader view by examining both formal and informal constraints in transition economies, and have found that SOEs and non-SOEs prefer different governance mechanisms following institutional framework. The study likewise examines the informal constraints from a different perspective compared with previous studies. Past research mostly focused on interpersonal ties (guanxi) (e.g., Xin and Pearce, 1996, Peng and Luo, 2000), but this study considers relational governance mechanisms as an informal constraint.

6.2.3 IS Outsourcing Success and Relational Continuity Expectation

This study extends previous knowledge of success on a continued basis by examining outsourcing relationship in transition economies. It shows that success of current projects does not always lead to continuity of future relationship. Previous studies argued that loyalty is caused by a combination of satisfaction and switching barriers, while this study indicates other factors that can affect future relational continuity. For firms that are not performance-driven, the success of current projects may not necessarily lead to future collaboration.

6.3 Managerial Contributions

Relationship management or governance becomes increasingly critical in highly competitive environments. Superior outsourcing relationship create stable environments for firms to solidify the two parties' collective power and resources, foster information and technological knowledge sharing, and achieve collective strategic goals. However, client-vendor dyads are filled with potential for opportunism and conflicts, especially in a transition economy changing from a central planning economy to a free-market economy (Peng, 2003, Peng and Luo, 1996). Governing such dyads is a key task for managers on both sides.

The two mechanisms are not interchangeable as each has distinct limitations. The study provides some useful guidelines for outsourcing relationship governance. It has been pointed out that when cooperating with SOEs, IT vendors should be aware that maintaining guanxi or interpersonal ties is not enough: they should also follow the rules. Standardized and formal procedures are necessary and formal contracts should not be neglected. On the other hand, in dealing with non-SOEs, IT vendors should realize that cooperative relationship is the most important issue to achieve outsourcing success and a better chance of future collaboration.

Another lesson learned pertains to the role of relational governance in enhancing outsourcing success and relationship commitment expectation. It is confirmed that compared to contractual governance, relational governance dominates variance explained for both outsourcing success and future relational continuity expectations. It reminds the managers that mechanisms stressing mutual benefits, cooperation and communication are more effective than mechanisms strictly following regulations and formal rules.

However, the above findings do not mean that contracts must be neglected in a transition economy, though in China, contracts are perceived as an ineffective means or a useless piece of "paper" (Liu et al., 2008). Contracts are generally effective in governing outsourcing relationship, as reflected in our sample. Furthermore, for specific firms such as SOEs, contractual governance is an effective mechanism in achieving outsourcing success. Managers in SOEs should take advantage of the strong institutional supports and sign contracts for their benefits.

Last but not least, managers of IT vendor should realize that to achieve a better chance of future collaboration, maintaining a cooperative relationship with non-SOEs is not enough, but outsourcing performance also matters.

6.4 Limitation and Future Research

This study has several limitations that need to be addressed in future endeavors.

First, as a group comparison study, the sample size was too small. Due to difficulty of data collection in China, only three provinces were chosen in the sample framework, and only less than 200 valid questionnaires were collected. Future studies that incorporate a broader and larger sampling frame may provide additional validity and empirical support for theoretical studies in this area. Furthermore, we did not examine these impacts from the service vendors' perspective. Results of our study would certainly be more robust if data from them were available.

Second, one main consequent construct of relational continuity expectation is not performance outcome, and the study is cross sectional. This limitation determines that we could not explain if governance mechanisms have varying impacts on short-term (project success/performance) and long-term outcomes (future collaboration/commitment), which can be an interesting research topic. Future research which adopts relationship performance in a longitudinal study will be beneficial. Furthermore, our study indicates that the choice of governance mechanisms may relate to time periods. As for SOEs, at the relationship building periods, contract may be appropriate and effective. However, with the development of relationship, the exchanging parties may rely on partnering relationships. As for the non-SOEs, the opposite situations occur, that is for current project, contract may not effective, while contract is desired for future relationship. Future research can analyze if the institutional impact also depends on relationship phrase.

Third, our study only examines the governance mechanisms in transition economies. It is desirable if future research can simultaneously examine and compare the effectiveness of governance mechanisms in both transition economies and developed economies, which will be even persuasive.

Four, the study can generalized to those countries that are experiencing the similar transition economies as China, such as Eastern Europe, the former Soviet republics, and some communist countries. However, in China alone, since it is so big, different places the transition economies may differ significantly. For examples, these areas with special economy policies, the institutional impact may be different from those traditional inland areas. Thus the generalizability of this study should take consideration of the specific situation of the region. Future research explore the difference of characteristics of transition economies and compare the governance mechanisms in different economic regions will be interesting.

Third, limitations may also be seen from the scales used to measure constructs of contractual and relational governance. Although they were all adapted from previous validated studies, oversimplified treatment of these two contracts became a limitation. Future studies with more convincing measuring scales will be needed. specifically for contractual governance, previous studies measured constructs with vast diversity, as contractual/contract-based governance (Ferguson et al., 2005, Lee and Cavusgil, 2006), legal bonds (Cannon et al., 2000), legal contract (Cai et al., 2008), formal contracts (Cavusgil et al., 2004), contract (Liu et al., 2008), formal governance (Hoetker and Mellewigt, 2009), contractual complexity (Poppo and Zenger, 2002), and contractual completeness (Handley and Benton, 2009). Studies investigating and summarizing their theoretical similarities and differences would be interesting.

6.5 Chapter Summary

We summarized and discussed analysis results of the full sample and sub-sample models. The former confirms the effects of contractual and relational mechanism, while the latter indicates the optimal choice of governance mechanisms. The most important finding of this study is the effectiveness of relational mechanisms in non-SOEs and the same impact contractual mechanisms have in SOEs concerning outsourcing success. We proceeded with the implications of the study on literature on governance mechanisms and institutional frameworks in transition economies and the relationships between outsourcing success and relational continuity expectations. The study is also helpful for managers in SOEs, non-SOEs, service vendors, and foreign investors who would like to seek chances in Chinese markets.

Appendix A. Outsourcing Relationship and Governance Mechanism

Authors	Major Findings	Theory	Constructs Focus	Research Approaches				Outsourcing Aspects			Governance Mechanism		Study Scope	
				Positivist	Interpretive	Descriptive	Conceptual	Contracts	Partnership	Success	Contractual	Relational	Western	Emerging
Lacity and Hirschheim (1993)	Outsourcing is portrayed as a strategic partnership instead of contractual relationship. The client firms need to incorporate negotiation strategies to balance the power in the outsourcing relationship.	None	Strategic Partnership, Contractual Relationship, Negotiation Strategies		√			√	√				√	
Fitzgerald and Willcocks (1994)	Strategic partnership exists in outsourcing relationships. Examined the issues of contracts and partnerships in outsourcing exchange, and stress that importance of partnership.	None	Strategic Partnership	√				√	√				√	
Clark et al. (1995)	Critical factors in managing what they term an alliance were flexibility and governance mechanisms based on mutual awareness and understanding.	TCT and MT	Strategic Partnership, Contract, Governance Cost and Mechanisms		√			√	√				√	
McFarlan and Nolan (1995)	Vital factors to successfully structuring an alliance are contract flexibility, and standards and control. Contracts cannot anticipate every contingency, thus the customer/vendor relationship becomes critical.	None	Contract flexibility, and standards and control.		√			√					√	
Klepper (1995)	Partnering relationships are advantageous under some circumstances. Examines the development of partnerships from the client firm's perspective and investigates the possibilities for managing the partnering process.	None	Attraction, communication and bargaining, expectation, norm, power and justice, and commitment	√					√				√	

Authors	Major Findings	Theory	Constructs Focus	Research Approaches				Outsourcing Aspects			Governance Mechanism		Study Scope	
				Positivist	Interpretive	Descriptive	Conceptual	Contracts	Partnership	Success	Contractual	Relational	Western	Emerging
Willcocks et al. (1995a)	Focuses on total IT outsourcing to examine the structure of cooperation, the relationship formed, Proposed a revised model for strategic partnerships.	None	Strategic Partnership, Cooperation		√				√				√	
Willcocks et al. (1995b)	Examines factors to be considered when determining how outsourcing should be used. Suggests that a strategic approach toward IT sourcing can pay long-term dividends.	None	Strategic approach;		√				√				√	
Currie (1996)	Both private and public organizations were looking to negotiate more fixed-term and fixed-price contracts, rather than flexible ones. Thus she recommends short-term contracts, which may provide the frequency of renewal.	None	Contract, Flexibility		√			√	√				√	
Grover et al. (1996)	Examines the relationships between IT functions and outsourcing success. Both service quality and elements of partnership are important for outsourcing success.	TCT, RBV, and NIT	Strategic/economic/technological benefits, service quality, partnership, outsourcing success	√				√	√	√			√	
Saunders et al. (1997)	Organizations need to look beyond simple recipes to ensure outsourcing success. Conditioned prescriptions are needed.	None	Perceptions of service provider, nature of contract, type of IT function, type of relationship	√				√	√	√			√	
Sharma (1997)	Investigated how to reduce the opportunistic behaviors of vendors. The authors stressed three kind of control: vendor self-control, community control and bureaucratic control.	AT	Opportunistic behaviors, Control Mechanisms				√		√				√	

Authors	Major Findings	Theory	Constructs Focus	Research Approaches				Outsourcing Aspects			Governance Mechanism		Study Scope	
				Positivist	Interpretive	Descriptive	Conceptual	Contracts	Partnership	Success	Contractual	Relational	Western	Emerging
Currie and Willcocks (1998)	The form of client/supplier relationship and the 'attributes of a contract' can depend on other organizational dimensions (determinants) such as uncertainty. Client firms should use short to medium term contracts.	None	Outsourcing Types, Strategic Sourcing		√			√	√				√	
Marcolin and McLellan (1998)	The study suggests that differences between the degree of uncertainty and contractual definition (loose or tight) will determine ideal combinations of strategic partnerships and buyer/seller relationships.	TCT and IV	Strategic Partnership, Contract, Uncertainty	√				√	√				√	
Sombrero and Schrader (1998)	Use meta analysis on contractual coordination and procedural coordination and their relationships, their determinants and their influences on performance.	TCT and SET	Contractual coordination and procedural coordination								√	√	√	
Willcocks and Kern (1998)	Organizations have begun to consider vendors as their partners. Many firms enter into more intricate deals that include both contractual and informal issues.	None	None	√				√	√				√	
Hancox and Hackney (1999)	Public organizations are more skeptical about the concept of partnerships with the vendor than private sector organizations, and the type of IS function being outsourced and the culture compatibility may be important factors in partnership-type relationships.	None	Partnership, culture compatibility.		√				√				√	
Lee and Kim (1999)	Establishes partnership quality as a key predictor of outsourcing success. Proposes a theoretical framework for outsourcing partnership based on a social perspective.	SET and PT	Partnership quality, determinants of partnership quality, outsourcing success	√				√	√	√			√	

Authors	Major Findings	Theory	Constructs Focus	Research Approaches				Outsourcing Aspects			Governance Mechanism		Study Scope	
				Positivist	Interpretive	Descriptive	Conceptual	Contracts	Partnership	Success	Contractual	Relational	Western	Emerging
Cannon et al. (2000)	Examined the performance implications of contractual agreements and relational norms, individually and in plural form under varying conditions and forms of transactional uncertainty and relationship-specific adaptation.	TCT and SET	Contractual agreements, relational norms, transactional uncertainty, relationship-specific adaptation	√							√	√	√	
Lee et al. (2000)	Lays an integrative groundwork for the understanding of outsourcing based on a review of past and current outsourcing research.	SP	None				√	√	√				√	
Logan(2000)	Addresses failed outsourcing relationships and suggested two possible solutions.	AT	None				√						√	
Lee (2001)	Examines the relationship between knowledge sharing and outsourcing success.	KBT and SP	Knowledge sharing, organizational capability, partnerships quality, outsourcing success	√			√	√						
Goles et al. (2002)	Uses relational view to lay a conceptual basis for identifying individual constructs that comprises a relationship. Develops a set of items to measure constructs.	RET	Relationship attributes (such as interdependence, trust), relationship processes (such as communication, cooperation,etc)	√					√				√	
Kern et al. (2002b)	Seeks to understand the operational characteristics of IT outsourcing relationships.	IA	Interaction process, parties involved, environment, atmosphere	√				√	√				√	

Authors	Major Findings	Theory	Constructs Focus	Research Approaches				Outsourcing Aspects			Governance Mechanism		Study Scope	
				Positivist	Interpretive	Descriptive	Conceptual	Contracts	Partnership	Success	Contractual	Relational	Western	Emerging
Luo (2002)	Examines the relationships of contract, cooperation, and performance within international joint ventures (IJV) and confirmed that contract and cooperation are not substitutes but complements in relation to IJV performance.	TCT and SET	Contract, cooperation, IJV performance	√							√	√	√	
Poppo and Zenger (2002)	Shows how managers have learned to mediate hazards by better choices, better contracts, and better relationship management.	TCT and SET	Relational norms, contractual complexity, asset specificity, measurement difficulty, technological change	√				√	√		√	√	√	
Gopal et al. (2003)	Studies the determinants of contract choice in offshore software development projects and examines how the choice of contract and other factors in the project affect project profits accruing to the vendor.	IC	Task uncertainty, incomplete contracts, bargaining power, contract type, actual performance	√				√	√				√	
Lacity et al. (2003)	Discusses pros and cons of approaches to transformation: DIY, management consultants, fee-for-service outsourcing, joint venture, and enterprise partnership.	None	None			√		√	√				√	
Ferguson (2005)	Relational governance is found as the predominant governance mechanism associated with exchange performance. Contractual governance is also positively associated to exchange performance, but to a much lesser extent.	TCT and SET	Relational norms, contractual governance, exchange performance, closeness	√							√	√	√	

Authors	Major Findings	Theory	Constructs Focus	Research Approaches				Outsourcing Aspects			Governance Mechanism		Study Scope	
				Positivist	Interpretive	Descriptive	Conceptual	Contracts	Partnership	Success	Contractual	Relational	Western	Emerging
Cavusgil et al. (2004)	Trust makes the relationship function while contracts institute and legitimize it. The study identified the influence of legal hostility on the governance of opportunism in the export market.	TCT and RET	Trust, contracts, legal hostility	√							√	√	√	
Lee and Cavusgil (2006)	Relational-based governance as opposed to contractual-based governance is more effective in strengthening partnership. The positive effects of relational-based governance are enhanced under high pressure of environmental turbulence.	TCT and SET	Relational-based governance, contractual-based governance, environmental turbulence	√							√	√	√	
Mellewigt et al. (2007)	Identify the dual role of formal contracts (controlling/coordinating) and find the moderating role of trust. They provide a new focus to the relationship between trust and contracts that may help reconcile some divergent perspectives in the literature.	TCT	Formal contract, trust	√							√	√	√	
Cai et al. (2008)	Identify four key elements of quasi-integration: legal contract, joint problem solving, joint planning, and collaborative communication, and examined their antecedent (interdependence) and outcomes (supplier performance and buyer commitment).	TCT and RDT	Contract, joint problem solving, joint planning, communication, interdependence commitment	√							√	√	√	
Liu et al. (2008)	Illustrate that transactional mechanisms are more effective in restraining opportunism while relational mechanisms are more powerful in improving relationship performance. The performance is improved more significantly when contracts and relational norms are used jointly.	TCT and SET	Transactional /relational mechanisms, opportunism, relationship performance	√							√	√		√

Authors	Major Findings	Theory	Constructs Focus	Research Approaches				Outsourcing Aspects			Governance Mechanism		Study Scope	
				Positivist	Interpretive	Descriptive	Conceptual	Contracts	Partnership	Success	Contractual	Relational	Western	Emerging
Rustagi et al. (2008)	Defined the amount of formal (contractual) control and build a model of the antecedents of the amount of formal control.	TCT and OC	Formal control, task characteristics, client knowledge	√				√	√		√		√	
Goo et al. (2009)	They developed eleven contractual elements and investigated their relationships with three relational governance attributes and with relational outcomes (trust and commitment).	TCT and SET	Service level agreements, relational governance, trust and commitment	√				√	√		√	√	√	
Handley and Benton Jr. (2009)	Investigated strategic evaluation, contractual completeness, and relationship management practices during the outsourcing processes that are key drivers of outsourcing performance.	TCT and SET	Contractual completeness, relationship management, strategic evaluation	√				√	√	√	√	√	√	
Hoetker and Mellewigt (2009)	Indicate that the formal mechanisms are best suited to property-based assets and relational governance is best suited to knowledge-based assets. Mismatch between governance mechanisms and asset type happens will harm performance.	TCT and KBT	Formal mechanisms, relational governance, property-based /knowledge based asset	√							√	√	√	
Susarla et al. (2009)	The study examined holdup problems in outsourcing relationships with relationship-specific investments and contract incompleteness. Task complexity is found difficult to draft extensive contracts. The role of nonprice contractual provisions, contract duration, and extendibility terms, can limit the chance of holdup.	TCT and IC	Contract extendedness, task complexity, contractual provisions, holdup	√				√					√	

AT=Agency theory, IC= Incomplete contracts, KBT= Knowledge-based theory, IA=Interaction approach, MT=Management theory, NIT=Network interaction theory, OC=Organizational control literature, RBV= Resource-based theory, RET=Relationship exchange theory, RDT=Resource dependence theory, SP=Strategic partnership literature, TCT= Transaction cost theory, SET=Social exchange theory.

Appendix B: Common Method Bias Analysis

Construct	Indicator	Substantive Factor Loading (R1)	$R1^2$	Method Factor Loading (R2)	$R2^2$
Contractual Governance	CG1	0.852***	0.726	0.096*	0.009
	CG2	0.961***	0.924	-0.032	0.001
	CG3	0.881***	0.776	-0.073	0.005
Relational Governance	RG1	0.879***	0.773	0.025	0.001
	RG2	0.887***	0.786	0.015	0.000
	RG3	0.910***	0.828	-0.041	0.002
Outsourcing Success	OS1	0.743***	0.553	-0.005	0.000
	OS2	0.674***	0.455	0.110	0.012
	OS3	0.666***	0.443	0.105	0.011
	OS4	0.818***	0.670	-0.022	0.000
	OS5	0.732***	0.535	0.032	0.001
	OS6	0.784***	0.615	0.018	0.000
	OS7	0.889***	0.791	-0.148	0.022
	OS8	0.761***	0.579	-0.036	0.001
	OS9	0.979***	0.957	-0.053	0.003
Relational Continuity Expectation	RC1	0.879***	0.773	-0.065	0.004
	RC2	0.887***	0.786	-0.003	0.000
	RC3	0.910***	0.828	0.066	0.004
Average		**0.838**	**0.711**	**-0.001**	**0.004**

Appendix C: Cross-loadings and Item-factor Loadings

	FULL SAMPLE (n=187)				SOE-GROUP (n=105)				NON-SOE GROUP (n=82)			
	CG	**RG**	**OS**	**RC**	**CG**	**RG**	**OS**	**RC**	**CG**	**RG**	**OS**	**RC**
CG1	**0.93**	0.58	0.49	0.56	**0.91**	0.54	0.48	0.45	**0.93**	0.46	0.39	0.52
CG2	**0.94**	0.49	0.45	0.48	**0.94**	0.51	0.45	0.45	**0.95**	0.62	0.47	0.67
CG3	**0.85**	0.41	0.39	0.42	**0.86**	0.41	0.43	0.43	**0.85**	0.40	0.32	0.41
RG1	0.52	**0.92**	0.60	0.70	0.46	**0.92**	0.53	0.72	0.56	**0.92**	0.61	0.69
RG2	0.52	**0.90**	0.62	0.65	0.55	**0.91**	0.61	0.71	0.47	**0.89**	0.63	0.60
RG3	0.39	**0.80**	0.41	0.47	0.41	**0.82**	0.42	0.55	0.39	**0.79**	0.40	0.39
OS1	0.46	0.56	**0.76**	0.52	0.48	0.56	**0.75**	0.54	0.26	0.50	**0.72**	0.58
OS2	0.43	0.54	**0.80**	0.55	0.41	0.52	**0.78**	0.53	0.44	0.56	**0.82**	0.58
OS3	0.45	0.51	**0.79**	0.54	0.45	0.50	**0.83**	0.53	0.28	0.64	**0.80**	0.49
OS4	0.33	0.53	**0.80**	0.45	0.32	0.44	**0.80**	0.44	0.42	0.52	**0.76**	0.54
OS5	0.32	0.48	**0.75**	0.47	0.35	0.46	**0.77**	0.40	0.40	0.56	**0.77**	0.51
OS6	0.35	0.49	**0.79**	0.47	0.32	0.40	**0.77**	0.40	0.35	0.58	**0.82**	0.54
OS7	0.36	0.44	**0.79**	0.47	0.39	0.42	**0.81**	0.45	0.31	0.43	**0.79**	0.54
OS8	0.38	0.46	**0.79**	0.47	0.42	0.47	**0.78**	0.43	0.29	0.44	**0.75**	0.50
OS9	0.44	0.56	**0.93**	0.59	0.46	0.52	**0.93**	0.53	0.39	0.61	**0.93**	0.68
RC1	0.45	0.61	0.55	**0.91**	0.43	0.65	0.48	**0.91**	0.61	0.60	0.59	**0.93**
RC2	0.48	0.68	0.59	**0.91**	0.38	0.68	0.56	**0.88**	0.58	0.68	0.58	**0.91**
RC3	0.54	0.63	0.57	**0.90**	0.48	0.67	0.52	**0.87**	0.48	0.56	0.54	**0.90**

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