A Framework For Negotiating Information Technology Outsourcing Agreements

Submitted by

Ms Subha Chandar

School of Management and Information Systems

Faculty of Business & Law

Victoria University

Melbourne, Australia

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Principal Supervisor: Professor John Zeleznikow

Email: schandar@chartgroup.com.au

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DECLARATION

I, Subha Chandar, declare that the PhD thesis entitled ***A Structured Framework for Negotiating Information Technology Outsourcing Agreements*** contains no material that has been submitted previously, in whole or in part, for the award of any other academic degree or diploma.

I assert that except where otherwise indicated, this thesis is my own work.

This thesis is no more than 100,000 words in length including quotes and exclusive of tables, figures, appendices, references and footnotes.

Signature **Date**

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Thank You.

ABSTRACT

It is becoming increasingly difficult for organisations to achieve strategic advantage through Information Technology outsourcing. Expectations of benefits and the significance or "business value" placed on them remain very high. However, research conducted by Gartner shows that as much as 50% of Information Technology Outsourcing agreements fail to achieve a satisfactory outcome.

Carefully negotiated IT outsourcing agreements can deliver substantial benefits to the organisation as a whole. However, current industry practices in negotiating IT outsourcing agreements are based on ideology, fashion and personal expectations rather than structured techniques. Subsequently, a large proportion of IT outsourcing agreements either fail to deliver expected results or terminate abruptly, with severe consequences to the organisation.

An Outsourced IT environment is complex. It is also exposed to many internal and external pressures. The long-term nature of an IT outsourcing agreement also poses additional challenges, as the contract that is put in place needs to withstand numerous changes. These include changes not only affecting the outsourced IT department directly, but changes to the client's or supplier's business priorities, and economic or global influences.

Negotiation of an IT outsourcing agreement is not an intuitive, ad-hoc process. Nor is it a procurement process, where negotiation can occur predominantly on price. Understanding the complex organisational, strategic and operational changes that need to take place in an outsourcing endeavour is imperative to the negotiation process. An organisation is most likely to benefit from outsourcing if it understands exactly how the outsourcing vendor will provide value and can use that knowledge to effectively negotiate an agreement.

Research shows that poorly crafted IT outsourcing agreements factor significantly in the eventual failure of such agreements. However, there is currently no structured methodology for negotiating information technology outsourcing agreements.

The PhD research project described in this thesis develops a structured framework for negotiating information technology outsourcing agreements and then evaluates the effectiveness of the framework. The framework is based on principled negotiation techniques and industry best practices.

INTRODUCTION

1.1 Aims Of The Research

The aim of this PhD Thesis research project is to develop and prove the effectiveness of a structured framework for the negotiation of information technology (IT) outsourcing agreements. This framework is based on existing structured negotiation techniques and industry best practices. The framework focuses on the negotiation process of an IT outsourcing agreement, rather than the execution, management or governance of the IT outsourcing agreement.

The following specific goals are fulfilled by the research project:

- An in-depth examination of IT outsourcing agreements.
- An examination of current Australian industry practices in the negotiation of IT outsourcing contracts.
- An evaluation of the need for a structured framework for negotiating IT outsourcing agreements.
- An exploration of existing structured techniques for supporting negotiation in non-outsourcing areas and an assessment of their applicability to the IT outsourcing domain.
- An examination of industry-based case studies and identification of best practices for the negotiation of IT outsourcing agreements.
- The development of a framework for the structured negotiation of IT outsourcing agreements.
- An evaluation of the framework through application to industry-based negotiation and consultation with industry practitioners.

1.2 Research Background and The Benefits of Conducting Research

Information Technology (IT) outsourcing can be described as the practice of selectively handing over the management, operations and delivery of some or all of the IT functions to third party vendor(s) (Barthélemy 2003, Hirschheim & Lacity 2000).

IT outsourcing is now considered an integral part of successful business operation. In recent years, private and public sector organisations worldwide have outsourced significant portions of their IT functions, among them British Aero-space, British Petroleum, Canada Post, Chase Manhattan Bank, Continental Airlines, Continental Bank, First City, General Dynamics, United Kingdom Inland Revenue, JP Morgan, Kodak, Lufthansa, McDonnell Douglas, South Australian Government, Swiss Bank, Xerox, and Commonwealth Bank of Australia (Hirschheim & Lacity 2000).

Beaumont and Costa studied IT outsourcing in Australia. They found that almost 40% of Australian organisations outsource one or more of their IT functions (Beaumont & Costa 2002). According to a more recent study that proportion is expected to increase steadily (Barthélemy 2003).

Empirical evidence suggests that carefully crafted outsourcing strategies increase the overall performance of the firm (Gilley & Rasheed 2000). Outsourcing is generally considered as a very powerful tool to cut costs and improve performance. Through outsourcing, firms can take advantage of the best outside vendors and achieve rapid change in technological direction and organisational structure. Outsourcing can also help organisations focus on their core business (Chandar & Zeleznikow 2006). Since building core competencies and serving customer needs are critical to a firm's success, anything that detracts from this focus may be considered for outsourcing (Barthélemy 2003).

Even though outsourcing IT is a widely adopted practice, and can deliver substantial benefits, handing over a part of, or the entire IT function to a third party involves considerable effort, costs and risks. Not all organisations benefit from outsourcing IT, and the disadvantages can create serious problems for organisations if they are not well understood and managed (Gottschalk & Solli-Sæther 2006).

It is not uncommon for an IT outsourced arrangement to fail within the first 2-3 years of being initiated, with massive cost overruns and degradation of service levels and consumer confidence. According to a study of 210 IT outsourcing customers and 242 providers published by Diamond Cluster International, the number of customers that prematurely ended both domestic and off-shore outsourcing contracts within a one-year span jumped from 21% in 2004 to 51% in 2005 (Cohen & Young 2006). Even if the outsourced arrangement survives beyond the initial testing period, many organisations fail to achieve the cost benefits or efficiency gains articulated as the reason for outsourcing.

It has been widely acknowledged that IT outsourcing relationships are wrought with difficulties. The relationship, even when it begins with clearly articulated expectations, can be wrought with confusion on accountability, communication issues, mistrust, blame, lack of transparency of total cost of ownership and dispersed focus on issues affecting key outcomes (Bendor-Samuel 2002, Cohen & Young 2006). Relationship problems, between the supplier and the client, result in loss of flexibility to change with the changing strategic imperatives of the organisation and may lead to costly litigation or early termination of contract (Cohen & Young 2006).

Many theories exist as to why IT outsourcing arrangements fail. Research indicates that effective negotiation of the IT outsourcing contract is a predicator for success (Ang & Toh 1996, Bendor-Samuel 2002, Barthélemy 2003, Cohen & Young 2006). However, De-Loof (1996) in his study of outsourcing practices found that formal methods and a theoretical foundation for outsourcing decisions are largely lacking. The study found that practitioners make decisions based on ideology, fashion and personal expectations instead of structured analytical techniques. More recent research also confirms this and suggests that 84% of Australian companies, almost twice the global average, approach IT outsourcing in an un-structured manner (Cohen & Young 2006).

Without an effectively negotiated agreement, problems quickly mount and the outsourcing relationship can deteriorate into mistrust, miscommunication and inflexibility. This can lead to significant risks for both the customer and provider(s) and eventually result in a total breakdown in the relationship with costly consequences such as litigation and early termination of the agreement (Cohen & Young 2006).

With recent exponential growth in the reliance on IT outsourcing, the increasing complexities and dissatisfaction over outcomes (Cohen & Young 2006), an urgent need for a structured approach to IT outsourcing negotiation has emerged. Key questions remain un-answered in published literature, such as how to structure the negotiation of IT outsourcing, what style of negotiation to use and what issues need to be considered during negotiation sessions. Structured negotiation techniques in other domains may help answer these questions and highlight a suitable technique to use for IT outsourcing negotiations.

A structured framework to negotiate and establish an effective IT outsourcing arrangement does not currently exist (Cohen & Young 2006, De-Loof 1996). While individually, the areas of IT outsourcing management and governance are well researched, as is the domain of negotiation, current research literature does not cover the specific domain of negotiating IT outsourcing contracts.

This project significantly contributes to domain-specific knowledge by establishing an effective method of structured reasoning and developing a 'best practice' model or framework for consistently negotiating IT outsourcing contracts.

1.3 Research Design and Approach

This research project developed a structured framework for negotiating IT outsourcing agreements. There is a large body of research in IT outsourcing in general, however, few specifically address the negotiation of IT outsourcing contracts. Due to a dearth in published literature in the specific domain of negotiating IT outsourcing agreements, the following approach was taken.

The research project examined published literature in non domain-specific structured negotiation techniques, outsourcing in general IT outsourcing specifically and finally IT Outsourcing Negotiations. The project used published literature in these domains to identify any gaps in knowledge or inefficiencies in current industry practices in the specific domain of IT Outsourcing Negotiations.

The project examined industry-based case studies to identify industry best practices in the domain of IT outsourcing negotiations. Using qualitative interviews with domain experts, practices associated with negotiation of successful agreements have been incorporated into a set of guidelines, which form the proposed structured framework for negotiating IT outsourcing agreements.

The quality of the guidelines and the effectives of the framework thus produced have been evaluated by industry-based domain experts.

How the investigation into published literature and case studies was structured:

It was first necessary to define IT outsourcing. We then examined how IT outsourcing success can be defined and measured. We also distinguished how IT outsourcing negotiations can be defined and measured. We examined current industry practices in negotiating IT outsourcing agreements and examined whether any structured methods were used. We then examined the effects of these practices on the overall success of the IT outsourcing negotiation.

We analysed how to define success of an IT outsourcing negotiation. To do this, we first evaluated existing strategies to define and measure success of negotiations in general. We then determined a suitable method to define and measure the success of an IT outsourcing negotiation.

We also explored how the success of the IT outsourcing agreement can be measured and at what time-points this measurement should take place. It was also necessary to explore whether (and how) the success or failure of the IT outsourcing agreement could be tied to the measurement of success in the negotiation process.

The PhD research project also investigated the possibility of using principled negotiation techniques in negotiating IT outsourcing agreements. A brief analysis was undertaken, using published literature, of existing negotiation techniques, including but not limited to principled negotiation, and how these techniques may be applicable to the IT outsourcing domain.

Using case studies and interviews with domain experts, replicable common factors associated with the negotiation of successful IT outsourcing agreements were extracted for use in the proposed framework.

Table 1 below, summarises the basis of this research study using the investigative lines highlighted above. The research questions themselves were not obtained from the review of published literature, but rather developed as a way to structure the examination into published literature. Due to a dearth of published literature specifically dealing with IT outsourcing negotiation, as mentioned in Chapter 1.3, a qualitative review of case studies and interviews with domain experts were also conducted. The justification for choosing this research design and approach is included in Chapter 1.6.

1.4 Conceptual Framework

Research Questions used to examine the domain of IT Outsourcing Negotiations	Methods used to answer questions	Outcome produced
▪ What is IT outsourcing? ▪ How can IT outsourcing success be defined and measured? ▪ How can success of an IT outsourcing *negotiation* be defined and measured? ▪ What are the unique constraints, challenges and drivers involved in negotiating IT outsourcing contracts? ▪ What are current industry practices when negotiating IT outsourcing agreements? ▪ What structured techniques are currently used for negotiating IT outsourcing? ▪ What would be the benefits of a structured framework? ▪ What industry practices lead to an effectively negotiated IT outsourcing agreement? ▪ What structured negotiation techniques are used in non-IT outsourcing domains? ▪ How are these applicable to the IT outsourcing domain?	▪ Literature Review ▪ Qualitative interviews with domain experts ▪ Examination of industry based case studies ▪ Development of the framework ▪ Evaluation by domain experts ▪ Refinement of the framework	A STRUCTURED FRAMEWORK FOR NEGOTIATING INFORMATION TECHNOLOGY OUTSOURCING AGREEMENTS

Table 1: Conceptual Framework

1.5 Justification For Chosen Research Design And Approach

There is, at present, a dearth of published research specifically focusing on IT outsourcing negotiations. However, the topics of negotiation in other domains and IT outsourcing are well researched. Hence, through necessity, this proposal is set in the context of existing research literature on negotiations in other domains and IT outsourcing in general. The PhD thesis examines existing literature to determine the need for a structured framework for negotiating IT outsourcing agreements. The study examines existing structured negotiation techniques in non-IT outsourcing domains and then analyses published research in IT outsourcing to assess the applicability of such structured techniques to the domain of IT outsourcing.

Due to the dearth in published research on IT outsourcing negotiation techniques and best-practice methodologies, this PhD research examines industry-based case studies and interviews with industry-based domain experts to glean successful strategies that can be adopted when negotiating IT outsourcing agreements.

The conceptual framework described in Figure 1 summarises the research approach used and the research questions anchoring the focus of the research. The 'Methods' column in Figure 1 describes the qualitative research techniques used to answer these questions. The third column in Figure 1 identifies the final outcome of the research study.

It would have been possible to conduct this research using only the review of IT outsourcing agreements and governance documents without the conduct of interviews with industry experts. However, this approach would have assumed that all the issues, problems and interactions between the suppliers and the clients during negotiation and beyond, would have been recorded in the documents. In practice, most of the techniques used and details of the discussions during negotiation of an IT outsourcing agreement are not recorded formally. The formal agreement would encapsulate the main points of the discussions. However, it is not possible to glean industry best practices using the review of these documents alone.

It would also have been possible to conduct this research with the sole use of interviews with industry experts. However, this would then increase the number of discussions needed for a complete understanding of each IT outsourcing agreement's background, the business environment and the issues and challenges pertaining to the negotiation of such agreements. It was necessary to keep the length of the discussions with busy IT executives to a minimum. It was also not possible to conduct a thorough analysis of all the case studies using interviews alone because not everyone involved in the negotiation and management of each IT outsourcing agreement was available for an interview.

The approach adopted by this research study was therefore to review the documents pertaining to each IT outsourcing case studies first, to identify areas that required further exploration, and identify specific techniques that produced an effective result. Then to augment the information collected through the review of documents, interviews were conducted with industry experts who were directly involved in IT outsourcing negotiations. The interviews were aimed at exploring issues and challenges in IT outsourcing agreements and practices in negotiating such agreements that consistently produced a successful outcome.

Forthcoming chapters describe in detail the research methodology adopted by this PhD research project.

1.6 Detailed Research Methodology

1.6.1 Overview

The project adopts qualitative research methods. Published research literature was used to identify gaps in knowledge. Qualitative analysis of industry base case studies was used to identify current practices and inefficiencies in industry practices.

Existing structured negotiation techniques used in non-IT outsourcing domains may be readily applicable to the domain of IT outsourcing. However, a thorough exploration and understanding of IT outsourcing agreements was needed before determining the most effective structured negotiation approach. Thus, the examination and documentation of IT outsourcing was the first task of this project.

Due to a lack of published research in the domain, existing structured negotiation techniques used in non-IT outsourcing domains were also evaluated for their applicability to the domain of IT outsourcing. It was also necessary to study how to define and measure the success of an IT outsourcing endeavour as well as success of an IT outsourcing negotiation. A qualitative study of industry-based case studies was needed, along with interviews with domain experts, to further explore negotiation factors that are necessary for a successful IT outsourcing arrangement. Given the difficulty of obtaining a large sample of busy IT outsourcing executives, and the need for in depth interviews lasting an hour, the sample size of 10 case studies was chosen for this study. The knowledge gained by this qualitative analysis was built into a framework – an industry best-practice model, for effective IT outsourcing negotiation.

This framework was then evaluated by industry-based domain experts and further refined before the publication of this PhD dissertation. The research methodology adopted is described in detail in the forthcoming chapters.

The project focuses upon case studies in Australia. Hence, the negotiation framework has been developed for and evaluated by Australian organisations. However, it is expected that the research outcomes should be readily applicable, with minor modifications, to organisations in any geographical region.

1.6.2 Phase 1: Literature Review

One of the major aims of the literature review was to gain an in depth understanding of IT outsourcing as well as existing structured negotiation techniques. Some of the specific objectives were:

- Examine IT outsourcing as distinct from other IT contracts.
- Compare outsourcing IT services with outsourcing other services.
- Identify the different types of IT outsourcing.

- Document the construct of the IT outsourcing lifecycle.
- Establish how success of IT outsourcing can be defined and measured.
- Establish the needs and benefits of a structured framework for negotiating IT outsourcing contracts.
- Examine existing structured negotiation techniques in IT outsourcing and other domains.
- Identify a suitable structured negotiation technique for use in IT outsourcing negotiations.
- Establish how success of an IT outsourcing negotiation be defined and measured.

1.6.3 Phase 2: Interview and Case Studies

Due to the dearth in published literature in IT outsourcing negotiation, it was not possible to fully answer all the research questions raised by a review of literature alone. It was therefore necessary to interview domain experts and thoroughly examine industry-based case studies.

Ethics Committee approval was sought and obtained on the proposed research methodology including sample interview questions. The aim of the examination was to answer the research questions stated in Table 1.

A semi-structured interviewing technique was used. Interview questions were designed to be flexible, rather than a set questionnaire. The skill base and authority level of the domain expert being interviewed dictated the discussions. Some sample questions are provided in Appendix 3.

The initial aim was to investigate approximately 25 outsourcing agreements in Australia spanning multiple large organisations. The sample size was reduced to 10 and a more in-depth examination of each case study was conducted.

The reason why large organisations were chosen for this study was because larger organisations are more likely to approach IT outsourcing on a big scale and have more rigour and structure in their processes, including the conduct of formal negotiations and selection of providers. A large organisation is also more likely to be able to provide the research team with access to documented knowledge regarding current or past arrangements than a medium to small size business. The research team was also able to readily access domain experts in a number of large organisations, which is another secondary reason for limiting the area of study to large organisations.

1.6.4 Phase 3: Construction of Framework

The aim of this phase was to develop a framework to enable effective negotiation of IT outsourcing agreements. This framework was based on structured negotiation techniques and industry best practices identified in the qualitative analysis phases of this project. Specific objectives were:

- Identify suitable existing structured negotiation techniques, or develop an optimal structured technique for negotiating IT outsourcing agreements.
- Incorporate into the framework, strategies identified from industry case studies and consultations with domain experts.

1.6.5 Phase 4: Evaluation and Refinement of Framework

Finally, industry-based domain experts evaluated the framework for effectiveness and completeness. Specific aims of this phase were:

- Fully define success criteria and mechanisms for measurement of success for the negotiation framework,
- Using industry experts, evaluate the framework developed by the candidate against defined success criteria.
- Refine the framework.
- Identify further research needs.

1.7 Participants In The Case Study

The PhD study examines industry-based case studies in IT outsourcing negotiations, to determine best practice methodologies. The research also includes the conduct of interviews with domain experts. Participants from several large organisations in Australia have been involved in this project on a voluntary basis. The participants were not chosen in any systematic way from a large pool of available resources. The research project had limited means to enlist the support of large organisations (more than 1000 employees) in Australia. Thus the participants chosen for the research project were any that agreed to participate.

Each of the participants has been directly involved with the negotiation of one of the IT outsourcing agreement under analysis by this research project. They hold, or held at the time of the negotiation, authoritative, executive roles in the organisations involved in the IT outsourcing agreement. They had the capacity to make decisions on the overall strategy of the organisation, as well as decisions pertaining to the outsourcing endeavour.

However, the publication of individual's opinions or observations, and the publication of confidential details of the contractual agreements could possibly cause adverse consequences, for the individuals and for the organisations involved. Hence, the participants' names and titles as well as the names of the organisations have been suppressed.

Although 14 industry-based cases were studied, a sample size of 10 case studies was chosen for this research study. An evaluation of the adequacy of this sample size is included in Chapter 10.

Six industry-based domain experts, consisting of three involved in the case studies of this research and three not involved in the case studies, have evaluated the outcomes of this project.

1.8 Research Outcomes

The following specific goals have been fulfilled by the research project:

- An in-depth examination of IT outsourcing agreements.
- Examination of current Australian industry practices in the negotiation of IT outsourcing contracts.
- An evaluation of the need for a structured framework for negotiating IT outsourcing agreements.
- An exploration of existing structured techniques for supporting negotiation in non-outsourcing areas and an assessment of their applicability to the IT outsourcing domain.
- An examination of industry-based case studies and identification of best practices for the negotiation of IT outsourcing agreements.
- The development of a framework for the structured negotiation of IT outsourcing agreements.
- Evaluation of the framework through application to industry-based negotiation and consultation with industry practitioners.

The result of the research project is a structured framework for negotiating IT outsourcing contracts.

The framework focuses purely on the process of negotiating an IT outsourcing agreement – rather than the execution, management or governance of the contract or other aspects of the IT outsourcing life-cycle.

The framework consists of:

- A list of factors that need to be considered prior to the negotiation of IT outsourcing contracts.
- Guidelines on how to prepare for the negotiation, such as, what information needs to be gathered.

- Guidelines on a suitable negotiation style and technique to use.
- Guidelines on how to structure the negotiation, who to involve, and how to develop a negotiation strategy.
- A checklist of considerations or discussion topics to aid dialogue during negotiation sessions.
- Guidelines on how to approach ongoing negotiations (or re-negotiations) once the contract is established.

The structure of the framework was not based on an existing structured methodology or on published literature dealing with IT outsourcing negotiation. The structure of the framework was based on the grouping of the findings derived by the project, that correlated with the sequence of events one might expect of the life-cycle of an IT Outsourcing negotiation. As mentioned in 1.7.3, there is a dearth in published literature specifically dealing with IT outsourcing negotiations. As supported by published literature detailed in Section 5.11, there are significant gaps in knowledge on industry best practices that lead to a successful IT outsourcing outcome. These gaps in published literature were used to develop sample interview questions and to develop the overall structure of the above research outcome, the framework for negotiating IT outsourcing agreements. The structure of the research outcome, was further refined from feedback obtained from the academic community during the PhD Candidature Approval Process, as well as during the review of papers and discussions at the academic conference listed in Appendix 7.

Whilst the research focuses upon IT arrangements in particular, the research outcomes should prove an invaluable tool for any organisation contemplating entering into an outsourced arrangement regardless or not whether the deliverables of that arrangement is for the provision of IT services.

1.9 Evaluation Of Research Outcomes

An important task in any research project is an evaluation of the results developed in the project. The quality of the guidelines and the efficacy of the framework for negotiating IT outsourcing agreements were evaluated using the following criteria:

- The level of improvement to the IT outsourcing negotiation process as a result of using this framework.
- Did the framework facilitate transparency of factors that need to be considered prior to conducting IT outsourcing negotiation?
- Does the framework provide guidelines on a suitable negotiation style and techniques to use when negotiating IT outsourcing agreements?
- Does use of the framework aid preparation for negotiating IT outsourcing agreements? Does it provide topics or factors to be considered for discussion during the negotiation? Does the use of the framework provide structure to the process of negotiation?
- Does the contract established as a result of using the framework, contain defined success criteria and mechanisms to measure these criteria objectively?
- Does the resultant contract contain flexibility? I.e., does it allow for the planned re-negotiation of certain terms and conditions? Does the contract allow for early termination under certain circumstances?
- Can the resultant contract cope with changes to the organisations' priorities, strategic direction and structure?

The structured framework for negotiating information technology outsourcing agreements was evaluated by industry-based domain experts.

1.10 Ethical Considerations

Participants in this research were senior members of the organisations involved in one or more IT outsourcing negotiations. They have been involved in this research project in a voluntary capacity.

Each Participant was given a document titled "Information for Participants" with details about the research project; what they will be asked to do; what they will gain from participating; how the information given will be used; the potential risks of participating; how the project will be conducted; contact details of researchers and the contact details of the Ethics Committee of Victoria University. This document is included in Appendix 1.

Each participant was also given a consent form. The consent form records the participants agreement to meet with the researcher for approximately one hour to answer questions pertaining to the negotiation of IT Outsourcing Agreements; and to confirm via email that the information gathered via this meeting and any documents viewed, has been accurately summarised in the Case Study Summary included in Appendix 5. The consent form is included in Appendix 2.

Victoria University's Faculty of Business & Law, Human Research Ethics Committee reviewed and approved the PhD research proposal at its meeting on the 28th of January 2010.

One of the conditions with which this approval was granted was to have written permission from any organisations, or participants whose name is to appear in this PhD dissertation before publishing their names and particulars. However, there was widespread concern among industry participants, that the opinions or observations communicated during the interviews, or the information made available in the case studies, may have a negative impact on the organisation or individuals involved in the IT outsourcing agreements.

There were possible privacy implications and possible breaches of contractual agreements, if particulars of specific IT outsourcing negotiations were made public. It was also deemed unnecessary that such details be made public. The aim of this research project was to glean industry best-practice methodologies and strategies in negotiating IT outsourcing agreements. Thus, the name and particular details of the organisations or persons involved in the negotiation was not considered in the qualitative analysis of the information.

Due to possible adverse consequences to the identification of specific organisations or individuals, and the publication of details of the negotiation, the names of the participants, as well as the names of the organisations have been suppressed in this dissertation.

In this PhD thesis, the participants and case studies have been represented as categories including broad industry sectors, generic job titles, the value and nature of the outsourcing deal and the size of the organisations involved.

1.11 Chapter Summary And Conclusions

Information technology outsourcing can be described as the practice of selectively handing over the management, operations and delivery of some or all of the IT functions to third party vendor(s). IT outsourcing is now considered an integral part of successful business operation. However, more than half of these outsourcing agreements fail within the first year, with massive cost overruns, and serious consequences for the organisations involved.

Research has linked the success of an IT outsourcing agreement with effective negotiation, when establishing the arrangement. However, studies confirm that current industry practice is to use unstructured methods of negotiation, based on ideology, fashion and personal expectations, rather than structured analytical techniques.

There does not exist an effective, structured methodology for negotiating an IT outsourcing agreement. The PhD thesis described in forthcoming chapters aims to address this gap, using qualitative research techniques.

The research has been conducted in four phases,

Phase 1: Consisting of the review of published literature in structured negotiation techniques, outsourcing in general and specifically, IT outsourcing.

Phase 2: Consisting of the examination of industry-based case studies and interviews with industry-based domain experts to glean industry-best practices or strategies that could be used to produce a successful IT outsourcing negotiation.

Phase 3: The construction of the "Framework for Negotiating IT Outsourcing Agreements" based on information gained through previous phases.

Phase 4: The evaluation of the framework by industry-based domain experts and the refinement of the framework incorporating any feedback.

Subsequent chapters present the work conducted as part of this PhD research project, including an analysis of the results.

2 THEORETICAL FOUNDATIONS OF NEGOTIATION

2.1 A Definition Of Negotiation

Harvard Business School (2003) define negotiation as the means by which people deal with their differences. These differences may involve a legal dispute, the purchase price of an item, the terms of sale, or a complex alliance between two companies. The precursor to negotiation is typically when two or more parties want to interact, have competing interests or drivers and a mutually satisfactory resolution is sought. To negotiate is to seek mutual agreement through dialogue (Harvard Business School 2003).

In the case of a negotiation between an outsourcing company and suppliers, the purpose of discussions is to reach a consensus regarding the type of services to be rendered, the price, the length of the legal contract, key aspects of the outsourcing relationship including how the relationship is going to be managed, as well as other terms and conditions. Whilst the resulting settlement of a successful negotiation, in this case a contractual agreement, can indicate success, another indicator is the level of satisfaction parties find with the negotiation process (Bellucci & Zeleznikow 2006).

2.2 Types Of Negotiation

Distributive Negotiation:

In distributive negotiations, a gain or win by one side is made at the expense or loss of the other (Walton & Mckersie 1965). The factor that influences negotiations here is related to content. In distributive negotiations multiple parties seek to access a limited resource. The basic assumptions in distributive negotiation are that:

1. Negotiation is a zero-sum game where parties want the same goals, items and values;
2. The contents must be divided. (Sourdin 2005).

Thus this kind of negotiation is also referred to as zero-sum or constant-sum negotiation. In a purely distributive negotiation, the value at stake is fixed and each party's goal is to get as much of it as possible (Walton & Mckersie 1965).

Distributive negotiation is often characterised by adversarial approaches and competitive behaviours. (Sourdin 2005).

Relationship and reputation factor less in distributive negotiations than in other forms of negotiation. However, information regarding the other party's constraints and interests play an important role.

Integrative Negotiation:

Integrative negotiation assumes that the objectives and interests of parties involved in the dialogue are not mutually exclusive. I.e., that by approaching the negotiation in a structured manner by defining the problem, exploring underlying issues and generating options, it is possible to create outcomes that satisfy more than one party's underlying interests (Sourdin 2005). An integrative negotiation is a negotiation in which the parties co-operate to achieve maximum benefits, by integrating their interests into an agreement. Companies use integrative negotiation methods when building long-term relationships with other organisations. In this type of negotiation, it is important to understand the interests, preferences and constraints of both sides. With the aid of this information, it is then possible to find opportunities for mutual benefit (Walton & Mckersie 1965).

Sourdin also affirms that mutually satisfactory (joint) outcomes are more likely to be achieved where integrative negotiation processes are used (Sourdin 2005). In addition the integrative negotiation approach is said to enhance relationships and enhance satisfaction. (Sourdin 2005, Atkin & Rinehart 2006).

It is most common for negotiators to mix both methods, integrative and distributive, when negotiating a business agreement. The resultant technique could be best described as a careful act of balancing competitive strategies with cooperative strategies.

Multiphase Negotiation:

In a multiphase negotiation, the negotiation takes places in phases, each phase devoted to one of several important issues. In these situations, early phases allow parties to build trust by performing their agreements as promised. A failure by one party to perform indicates to the other party the need to be wary in future dealings. Early phases also allow parties to become familiar with each other's negotiation styles and exchange information regarding interests, preferences and constraints. This familiarity and added information leads to more productive negotiations in later phases (Harvard Business School 2003).

Multiparty Negotiation:

Most business negotiations are multiparty negotiations, involving more than two parties. In this type of negotiation, coalitions can form among the parties involved. A natural coalition can form between allies who share a broad range of common goals or interests. Or, a single-issue coalition can form, in which parties that differ on other issues unite to support or block a single issue. The challenge of multiparty negotiations is managing coalitions to optimise outcomes that support your interests (Harvard Business School 2003).

2.3 Negotiation Styles

Selected negotiation styles are described in brief below. It is the intent of the researcher to briefly introduce the different styles and describe principled negotiation style in detail and how it may be suited to IT outsourcing negotiations.

Interest-Based Negotiation:

This style of negotiation incorporates integrative methods, where parties seek to create an outcome that mutually satisfies their interests. Interests do not necessarily need to be aligned. However, an open and honest dialogue is necessary to create the best "value-add" alternatives.

Power-Based Negotiation:

Negotiating on the basis of power is notable for the following characteristics. Firstly, it can occur when the influence each party has over the other is not equal. I.e., one party holds more power to affect the other party's overall success. For example when a small, unknown IT provider is negotiating a deal with an influential multi-national company. The large, multi-national company does not need to do business with the small, unknown IT provider. However, the unknown IT provider would have considerable interests in doing business with such a significant client. The promise of a stable, lucrative alliance with the multi-national organisation, the potentially beneficial influence on other clients and on future prospects, makes the small, unknown IT provider more inclined to make concessions and less inclined to dictate terms during the negotiations. Thus, the multi-national firm holds greater power during the negotiation.

The second characteristic of a power-based negotiation is that negotiation does not rely on sound arguments, or on the consideration of the best solution for mutual gain. It rather relies on which of the negotiating parties is the stronger. The parties may not be open and honest about their interests, constraints or on the shortcomings of the proposed solution. The discussion may be instead focussed on conveying power and how outcomes may impact the weaker party. International disputes are often power-based.

Positional Bargaining:

Positional bargaining is a negotiation strategy that involves each party holding on to a fixed idea, or position, and often opposing viewpoints. Each side may start with an extreme position and proceed from there to negotiate and make concessions. Haggling over a price is a typical example of positional bargaining. Fisher, Ury & Patton argue that positional bargaining does not tend to produce good agreements. They advise that it is an inefficient means of reaching agreements, and the agreements tend to neglect the parties' interests. The style encourages stubbornness and so tends to harm the parties' relationship. Parties may be forced to trade off substantive issues to save the relationship (Fisher, Ury & Patton 1994). Even if a compromise is reached, the resultant agreement may not effectively satisfy the interests of any of the parties involved. Ambit claims in industrial disputes are examples of positional negotiation.

Persuasive or Argumentative Negotiation:

Negotiation based on argument and persuasion differs slightly from interest-based negotiation in that satisfying the interests of both parties is not of paramount importance in persuasive negotiation. The negotiator may argue points, and use the powers of persuasion to get the other side(s) to agree. The arguments may not necessarily be sound. Information may be carefully omitted in order to support a position. Importantly, the motive for the agreement is for personal gain – not mutual gain. While this strategy may work in a situation where the parties do not interact in an ongoing fashion, it is unwise to pursue this style when a long term, ongoing agreement is being negotiated.

Negotiating in the Shadow of the Law:

Mnookin and Kornhauser introduced the shadow of trial concept. By examining the case of divorce law, they contended that legal rights of each party could be understood as bargaining chips that can affect settlement outcomes. Negotiations that are "in the shadow of the law" are shaped partially by the parties' estimates of what a court will do if no agreement is reached and the case goes to trial (Mnookin & Kornhauser 1979). I.e., in negotiations involving divorce or private disputes, each party considers how the court will decide on certain issues, and this information shapes the agreement. Clearly, this style of negotiation may be more applicable to dispute resolution rather than to the negotiation of a long-term contract.

Principled Negotiation:

Principled negotiation is the name given to the interest-based approach to negotiation. Fisher, Ury and Patton advocate four fundamental principles of negotiation:

- Separate the people from the problem;
- Focus on interests, not positions;
- Invent options for mutual gain; and
- Insist on objective criteria (Fisher, Ury & Patton 1994).

2.4 The Concept Of Fairness In Negotiation

Brams and Taylor state that a negotiation is fair when it satisfies the following criteria (Brams & Taylor 1999).

Proportionality and Envy-Freeness:

The concept of proportionality dates back to the Greek philosopher Aristotle, who proposed that goods be divided in proportion to each claimant's contribution. The concept of proportionality requires that some common scale is used, even if that only refers to percentages of individual benefit.

However, the concept of envy-freeness as Brams and Taylor define it, is when two or more parties receive (or think they are receiving) an equal share of the settlement. Envy-freeness is therefore a purely individualistic concept that requires no inter-personal comparison of benefits at all. Satisfaction is linked to receiving a "fair share". The perception is that each party is getting a fair deal (Brams & Taylor 1999).

Equitability:

When parties place different values on a certain asset or benefit, each of the parties may not receive the same fraction of the total value, however, they *believe* they got a greater share than the other claimant(s). Equitability is where parties are equally pleased by the agreement.

Disputants often have differing opinions about what they consider "fair". Measuring "fairness" in a negotiation will greatly depend on the nature of negotiated items and what value each party places on these items (Brams & Taylor 1999).

Fisher, Ury and Patton advocate using fair standards and fair procedures in complex negotiations (Fisher, Ury & Patton 1994).

Fair Standards is when all parties involved in the negotiation, reach an agreement, using only objective criteria.

Procedural Fairness refers to a process that provides fairness to all parties. It includes the right to be heard, the right to be treated without bias, the right to be fully informed and to be provided with equal opportunity to participate.

Components of procedural fairness include:

- ***Openness:*** there needs to be a clear & well-publicised negotiation process;
- ***Impartiality:*** the process should use objective criteria for decision making and avoiding bias;
- ***Accessibility:*** each party should have equal access to the individuals involved, and to all information;
- ***Completeness:*** the process should allow all parties to participate fully in the negotiation;
- ***Equitability:*** each of the parties involved in the negotiation should be treated equally.

When multiple parties are involved in negotiations, there is an increased need to focus on the concepts of fair standards and process, and ensure that the negotiation is both structured and efficient.

When specifically analysing contract negotiations in a corporate setting, the concept of "fairness" is harder to measure and rarely included in the success criteria by which the negotiation is measured.

However, in an IT outsourcing negotiation, it is important to note that an agreement that is reached using fair standards and a fair process is more likely endure, over the long term, rather than an agreement where one party is severely disadvantaged.

Consider an IT outsourcing agreement, where the customer (or client), is a high profile organisation of substantial market presence and thus has the ability to influence other organisations in their decisions to chose an IT outsourcing provider. Suppose also that a fairly small, unknown IT outsourcing services provider is in the mix of several potential candidates to become an IT service provider. The small external service provider (ESP) may consider it "fair" that significant concessions need to be made in terms of costs and increased levels of services, to "win" such a lucrative alliance. The large client may also feel it is fair that some of the risks of proceeding with a small, unknown ESP are mitigated with increased levels of services at a substantially reduced price. Both parties may feel equally satisfied with the outcome of the negotiation. The agreement may be perfectly legal. The process of negotiation may be structured and "fair". However, it may be possible that the small ESP is unable to sustain the levels of services agreed, at such a low cost. The client would have spent a considerable investment in time and effort to outsource its IT services and have transitioned operational activities to the ESP. If the client previously had capability to provide the selected IT services internally, that capability would be greatly diminished once the transition to the outsourced provider had been completed. The client's focus would have shifted from providing IT services to managing the outsourced provider. Thus the client would be heavily reliant on the now struggling, ESP for these IT services. The inability of the ESP to sustain its business will then affect the client's ability to sustain its market competitiveness. It is therefore, vitally important, in the case of IT outsourcing agreements, that the durability of an agreement be considered and employing fair standards and fair process may well be important factors in this.

2.5 Challenges In The Negotiation Process

There are challenges with every negotiation. These include people issues, tactical issues such as corporate structure impediments, or mental errors or traps a negotiator can fall into. There are also additional problems such as: What if other parties are more powerful? What if the other party won't play by the same rules? What if other parties play dirty tricks?

In IT outsourcing negotiations, the client in the market for outsourced IT services, may enter into negotiations with several IT services providers. The negotiations may be fairly advanced before a final service provider is selected. In some cases, a number of service providers may be selected, and services may be divided up and awarded to multiple parties, thus mitigating several risks, including that of being solely dependant on one IT service provider.

In a multi-party negotiation, there are additional challenges such as the formation and dissolution of coalitions, the increased difficulty in process management, and the need for each party to continually assess their best options away from the negotiation table.

Lodder and Zeleznikow describe the inability to realise the repercussions of a negotiation as another significant challenge. In the haste to arrive at a negotiated agreement, or to avoid lengthy and costly negotiations, often negotiators consider concessions and trade-offs. However, it is not uncommon to erroneously assume that concessions reached during a negotiation as having no substantial impact outside the environment of the agreement. Negotiators who do not fully explore repercussions of a decision, concession or trade-off, may be exposing their organisations to significant risks. Lodder and Zeleznikow discuss the case of the late Richard Pratt, who secured an early, negotiated settlement with the Australian Competition and Consumer Commission, avoiding months of potentially damaging publicity for Mr. Pratt and his organisation. However, the concessions Mr. Pratt made to expedite an agreement, later led to criminal proceedings being lodged in the

Federal Court against Mr Pratt. These were subsequently dismissed on 27 April 2009, on account of Mr Pratt's poor health and impending death (Lodder & Zeleznikow 2010).

Druckman and Albin explore the relationship between principles of justice and the durability of negotiated agreements. Focusing primarily on peace agreements negotiated during the early 1990s, the study provides evidence for a positive relationship between a negotiation being just and that negotiation enduring over time (Druckman & Albin 2009). However, in IT outsourcing, procedural fairness, or distributive justice, may not be the only important factors in the overall success of the endeavour. As described in the previous chapter, distributive justice in negotiating an IT outsourcing agreement, or a successful negotiation in the eyes of those involved in the negotiation, does not guarantee an IT outsourcing agreement that will endure long term. Success in IT outsourcing negotiations is discussed in more detail in Chapter 6.5.

One of the key challenges in negotiating IT outsourcing agreements is that both the client and the external service provider need to make a considerable investment in time and effort, upfront, in order to exchange relevant information and establish an overarching agreement that will endure over lifetime of the agreement, through the different stages in the IT outsourcing life cycle. Due to the long-term nature of the agreement, and the several internal and external pressures it is exposed to, the terms and conditions negotiated initially will need to change, or information will come to light only at later stages of the outsourcing endeavour.

The negotiation also needs to take into account the strategic objectives of the organisation, as well as detailed operational factors, in order to produce a sustainable agreement. The complexity of such a negotiation means that several key people in the organisation need to be involved in the negotiation, each with their specific area of knowledge and they need to be supported by legal and outsourcing experts.

A number of case studies were examined by this research study. Detailed analysis of these case studies is included in Chapter 7.3. The case study transcripts are summarised in Appendix 5. The level of complexity can be elaborated by examining case study #11, a summary of which appears in Appendix 5. In case study #11, the new term of the IT outsourcing agreement was negotiated with the existing supplier, solely by the client's operational management staff. The clients involved in the negotiation were well aware of market conditions, the competitive offerings that were available to them, and were keenly aware of the operational requirements, and current problems within the department. They consulted internal lawyers on the terms and conditions of the IT outsourcing agreement. However, they were not aware of a change in strategic direction that was being undertaken, by the company's board, across the organisation, on a global level. This change in strategic direction meant that the decisions taken during the negotiation were no longer aligned with the client organisation's longer-term priorities. In this particular case, the contract was not renewed with the supplier for a new term. However, had the negotiation resulted in a agreement, since the change in the company's strategic direction was not anticipated by the operational manager, any contract that may have eventuated, may not have stipulated clauses or mechanisms by which this strategic change could be accommodated. Establishing a contract that is flexible enough to cope with unexpected changes, yet rigorous and detailed enough to ensure delivery of key objectives is a significant challenge when negotiating an IT outsourcing agreement.

2.6 Chapter Summary And Conclusions

This chapter has explored the definition of negotiation, and the various types and styles of negotiation in practice today. It has also examined the concept of "fairness" in negotiations, and some of the challenges.

The following chapter will undertake a detailed examination of one of the styles of negotiation, principled negotiation.

3 PRINCIPLED NEGOTIATION

3.1 Key Concepts Of Principled Negotiation

Principled negotiation advocates deciding issues on their merits rather than through a haggling process focused on what each party promises it will or will not do. It suggests that you look for opportunities for mutual gain, wherever possible and that where your interests conflict, you should insist that the results be based on some fair standards independent of the will of either side (Brams & Taylor 1999).

Harvard Business School suggests that for a negotiation to be successful, it must have a fundamental framework based on knowing the following (Harvard Business School 2003):

- What are the alternatives to negotiation (what would occur if negotiation did not take place)?
- For each of the items being negotiated, what is the minimum threshold of acceptance, for a deal to be finalised?
- How flexible is either party willing to be, and what trade-offs are they willing to make?

Three concepts are important for establishing this framework: BATNA, Reservation Price, and ZOPA. These are described below.

3.2 BATNAs And ZOPAs

BATNA:

The Best Alternative to a Negotiated Agreement is essentially a party's fall-back position (Fisher, Ury & Patton 1994). E.g., when negotiating an IT outsourcing contract, the client's fall-back position or BATNA could be to cease negotiations and continue with the current sourcing arrangement. A strong BATNA (I.e., an alternative to a negotiated agreement that is almost equally good as a negotiated agreement) gives more bargaining power. A weak BATNA (or an ill-suited alternative to a negotiated agreement) makes it difficult to walk away from a proposal, no matter how unfavourable it may be (Harvard Business School 2003). A party can improve their bargaining power in several ways. These include strengthening their BATNA, identifying the other party's BATNA, and weakening the other party's BATNA.

Parties can strengthen their BATNA by exploring ways in which the alternative option could be made more viable or attractive. Knowing the other side's BATNA let's the party know how far they can go. Here, background information regarding the other party could prove vital. This information includes the other party's concerns, constraints, corporate structure, strategic business direction, other deals and goals. This knowledge makes it possible to create mutually beneficial options sometimes above and beyond what was originally on the negotiating table.

Reservation Price or Walk-Away: This is the least favourable point at which a party will accept a deal. Harvard Business School suggests that the reservation price/walk away can be derived from the BATNA, but that it is usually not the same thing as a BATNA (Harvard Business School 2003). Using the above example of an IT outsourcing negotiation, the BATNA might be to stay with the current sourcing arrangement. The current sourcing arrangement may provide certain IT services. It could be the requirement that any new arrangements provide, at a very minimum, these key services. This minimum requirement being met could be the walk-away position.

ZOPA: Zone of Possible Agreement. This is a range of agreements that satisfies all parties involved in the negotiation. In our above example of an IT outsourcing negotiation, the client may be satisfied if certain services are offered within a set price-range. The supplier may have their own price-range in mind, which makes the deal viable to them. When these requirements from both parties overlap, that overlapping region can be termed the ZOPA for that negotiation (Raiffa 1982).

3.3 Principled Negotiation Steps

The Harvard Negotiation School identify nine steps to achieve an agreement through principled negotiation (Harvard Business School 2003).

Step 1: Participants need to consider what constitutes a good outcome: For any negotiation to be effective, it is necessary for the negotiator to prepare well for the endeavour. Lack of preparation may necessitate the negotiator to accept the other party's proposal or options, without adequate analysis of how they will impact him/her. Each party needs to identify their own requirements and priorities first, then seek to understand the requirements for other parties. Thought should be given to which outcomes would satisfy the interests of all parties.

Step 2: Participants need to identify potential value creation opportunities: Assessing the other party's position and interests, as well as one's own, should give way to solutions that best meets both parties' interests. Sometimes it is necessary to "expand the pie" or go beyond the initial scope of the discussion to find the best opportunity for mutual gain.

Step 3: Participants need to identify their BATNA and reservation price, and do the same for the other side: Understanding one's own BATNA and walk-away point, and having knowledge of these regarding the other party, gives added negotiation power to the negotiation participant. The knowledge can also assist in determining whether a proposal is or is not a "good deal".

Step 4: Participants need to improve their BATNA: Strategies to strengthen a weak BATNA include forming coalitions, exploiting existing alliances and creating other value-add alternatives.

Step 5: Participants need to anticipate the authority issue: Negotiating directly with parties that have the authority to make decisions is the most effective option. However, this is not always achievable. The Harvard Business School suggest that instead of insisting that the person on the other side of the bargaining table has full authority, it is more important to determine the authority level of the person with whom negotiation proceeds, so that each party can plan accordingly. It is important for the negotiator to ascertain his/her own level of authority in the process as well. I.e., What decisions can they make? What authority do they have to create opportunities beyond the scope of the original intent of the meeting? What are the limitations or boundaries with regard to scope or decision-making?

Step 6: Participants need to learn about the other party: This can be done through effective communication during negotiation sessions and away-from-the table investigations through informal methods using external contacts such as other players in the industry. The more that is known about the other party, the more fruitful the negotiation will be. Information regarding the people, organisational structure, culture, their goals, their negotiation style, and how they have framed the issue can be useful.

Step 7: Participants need to be flexible in the process: Negotiations can have unanticipated developments, caused either by external factors or through information that has come to light during negotiation sessions. The Harvard Business School suggests exercising patience, anticipating changes on both sides, and treating every change as an opportunity for learning.

Step 8: Participants need to gather objective criteria to establish a fair and equitable outcome: Objective criteria are legitimate and practical, based either on scientific findings or professional standards. By using objective criteria, the focus will not diverge to emotions, or issues with people, perceptions or power.

Step 9: Participants need to re-frame the process in their favour: When negotiation is not proceeding in the favoured direction, it is possible to change the process away from the table. Kolb and Williams suggest that executing "process moves" does not address any substantive issues in a negotiation, rather they affect the hearing those issues receive during the negotiation. Strategies include forming coalitions, educating others about your ideas, and highlighting the impact of issues in the context of other parties involved (Kolb & Williams 2001).

3.4 Successfully Using Principled Negotiations

Fisher, Ury, Patton and the Harvard Business School class an effective negotiation as having the following characteristics:

- There is an alignment of negotiating goals to organisational goals.
- Effective information gathering takes place about each party's BATNA and reservation price.
- Negotiators prepare adequately for each negotiating phase, with facts and proposals thoroughly explored before each meeting.
- There exists an identification of the interests of both parties and the creation of value-add opportunities.
- The negotiation is not focussed on people or personal issues.
- Objective criteria are used to determine outcomes, not personal preferences or positions.
- There is recognition and attention to the potential barriers to an agreement.
- Negotiators form effective coalitions in multi-party negotiations.
- The negotiators have reputations of trust-worthiness and reliability (Fisher, Ury & Patton 1994, Harvard Business School 2003).

Brams and Taylor illustrate four criteria, which can be used to measure the level satisfaction with a negotiated outcome (Brams & Taylor 1999).

- Proportionality: The perception that each party is getting what they deserve.
- Envy-freeness: The perception by each party that the other party or parties did not receive a better deal.
- Equitability: Where parties are equally pleased by the agreement.

- Efficiency: When there is no alternative agreement that is better for any of the parties without harming another party.

Can these definitions of a satisfactory negotiation be applied to the IT outsourcing domain? Outsourcing IT is not purely a procurement exercise. The negotiation of IT outsourcing agreements needs to take into account many operational issues and organisational implications.

In international disputes, procedural justice may play a big role in such negotiations being classified as successful. However, in IT outsourcing, the process and most aspects of the negotiated agreement remains private and confidential.

The ability for parties to conduct discovery in negotiation, and the thoroughness with which this process is undertaken, particularly in IT outsourcing negotiations, plays a significant role in whether the negotiated agreement can withstand long-term pressures and changes.

Sourdin, asserts that negotiation, rather than being dependent solely on the flair and natural skills of the negotiator, can be greatly improved through a structured process. The skills of active listening and effective communication can be significantly improved by following certain strategies, focusing on creating an atmosphere that is conducive to collaborative discussions and approaching the whole process in a structured manner. (Sourdin 2005)

Sourdin describes in detail, successful strategies and techniques which may be readily applied to a commercial negotiation setting. A loose structure for a commercial negotiation process can involve introductory joint sessions where parties are allowed to introduce themselves, “state their story” and set the scene for the rest of the negotiation. The subsequent sessions can be used to explore issues and find solutions or mutually satisfactory options. There may be several sessions needed to formulate a commercial agreement. At the conclusion of these sessions, parties may validate any assumptions, test the terms and conditions stated in the agreement, and prescribe next steps including how the formulated agreement is to be initiated and managed. (Sourdin 2005)

In the introductory session, it is important to agree about the process to be followed, clarify the role of each of the individuals involved in the negotiation, and clearly communicate the objective in mind. In a commercial negotiation, it is also important to address other factors, such as the possible need for parties to enter into a non-disclosure agreement to ensure that confidentiality is maintained. It is also necessary to explore whether any external experts need to be consulted during the negotiation process, discuss any costs, time constraints, dependencies etc. (Sourdin 2005)

Sourdin also explores the recent development of negotiation practice towards transforming the relationship between the parties rather than just focusing on resolving issues. Sourdin states that the use of structured negotiation processes, whilst achieving the immediate outcomes, may not change the underlying relationship in any way. The parties' attitudes of one another may not be enhanced in any way by the interaction and there is a potential for conflicts to arise at a future date. (Sourdin 2005).

Sourdin and Salla state that the negotiation process has to be taken as an opportunity to transform the parties' perceptions and promote a greater understanding of each other to enhance the relationship and prevent conflicts arising at a later date. (Salla 2003, Sourdin 2005). If parties learn about each other's needs, perceptions, underlying issues and constraints, and look at win-win options, then the resulting relationship can be strengthened by this increased understanding as well as produce mutually satisfactory results. (Sourdin 2005).

The National Alternative Dispute Resolution Advisory Council (NADRAC) of Australia has proposed that "achieving outcomes that are lasting" should be the goal of any successful negotiation (Sourdin 2005).

Included in Chapter 5.10, is a more in-depth discussion of how the success of an IT outsourcing agreement can be defined and measured.

3.5 Chapter Summary And Conclusions

This chapter explored principled negotiation, namely negotiation that considers the interests of both parties, where the negotiation style is not positional or power-based, but rather creates opportunities for mutual gain by both parties. Key concepts in principled negotiation were examined, such as the BATNA, reservation price and ZOPA. The success of principled negotiation and how that it can be defined and measured, has also been discussed.

4 FUNDAMENTALS OF OUTSOURCING

4.1 Definition Of Outsourcing

Outsourcing can be defined as turning over all or part of an organisational activity to outside vendor(s) (Barthélemy 2003). However, the term outsourcing equally applies to contracting out activities, which were hitherto not undertaken by the internal organisation (Chandar & Zeleznikow 2006).

Gartner describes outsourcing as “Contracting with an external firm for the ongoing management and delivery of a defined set of services to a prescribed level of performance” (Cohen & Young 2006).

Popular belief is that outsourcing and off-shoring are one and the same. However, outsourcing doesn’t necessarily involve sending jobs overseas. Outsourcing can be one or more of the following:

Internally located: Where the third party supplier provides staff and services at the recipient’s premises.

Externally located: Where the third party supplier provides services from a location outside the recipient’s premises, but still in the same country or city etc.

Located overseas: Where the vendor provides services from premises in another country (off-shore).

Off-shoring is the practice of out-sourcing to a provider who will provide the major portion of the services from an overseas location. It is not uncommon for a vendor, even when providing services from an overseas location, to have a base team located near the customer. It is also possible to combine internal, external and off-shore segments in the final outsourcing arrangement.

In-sourcing or back-sourcing can be considered as the reversal of outsourcing. It is the practice of having internal staff perform functions that were previously outsourced.

How Outsourcing differs from buying products and services:

Outsourcing is when an organisation makes an arrangement with one or more external entities, for the *long-term* provision of goods or services. The client may aim to supplement or replace internal efforts, or to make a commitment to utilise, over a long term, selective goods/services that were previously not consumed by the organisation.

In contrast to the once-off procurement of products and services, outsourcing is when two or more parties get together to form a long-term partnership, to attain goals that are *mutually beneficial*. There is considerable effort and investments made by each party in the transition of operations and in the ongoing governance of the contract. Sometimes, assets and even personnel are transferred to the supplier during the initial transition period.

4.2 Off-shoring

Outsourcing and 'off-shoring' have often been incorrectly assumed as one and the same. Off-shoring or off-shore outsourcing is the practice of outsourcing a business function to one or more suppliers located in another country. Typically, off-shore providers are chosen from outside the first world, typically India or China (Morstead & Blount 2003). The negative connotations of off-shoring include the perception that by choosing to off-shore, you are electing to "send jobs overseas" and that you are "cutting corners" or producing a sub-standard product/service offering.

Off-shoring is a growing trend predicted to escalate in the coming years (Business Week 2003). This trend may have been initially sparked by the need to reduce costs, by using a cheaper labour force, or have access to skills that are generally under-valued in the industrialised nations.

Many organisations initial expectations were to dramatically improve their profit margins by off-shoring labour intensive functions to third world countries. However, there is a growing awareness in recent years, that there are many additional benefits to off-shoring. The skills, products and services, rather than being sub-standard or unsophisticated, can actually be significantly improved.

Many off-shore companies offer a more robust and comprehensive set of products and services than available locally. For example, India alone is reported to have over 150 IT software development and maintenance companies possessing the Software Engineering Institute's 'Capability Maturity Model' (SEI CMM) level 4 or level 5 skills (Dibbern et al. 2004). The capability maturity model can be viewed as a set of structured levels that describe how well the behaviours, practices and processes of an organisation can reliably and sustainably produce required outcomes.

The capability maturity model can be used as a benchmark for comparison on the capabilities of different organisations. It is based on a 5-Level process maturity continuum - where the uppermost (5th) level is a notional ideal state where processes are systematically managed by a combination of process optimisation and continuous process improvement.

Although there are many benefits, off-shoring involves far greater risks than outsourcing to a local organisation. It is also a far more complex concept to analyse than local outsourcing. There is at present a lack of knowledge in IT outsourcing partnerships between Western nations and countries other than India (Lacity et al. 2010). There is also a need to understand the practices and processes that would consistently produce successful outcomes in offshore outsourcing.

This thesis will not specifically explore off-shoring, or the negotiation practices ideally suited to off-shoring.

4.3 Theoretical Perspectives Of Outsourcing Relationships

Currie and Willcocks distinguish four types or levels of outsourcing:

- Single sourcing vs. multiple supplier outsourcing,
- Total outsourcing,
- Joint venture/strategic alliance or selective outsourcing,
- Insourcing (Currie & Willcocks 1998).

In single outsourcing, one organisation is chosen as the supplier responsible for the delivery of the outsourced business function or services. In contrast, by choosing multiple suppliers, the client may select a number of suppliers to strategically award specific services or functions to each supplier. These arrangements can help the client minimise the dependency on one single supplier. However, the ensuing outsourced arrangement needs to be negotiated and drafted carefully to ensure that service delivery expectations and areas of responsibility are clearly defined. If negotiation is not handled properly, it could result in an agreement where the boundaries of areas of responsibility of one organisation overlap with another organisation and thus cause confusion on accountability. Co-ordinating delivery of the many suppliers, integrating the outcomes to achieve the client's strategic imperatives and ensuring effective communication between all parties may prove very challenging.

In total outsourcing, the responsibility for the delivery of a business function or service, in its entirety, is handed over to one or more external suppliers. Typically, the drivers for adopting the total outsourcing approach include cost reduction, or the motivation to shift the client organisation's focus away from a non-core or problematic function. When adopting total outsourcing, the client needs to negotiate and govern the outsourcing relationship very carefully, to ensure that the client's strategic goals are aligned and translated into service delivery objectives that are reviewed regularly to maintain relevance. The supplier will take over the strategic control of the business function and the client will focus on monitoring the delivery of the end-result. It is therefore particularly important for the supplier and client to understand each other's strategic direction and challenges, and to adopt a relationship that resembles a partnership where opportunities for mutual gain are explored and risks are shared.

Selective outsourcing is when the client retains control over some aspects of the business function or services internally, while outsourcing other aspects. Again, there may be a single supplier or multiple suppliers, but the key difference over total outsourcing is that strategic control of the entire business function, such as IT, does not pass over to the external suppliers. The client may outsource some work to the supplier, and retain the core competencies or services/function that give the client a competitive edge in the market.

There are combinations of these above arrangements such as single-total, multiple-selective etc. There are also multiple motivations or expected benefits of outsourcing. These are described in more detail in Chapter 5.8. However, the primary focus of the relationship may be summarised into the following categories:

Reduce cost or make a gain in efficiency: With these outsourcing endeavours, the focus is on maintaining the delivery of selected services at a reduced cost, perhaps, as a result of more streamlined processes and improved productivity.

Focus on strategic priorities, or reduce the attention given to non-core competencies: The goal of these outsourcing agreements will be to shift the client's focus and consequently the strategic control, away from a non-core or problematic function, thus freeing up the organisation's key resources to focus on strategic priorities.

Achieve transformational change: Outsourcing relationships are typically long term. However, transformational outsourcing arrangements can also be "transitional" or temporary. An organisation faced with the prospect of significant change, such as a merger or the rollout of a new technology platform, could outsource the task of achieving or implementing this business objective to a third party. The third party supplier may be better equipped to supply innovative capacity or have more experience in implementing the specific change. The focus is on achieving a new "state" and then transitioning strategic control of normal operations back to the client.

In published literature, the following theoretical concepts are used to explain the nature, motivation and practice of outsourcing (Urquhart 2002):

- Core competencies,
- Resource-based theory,
- Resource-dependent theory,
- Transaction cost theory,
- Agency cost,
- Partnerships,
- Game theory.

These theories can be broadly grouped into three distinct categories (Dibbern et al 2004):

- Strategic,
- Economic,
- Social / Organisational.

A brief overview of each theoretical concept is included in the following chapters. The descriptions are brief by design, since the researcher is keen to focus on the negotiation of IT outsourcing agreements, and not specifically on the theoretical foundations of IT outsourcing. The links between the theoretical foundations and the negotiation of IT outsourcing is also discussed briefly.

4.4 Core Competencies Theory

Core competencies may be defined as those business functions that are aligned with the strategic priorities of an organisation or those functions/services, which give the organisation a competitive edge in the market place. An organisation's strategy is the determinant of the long-term goals of an organisation and the adoption of courses of action including the allocation of resources needed to achieve these goals (Chandler 1962, Quinn 1980). In essence, the Core Competency theory subscribes to the notion that core competencies should be kept in-house, but that other things that the organisation does, which are not deemed core, or critical to its mission or function, should be considered for outsourcing (Urquhart 2002). In the context of IT Outsourcing Negotiation, a manufacturing company may consider IT as a non-core function and decide that it needs to outsource all IT services and hardware. However, it may consider supply chain management as a vital function of the organisation and negotiate that IT staff responsible for the operation and maintenance of the supply chain management related systems, remain on-site.

In today's business landscape of constant change, including the constant shifting of strategic focus, the rapid evolution of technology and the tight integration of business functions with IT, make it difficult to differentiate which organisational functions are core competencies. The core competency perspective is useful in prompting serious consideration about the functions which are cost-effectively done in-house, and those which could be outsourced without any loss to future requirements in expertise. This theoretical perspective is however less useful when it would be strategically more advantageous or cost-effective to outsource some, or most of the "core" tasks (Urquhart 2002).

4.5 Resource-Based Theory

There are basically two types of resource theories: resource-based and resource-dependence (Dibbern et al. 2004). Both concepts are based on the principle that the organisation's resources underpin its strategy (Coase 1937, Chandler & Hanks 1994).

The resource-based theory focuses on an organisation's internal resources and capabilities. The resource-based theory defines resources as key requirements for performing an organisational function towards an organisational goal. The organisation is then considered a collection of resources.

In an IT outsourcing negotiation, competitive advantage is achieved by the supplier organisation analysing any gaps in resources or capabilities in the client's organisation, and then proposing to 'plug' these gaps (Urquhart 2002). The client organisation will seek to close these resource gaps in the most cost-effective manner and the IT outsourcing supplier will seek to benefit from providing this service.

4.6 Resource-Dependence Theory

Resource-dependence theory also considers the organisation's resources as necessary requirements to achieve a strategy. However, in contrast to the resource-based theory, the resources considered are generally external to the organisation. Organisations are considered dependent on some aspects of their external environment (Dibbern et al. 2004). The external environment of the organisation is considered almost as important as the organisation itself (Urquhart 2002). The principle is that the success of the organisation is determined by the control an organisation is able to assert over its external environment.

From an IT outsourcing negotiation perspective, an organisation may strategically establish external relationships or partnerships with other organisations to gain access to, and secure, key external resources, in order to achieve its strategic goals and maintain market competitiveness. The relationship may alleviate risk of instability, caused by the dependence on external elements. It may also allow the organisation to optimise the use of external resources by accessing external resources more effectively and efficiently.

4.7 Transaction Cost theory

Transaction cost theory is based on the principle that the sourcing decision for each transaction, i.e., whether to use an internal resource to achieve a goal or whether to use an external resource, is based on economic efficiency. The decision is primarily based on the total cost of the transaction, which may consist of how much it costs to produce the result internally vs. the costs of securing and managing external resources to achieve the same result. The theory also takes into account the uncertainty in the organisation's environment, the extent to which the transaction may be more broadly useful to the organisation, as well as the frequency of the transaction (Urquhart 2002).

In the context of an IT outsourcing negotiation, if the decision was made to outsource certain transactions, then the transaction costs may be further reduced by working collaboratively with the outsourcing provider or with other potential clients.

The theory is built on two fundamental *behavioural* assumptions: (Dibbern et al. 2004)

Limited rationality: Where it is assumed that it is only possible to enter into a contract that is *incomplete*. Hence the need to create a partnership type relationship, where risks and uncertainties are shared.

Opportunistic behaviour: Where it is assumed that each party will take advantage of opportunities to benefit at the expense of the other party.

The transaction cost theory perspective is useful in examining what elements contribute towards the total cost of a transaction, and analysing how these costs may be reduced.

The IT outsourcing provider can gain efficiencies in costs by employing economies of scale (providing the same service to many customers). In the context of an IT outsourcing negotiation, the supplier may be able to offer the client, reduced transaction costs during negotiations, while still maintaining a healthy profit margin.

4.8 Agency Theory

The basic principle underpinning agency theory is that each party involved in the contractual arrangement has access to information at a different level, and perceptions of risks and uncertainty vary between each party (Eisenhardt 1989, Stiglitz 1987). In an IT outsourcing negotiation, the client may perceive certain risks differently to the supplier. Each may operate in a different organisation environment or business landscape, leading to different uncertainties. Thus, the contract formulated would bring the agent down to his minimum acceptable reservation utility.

The agency theory differentiates between outcome-based contracts, and behaviour-based contracts. In an outcome-based contract, the results dictate the incentives for the supplier. In a behaviour-based contract, the contract will focus on what the supplier should do, and how it should be done, rather than the results (Eisenhardt 1989, Stiglitz 1987).

In the context of an IT outsourcing negotiation, for example, in an outcome based IT outsourcing contract, the client may stipulate that x number of IT support calls should be resolved per week. With payment terms driven by the number of systems issues addressed and resolved. If the same outsourcing contract was behaviour based, it may stipulate that priority calls, such as when a critical IT system is down, are handled first, with all resources being allocated to expedite resolution. The client may be less concerned about the number of calls resolved, but focus more on the amount of time and resources being allocated to systems issues that could critically impact its business functions. The client may provide incentives for the supplier to perform certain tasks at stipulated times, or attach a certain amount of importance to certain functions. The supplier may also want to ensure that effort towards delivery is recognised, even if the expected results or outcomes could not be achieved. On the supplier side, a behaviour-based contract allows the supplier to be rewarded based on the amount of effort expended on a particular task.

The IT outsourcing contract negotiation may also address how risks are shared between the supplier and the client. The client will want to ensure the supplier delivers consistent outcomes over the term of the outsourcing agreement. Thus, the outsourcing arrangement may stipulate incentives for the supplier to address underlying issues and reduce risks.

4.9 Relationship Theories

Relationship theories assert that inter-organisational relationships play a major role in the interactions, social and economic exchanges and the level of cooperation that exists between organisations.

IT Outsourcing research has examined the development of partnerships between client and supplier (Urquhart 2002). A partnership is where each party mutually benefits from an arrangement.

In the context of IT outsourcing negotiations, principled negotiation style or technique may be ideally suited, where the interests of each party is considered in working towards a mutually beneficial outcome.

Relationship theories focus on building an arrangement that result in outcomes that motivate each party to consider the relationship important and devote resources towards the development and maintenance of this relationship (Klepper 1995).

4.10 Game theory

Game theory attempts to explain the strategic behaviour of organisations using game situations (Kreps et al. 1982, Nash 1953, Spence 1976). Using game theory, it is assumed that organisations involved in a contractual arrangement operate in a similar environment and have equal access to information. It is assumed that each organisation makes decisions in a rational and intelligent manner with the sole objective of maximising its profits. The decisions are based on the expected actions of the other party.

In the context of IT outsourcing negotiations, game theory may be used to explain that if one party strategically manipulates the outcome for their own benefit, at the expense of the other party, then it may pay-off in the short term. However, as most IT outsourcing arrangements are long-term this may not be a successful strategy to employ.

The game theory perspective can be useful in highlighting that it is not necessarily in the other organisation's best interest to co-operate with you unless it is of benefit to do so. It can be a useful theory to employ when negotiating a long-term outsourcing agreement.

4.11 Power And Politics Theories

These theories assume that power, personal interests, and politics are major factors in organisational decision-making (Pfeffer 1981, Pfeffer 1982).

The theory states that organisations are political entities and people within organisations have different degrees of power. Dibbern et al., define power as the basic energy to initiate and sustain action to translate intentions into reality (Dibbern et al. 2004). When an organisation attempts to implement the decision of people with power, on personal objectives, then organisational politics transpire. Power and politics can play an important role in IT outsourcing negotiations (Lacity & Hirschheim, 1993). Research has confirmed that globally, a large proportion of companies approach IT outsourcing negotiations in this manner (De-Loof 1996).

4.12 Chapter Summary And Conclusions

This chapter defines outsourcing, explores the concept of off-shoring and distinguishes between outsourcing and the act of buying products or services. It also explores published literature on outsourcing to examine the theoretical foundations used to explain the nature, motivation and practice of outsourcing. The next chapter will more specifically address information technology outsourcing concepts.

5 INFORMATION TECHNOLOGY OUTSOURCING

5.1 A Definition Of Information Technology Outsourcing

Hirschheim and Lacity describe information technology outsourcing as the practice of transferring IT assets, leases, staff, and management responsibility for delivery of services from internal IT functions to third-party vendors (Hirschheim & Lacity 2000).

Gottschalk and Solli-Sæther in their exploration of research literature on IT outsourcing, found that many of the researchers did not define outsourcing. Among those who did, they saw that definitions vary, both according to outsourcing perspective and according to theoretical perspective. They describe IT outsourcing as "A process whereby an organisation decides to contract out or sell the firm's IT assets, people, and/or activities to a third-party supplier, who in exchange provides and manages these assets and services for an agreed fee over an agreed time period" (Gottschalk & Solli-Sæther 2006).

By extending Gartner's definition of outsourcing, we could define IT outsourcing as: "Contracting with external vendor(s) for the ongoing management and delivery of a defined set of IT services within agreed terms and conditions, to a prescribed level of performance, over a set time-frame" (Chandar & Zeleznikow 2006).

The IT services being considered for outsourcing could be hitherto undertaken by the internal organisation, provided by another external organisation, or be new services.

5.2 How IT Outsourcing Is Distinct From Outsourcing Other Services

Willcocks and Lacity identify some distinctions between outsourcing IT and outsourcing other services, namely:

- IT evolves rapidly making sourcing decisions highly volatile.

- Underlying economics of IT changes more rapidly than most other industries.
- Unlike other products and services, IT cannot be easily isolated from other organisational functions.
- Switching costs to alternative technologies or suppliers are high and sometimes cost prohibitive.
- Customers are highly inexperienced in IT outsourcing, putting them at a significant disadvantage when negotiating and managing outsourcing contracts (Willcocks & Lacity 1998).

5.3 How IT Outsourcing Is Distinct From Other IT Agreements

In a typical IT agreement, terms and conditions of the delivery of distinct components of the IT function (products or services) are detailed. However, the management of the delivery of outcomes, including budgetary management, reside internally within the organisation. The organisation that is the recipient of the product or service controls specifically how the outcomes need to be achieved, the processes that need to be adopted for development and delivery of the products or services and who is involved throughout the life cycle of the process.

An outsourcing agreement involves giving the supplier a portfolio of products and services to manage, often referred to as a tower, and a certain degree of freedom to deliver the end result in a manner that is commercially viable to the supplier. Well-formed agreements will dictate the end result in great detail including specification of services/products within the scope of the agreement, costs of specific components and other terms and conditions. However, decision-making on what is necessary to deliver the end-result, budgetary management of the delivery of the end-result, and accountability for the services rendered resides externally with the supplier.

Lacity and Willcocks observe that outsourcing IT is different to other IT agreements in that it represents an alternative way of managing the IT functions. It does not in any way eliminate the need to supervise the efforts but the emphasis is on doing this in a different way. (Lacity et.al., 2009). While capabilities and knowledge relating to the delivery of services is transferred to the supplier, to optimise the benefits, the organisation needs to ramp up its in-house capability to manage the IT outsourcing relationship effectively. This management effort is often severely under-estimated.

IT outsourcing, by nature, is a long term, ongoing relationship. The same is not necessarily true with all other IT agreements.

5.4 Levels Of IT Outsourcing

Grembergen notes that an organisation can have their entire IT totally outsourced or have selective services outsourced to third party supplier(s) (Grembergen 2004). Furthermore, IT services can be outsourced to a single vendor or to multiple vendors. Currie and Willcocks refer to this as “single sourcing” and “multiple outsourcing” respectively (Currie & Willcocks 1998).

There are combinations of these e.g., selective, multiple outsourcing where the outsourcing organisation contracts out a portion of its IT services to multiple external IT suppliers in combination with portions that are performed by the internal IT division.

In addition to these, there is also the choice of transitional outsourcing where an organisation temporarily contracts out its IT services (Willcocks & Lacity 1998a). This is typical during a major change in the organisation such as an acquisition or the implementation of new technology.

5.5 Types Of IT Outsourcing

This section seeks to provide the reader with a general background to the different types of IT outsourcing. It is also included here to point out that not all IT outsourcing agreements are the same, and to highlight the level of complexity in negotiating an IT outsourcing agreement.

Gottschalk and Solli-Sæther identify the following types of IT services outsourcing (Gottschalk & Solli-Sæther 2006).

Information Systems Outsourcing: A long-term contract, including facilities management, in which the IT supplier assumes responsibility, or part of the responsibility, for providing the IT services. There is also a possibility that the IT supplier takes over parts of the property and personnel of the internal IT division.

Processing Outsourcing: This involves outsourcing specific processing functions that include a high degree of standardisation. The IT supplier carries responsibility here for executing a process that includes IT and non-IT related elements. There is no transfer of personnel or transfer of property to the IT supplier.

Business Process Outsourcing: This involves outsourcing a specific set of activities along with the knowledge required by the outsourcing supplier to carry out the activities. The set of activities could relate of a division, process or function of the client organisation. The execution of these activities in support of an IT system or application forms part of the services provided, whereby the IT supplier also carries responsibility for non-IT related activities.

The most important difference here in relation to 'Information Systems Outsourcing' and 'Business Process Outsourcing' is that in the case of business process outsourcing the primary emphasis is on the performance of the outsourced business process rather than on the performance of the information systems. It is important to understand these distinctions when negotiating the outsourcing agreement.

5.6 Political And Economic Influences On IT Outsourcing

Gottschalk observes that today's IT organisation is an extremely complex and volatile environment (Gottschalk 2006). Not only is the IT department mandated to deliver technology and technical services at significantly reduced costs, it is required to deliver strategic vision, competitive advantage, and be an “enabler” to market dominance. The typical CIO[*] or CTO[†] and his/her staff must grapple with the unrelenting challenges associated with acquiring current technical knowledge whilst maintaining legacy systems. They must deal with an increasingly volatile and distributed IT workforce. Attracting, retaining, motivating, and leveraging IT skills has become harder than ever due to increased opportunities and a short supply of skills. On top of this, there is a proliferation of IT products and services with high expectations placed for the delivery of these. There are also a variety of relationships to manage – vendors, user groups, non-IT department executives, board members, auditors etc. In this extremely complex environment, organisations that are not in the business of providing IT services as their core objective, may find outsourcing an attractive proposition.

In a study conducted by Lacity and Willcocks it was found that 80% of CIO’s cited cost reduction as the main reason for outsourcing (Lacity & Willcocks 1996). It was perceived that a supplier with a large customer base could offer the same services at a lower cost by utilising economies of scales and gains in efficiency.

Though not specific to IT outsourcing, the tendency to outsource a business function or department, because it is complex or problematic is a practice that is prevalent in the IT

[*] CIO - Chief Information Officer
[†] CTO - Chief Technology Officer

industry. Unfortunately, in order to reap the benefits of IT outsourcing or indeed to avoid the numerous pitfalls, it is first necessary to understand and resolve some of those internal departmental issues. The theory is that you need to get the business function in order, before you hand it over to someone external, otherwise, it may end up being a lot more problematic, or the effort to transition may end up costing significantly more than first anticipated.

The above point is further elaborated by examining the case studies. A summary of each case study examined by this research has been included in Appendix 5. In case study 10, the CIO decided to outsource a problematic division of IT, the service provider assured the CIO that they would provide a custom-made model of services, to fit in with the business practices of the client. The agreement was signed and transitional activities began in earnest. However, because of inherent problems and complexities, the activities to transition the services took much longer than expected. The service provider eventually abandoned trying to make a tailor-made solution, and instead made the client re-engineer their business processes to fit in with the service provider's delivery model. The client had already sunk a lot of cost into the outsourcing endeavour and could not revert back. Thus, the client had to go through extensive business re-engineering and internal training to enable the transition. The service provider adopted a best-practice model to deliver the services. In case study 3 as well, the problematic IT function was outsourced, with an expectation that outsourcing would fix the issues. On the contrary, the problems rather than diminishing only compounded under an outsourced environment.

Another driver for organisations to outsource non-core competencies is to help focus internal staff on strategic objectives, such as in case study 2, which is included in Appendix 5. When priorities have changed due to changes in the business environment, such as in case study 5, in Appendix 5. or capabilities needed to fully grasp new opportunities in the marketplace are not available in-house (such as in case study 8), outsourcing may seem an attractive option.

The deployment of new technologies or IT services is another reason for outsourcing, providing ready access to specialist skills not available in-house. Rapid technological deployments require a significant investment in human resources capacity and training. It is expected that a specialist IT supplier is able to keep its IT staff's skills up to date more effectively and efficiently (Grembergen 2004)

Outsourcing can also enable rapid change to organisational structure during acquisitions, mergers or divestitures (Gottschalk & Solli-Sæther 2006).

The generation of one-off cash flows through the sale of IT assets is another opportunity offered by outsourcing (Earl 1996, Willcocks & Lester 1997).

5.7 Internal and External Pressures

The outsourcing environment can be viewed from the buyer's or supplier's perspective. The outsourcing organisation is interested in getting the best value out of the deal. Its objective is to get high quality services at low costs. The supplier on the other hand needs to sustain growth and increase profits. Outsourcing relationships can come under stress when these needs lead to conflicting priorities (Everest Group 1998).

There are also business changes that affect both the supplier and the buyer. Acquisitions, mergers, divestitures and other organisational structure changes can affect the conditions of the outsourcing contract. Changes in the marketplace or changing business needs can suddenly cause the buyer to have different service needs, different to when the contract was originated (Bendor-Samuel 2006). Changes affecting the business landscape of the suppliers may translate into focus away from services that were previously considered core objectives.

By far the area of most significant change that affects an IT outsourcing agreement is changing technology. The need to keep up with technology, which changes at a rapid speed, makes a rigid IT outsourcing agreement ineffective in the longer term.

These above challenges, together with regulatory changes and economic factors epitomise the several pressures affecting the outsourced IT environment. The long-term nature of IT outsourcing contracts permits these pressures to compound during the term of the contractual agreement unless properly handled.

5.8 Benefits Of IT Outsourcing

Some of the benefits described here of IT outsourcing are also more widely applicable to outsourcing in general.

- ***Outsourcing a non-core function of an organisation:***

With increasing complexity and rapid changes in the IT environment, organisations that have an internal IT function need to invest heavily in this area to maintain competitive advantage in the marketplace. There is also a significant investment that needs to be made to manage various relationships, with multiple suppliers, user groups, non-IT department executives, board members, auditors etc. An internal IT department also needs to keep abreast of trends and new innovation, to maintain that competitive edge. In this extremely complex and rapidly changing environment, organisations that are not in the business of providing IT services as their core objective, may find IT outsourcing an attractive proposition.

- ***Cost Reduction***

In a study conducted by Lacity and Willcocks they found that 80% of CIOs cited cost reduction as the main reason for outsourcing (Lacity & Willcocks 1996). It is *perceived* that a supplier with a large customer base and with specific expertise in the IT domain, with streamlined processes that usually result from long-term successful operation, can offer the same services to the client, at a lower cost, by utilising economies of scales and gains in efficiency.

- ***Predictability of Costs and Better Management of Costs***

Another benefit is increased flexibility to accommodate varying levels of services consumption. This could include the ability to pay for only what is used and vary capacity with the changing needs of the business. For example, instead of having an in-house team of database experts, readily available to maintain the client's critical databases, and applications, the executives involved in case study 11 (Appendix 5), decided to outsource the entire effort of ongoing operations. The anticipated benefit was, instead of having highly paid experts, sometimes under utilised, and at other times, over stretched to meet the demands, the client expected to pay a monthly fee based on utilisation, say for example, on the number of service calls logged. The utilisation of resources and service levels should be reviewed regularly to ensure both the client and the supplier have a mutually beneficial arrangement.

Why this model may work better is that an IT supplier with a large customer base may be better able to absorb the peaks and troughs in the demand for IT services than an internal IT division (Lacity & Hirschheim 1993, Klepper 1995).

There is also the added advantage of being able to predict the costs, based on prescribed levels of consumption. The monthly arrangement in this particular scenario also affords the organisation additional cash flow by adopting a "pay as you go" model, compared with the significant up-front cost of employing an entire team of experts.

- ***Better Quality of Services / Streamlined Processes***

Other possible benefits include increased customer satisfaction levels. It is expected that by outsourcing to a supplier whose core objective and expertise is to provide the specific services in question, and who provides the same services to multiple customers, would enable improvements to the standard of services. It is assumed that such a supplier would provide access to a greater level of expertise and superior technology. With a large customer base and thus greater exposure to common issues and needs, it is expected that processes would be streamlined and thus enable greater end-user satisfaction (Gottschalk & Solli-Sæther 2006).

- ***Achieve a Better Resourcing Model***

As mentioned earlier, outsourcing can also help organisations focus internal staff on core competencies and strategic objectives. Outsourcing is also an option when developing a particular service delivery capability in-house, is not aligned with the strategic imperatives of the organisation as a whole (Earl 1996). When priorities have changed due to changes in the business environment and functions previously handled internally are no longer considered “value-adding”, outsourcing those functions may seem an attractive option.

- ***Increased Flexibility / Better Management of Changes***

The deployment of new technologies or IT services is another reason for outsourcing, providing ready access to specialist skills not available in-house. Rapid technological deployments require a significant investment in human resources capacity and training. It is expected that a specialist IT supplier is able to keep its IT staff’s skills up to date more effectively and efficiently (Grembergen 2004)

Outsourcing can also enable rapid change to organisational structure during acquisitions, mergers or divestitures (Gottschalk & Solli-Sæther 2006).

5.9 Risks Of Outsourcing IT

The following are some risks that not only undermine the success of IT outsourcing agreements, but which can also lead to a total breakdown in relationships, litigation, and untimely termination of contracts. Some of these risks may also be applicable to outsourcing in general.

- ***Hidden costs of IT outsourcing:***

While cost reduction and control may be the most anticipated gain from outsourcing, many firms underestimate the "hidden" costs associated with an outsourcing arrangement. Activities to set-up an outsourced environment such as evaluation and selection of service providers, negotiation of contract, knowledge transfer and transition of operational activities do not come without a cost. Once the contract is established, the effort of governing the agreement, monitoring vendors to ensure that they are fulfilling their contractual obligations and management of the relationship are additional activities that must be undertaken. "Companies rarely anticipate the management resources and time, and thus cost, that has to be put in" (Earl 1996, Gottschalk & Solli-Sæther 2006). These hidden costs can easily undercut anticipated benefits of outsourcing. Barthélemy suggests there are four types of hidden costs: vendor search and contracting, transition to the vendor, managing the effort, and transitioning after outsourcing (Barthélemy 2003).

- ***Unclear scope or division of responsibility:***

Much of IT is not divisible or capable of separation (Gottschalk and Solli-Sæther 2006). Overlaps or gaps in service delivery, or misunderstanding on scope around the "boundaries" of responsibility are risks that plague many outsourcing relationships. The situation is exacerbated when multiple outsourcing vendors and internal components are involved.

- ***In-effective communication between operational entities:***

"Multiple" and "selective" outsourcing require greater levels of communication between operational entities. The integration of service delivery outcomes is non-trivial when multiple internal and external service providers are involved.

- ***Dependency on a particular supplier:***

This risk is greater with long-term contracts or when product or service specifications limit the choice to a small number of suppliers (Earl 1996).

- ***Inferior quality of staff & technology:***

Maintenance of technological currency is necessary, both in terms of skill-level of staff and adoption of up-to-date technology to service the needs of the client. If cost reduction is the main objective in an outsourcing deal, the emphasis on continuous improvement of vendors' skills and services portfolio may be diminished.

- ***Inexperienced staff or lack of service delivery capability:***

The specialist skills and experience of the supplier's staff depend on the organisational and capability maturity of the outsourcing provider.

- ***Business uncertainty:***

At the onset, future business direction and needs may be clear. However, these may change during the term of the outsourcing agreement, which is long-term in nature (Earl 1996).

- ***Rigid or poorly drafted contract:***

As the IT landscape changes at a rapid pace, rigid outsourcing contracts may become irrelevant in the longer term. At the same time, contracts should be precise, complete, incentive-based, balanced, and flexible (Barthélemy 2003a).

- ***Defining and filling the outsourcing manager role:***

Management of the IT outsourcing relationship requires specialised skill and experience. Many organisations have difficulty defining this role, and filling it. The skills needed to establish, govern and manage an IT outsourcing relationship are many. Experience in technology negotiation, contract facilitation, contract management, vendor relationship management, IT operations management, IT infrastructure management, and general leadership are needed.

- ***Lack of confidentiality:***

Outsourcing arrangements cause the outsourcing organisation's confidential data to be accessible to the IT supplier's employees. This constitutes another risk that must be considered when the decision to outsource is taken (Willcocks & Fitzgerald 1994, Klepper & Jones 1998).

- ***Loss of control over technology direction and IT function***:

"Firms should be especially cautious when using an outsourcer to develop or to operate applications that give it some type of competitive advantage" (Gottschalk & Solli-Sæther 2006).

- ***Loss of innovative capacity:***

If the company has outsourced IT services and downsized as well, its ability to innovate (exploiting IT for business) may be impaired. Innovation needs slack resources, organic and fluid organisational processes, and experimental and entrepreneurial competencies, all attributes that external sourcing does not guarantee.

- ***Lack of alignment in organisational culture:***

Culture mismatch between the supplier and the customer organisation is common in off-shore, outsourced arrangements but is prevalent in domestic outsourced arrangements as well.

- ***Off-shoring:***

Off-shore outsourcing projects carry additional risks. Gottschalk and Solli-Sæther quote a Meta Group report that indicates off-shoring saves 20% in the first year, and creates a 20% loss in productivity. Other off-shoring pitfalls include security, knowledge transfer, transition of operations, language barriers and differences in customs. Time and effort to educate and train the overseas vendor is a cost rarely anticipated by the IT client organisation

(Gottschalk & Solli-Sæther 2006). Furthermore, costs become unpredictable if prices are based on foreign currency exchange rate.

- ***Personnel Issues:***

When the provider “ramps up” to a new contract with an influx of newly recruited staff (who may have come from the customer organisation), the risk of staff issues is greater. The customer may also lose valuable internal staff during the outsourcing process. After outsourcing, the remaining IT staff may act as conduits between the business line managers and the vendors. However, in practice, the liaison roles often only succeed in keeping the two communities apart and in creating more confusion (Earl 1996, Gottschalk & Solli-Sæther 2006).

Although outsourcing of IT is a widely prevalent management approach used for dealing with problematic IT functions, it can be far from easy to extract anticipated benefits and avoid exposing the whole organisation to multiple, significant risks (Lacity et. al 2010). Lacity et al. state that outsourcing IT represents a different way of managing the IT function and that outsourcing the IT function does not eliminate the need to administer or oversee the efforts (Lacity et.al., 2009). They suggest that organisations must anticipate a steep learning curve when outsourcing IT and to fully exploit the opportunities it affords, they must invest heavily on building in-house capability to effectively manage the outsourcing agreement. (Lacity et al., 2009).

5.10 Achieving Success In IT Outsourcing

Dibbern et al. reasoned that the field needs a better understanding of which factors contribute to success in IT outsourcing, arguing that more studies need to be conducted before dependent variables can be identified (Dibbern et al. 2004).

Success in an IT outsourcing endeavour is not unlike success in any other initiative. The criteria for measuring success in any endeavour should start with on-time delivery of outcomes, delivery of pre-defined outcomes within budget and meeting set objectives (Greaver 1999). In an IT outsourcing initiative, there are additional criteria that need to be considered.

- **Were improvements in costs, performance or other factors stipulated as the reason for outsourcing achieved?**

Carefully crafted Service Level Agreements (SLAs) can be used to measure achieved outcomes against set objectives. You can stipulate penalties or rewards tied to the measurements of SLAs to drive the right sort of behaviour in a vendor. Care must be taken that these SLAs and measurements maintain currency and reflect the priorities of the customer at any time during the long-term outsourcing relationship. However, SLA metrics are just measurements and indicators. For organisations to benefit from using SLAs, these measurements need to be properly analysed and used as a means of challenging the organisation to continuously improve on performance and delivery (Power, Desouza & Bonifazi 2006).

- **Success metrics need to also cover two additional criteria: contract and relationship, alignment and vision** (Cohen & Young 2006).

You could measure the level of trust and confidence that exist in the relationship, and the provider's engagement in, and value-add to, various business processes. Given that these are qualitative measures, a method to guarantee objective measurement of these need be developed.

- **Did personnel involved in the outsourcing venture deliver on commitments**?

Care must be taken to define roles that assist the organisation to work towards the overall objectives of the initiative. It is also necessary to define and measure tangible deliverables for each role.

- **Are processes used in the outsourcing environment optimal?**

The first step in measuring processes is to define each process and exactly what is being measured. Unless this step occurs first, there will be differing measurements by different people, or at different times, which could lead to incorrect conclusions. Processes to consider tracking could include dispute resolution, problem escalation, service disruption notification etc.

- **Was the damaging influence of the outsourcing initiative contained**?

Factors to measure could include employee turnover and level of engagement with outsourced functions by retained staff (Greaver 1999).

In an IT outsourcing endeavour, the most rudimentary measure of success could be whether the contract persisted to the end of term specified, and whether it was renewed for another term. However, external factors not connected to performance of the outsourcing provider could influence the termination of contract. Thus, it is important to consider the above criteria for measuring success.

Lacity and Willcocks suggest that the duration of the IT outsourcing contract is a determinant of the overall success of the IT outsourcing endeavour. In their review of recent research, they found evidence to suggest that IT outsourcing agreements that had an initial duration of three-to-five-years were more successful than longer term IT outsourcing contracts (Lacity & Willcocks 1998).

Fjermestad and Saitta conducted a review of a number of articles on IT outsourcing and strategic decision-making related to sourcing. (Fjermestad & Saitta 2005) The study reviewed factors that were crucial to the success of IT outsourcing. Through this study they developed a critical factors framework, which was composed of eight measures of success. These measures included alignment of business strategy, contracts, infrastructure and technology, culture, strategic partnership, management support, governance committees, and economics (Fjermestad & Saitta 2005). However, when measuring the success of an IT outsourcing endeavour, care must be taken to formulate objective and consistently repeatable methods of measuring these aspects.

Poppo & Zenger state that there is general agreement in outsourcing literature that contractual governance is necessary but not sufficient for a successful outsourcing partnership (Poppo & Zenger 2002).

Beimborn et. al. studied outsourcing relationships to answer two important research questions: what are the relevant facets of importance (in outsourcing relationships) and how do they affect relationship quality and overall outsourcing success? So far, most research on relationship quality has treated this element quite superficially as a single- dimensional construct and has failed short to clearly differentiate between *dimensions* of relationship quality and its *drivers.* (Beimborn et.al., 2009)

Beimborn et. al explore one particular, and they argue, highly relevant, contextual factor that drives relationship quality: *the importance of the outsourcing deal to the provider*. By turning around the traditional application of resource dependency theory on the outsourcing domain, Beimorn et. al., propose that not only the provider possesses resources which need to be acquired by the client, but that the client has or represents a valuable resource from the provider's perspective, as well.

They form two hypotheses:

1. *High relationship quality is related with high outsourcing success*
2. *A high importance has a positive impact on relationship quality.*

Beimborn et. al., test their proposed hypotheses with multiple case studies. Their case study series comprised of selected IT outsourcing relationships of four German banks and seven outsourcing providers. (Beimborn et.al., 2009)

They found that Banks with high relevance for their providers (in terms of e.g. strategic considerations like visibility in the market as reference customer or economic considerations like the deal volume) are expected to have a better relationship quality than banks that are less important.

Regarding the impact of relationship quality and outsourcing success: their results support the findings from previous literature that highlight the positive correlation of relationship quality and outsourcing success.

Thus Beimborn et. al., concluded that IT outsourcing clients whose perceived “importance” in the provider’s portfolio is high, either strategically or economically, are more likely to experience a good relationship quality and, thus, a successful outsourcing relationship. (Beimborn et.al. 2009)

Since IT outsourcing is a long-term relationship, the measurement of success could differ at different stages of the contract. This is not just due to vagueness in measurement criteria or differing measurements by different people. The outsourced environment or levels of achievements required may change at different stages during the term of the agreement.

For example, during the review of case study 11 (Appendix 5), we came across a contract with specific measures of success defined at the start of the negotiation process. At that time, the organisation outsourcing their IT function was experiencing significant issues with the network and IT application performance. A number of initiatives were already underway to implement new infrastructure, however, the initial measures of success included a number of metrics to ensure a certain level of network / application performance was delivered. Once the new infrastructure was in place, the main concerns shifted away from network performance to another source of business frustration. However, since the contract was never reviewed, or actively managed, the original measures of success were still being reported on, and “skimmed over” by management staff. The more pressing needs of the client, their new and “implied” measures of success, were not being reported on, or discussed.

So, do you consider the measurement of success at some defined point in the long-term relationship? Or should the measurement be a computed value incorporating several measurement points? In some cases, success cannot be achieved quickly. Such as, when the provider needs to make a significant investment, in skills or capital, to achieve the reasons attributed to the outsourcing decision.

In case study 11 (Appendix 5), the outsourcing provider, during the transitional phase, analysed the root cause underlying the customers IT support calls. It was found that the client's organisation had deployed new technology a number of months ago, without providing adequate training to the staff using these technologies. By conducting a series of user forums and training sessions, the service provider was able to reduce the call volume significantly. It is important that the contract rewards the service provider for improvements such as these, and that innovation and continuous improvement is taken into account when measuring the success of the outsourcing arrangement. It would be short sighted, for example, to limit the success measurement to "the number of IT calls resolved within time". In the re-negotiation of case study 4, (Appendix 5), a strategy was discussed to share efficiency gains between both parties.

There could also be significant uncertainties involved when the outsourcing contract was initially established, or uncertainties introduced during the term of the contract. Significant changes to the organisation such as mergers or divestitures, or changes to the organisation's operations as a result of global economic influences or the introduction of new competitors in the marketplace are changes that may not be known at the time when the contract was signed. These could make the task of determining success difficult or inaccurate.

Lacity et al. observe that more research needs to be undertaken to understand the extent to which organisations that have embarked on IT outsourcing ultimately achieve the strategic objectives they initially set out to achieve. Lacity et al. also acknowledge that more study is necessary to specifically identify the practices and processes that can be attributed to successful IT outsourcing outcomes (Lacity et al. 2010).

5.11 IT Outsourcing Research and Gaps in Knowledge

Although a large body of research exists in IT outsourcing, practitioners still struggle with concepts such as: Measuring success in IT outsourcing; How to maintain a fruitful and enduring long-term relationship between the customer and the supplier; How to formulate a contract that provides incentives for the supplier to act in the best interest of the customer; and How to maintain alignment of outcomes with the strategic objectives of the customer.

Lacity et al. (2009) examined 191 IT outsourcing articles and classified them according to the IT outsourcing topics covered by each paper. These six topics were:

1) The types of firms most likely to outsource IT outsourcing,
2) The strategic intent and effects of IT outsourcing decisions,
3) The risks of IT outsourcing and risk mitigation strategies,
4) Practices associated with successful IT outsourcing,
5) Client and supplier capabilities, and
6) The extent to which IT outsourcing practices must be adapted for other forms of outsourcing such as business process outsourcing.

Lacity et.al. (2010), reviewed recent studies to identify gaps in current knowledge and proposed future paths of research. They examined 164 empirical IT outsourcing research articles published between 1992 and 2010 in 50 journals. The review set out to answer two research questions: What has the empirical academic literature found about information technology outsourcing decisions and outcomes? What are the gaps in knowledge to consider in future research? (Lacity et.al. 2010).

The study categorised recent published research literature on IT outsourcing using the following four categories:

1) **The organisation:** The focus of the research being the consequences of IT outsourcing on organisation-level performance indicators such as, stock price or financial performance. Research in this category includes work done by Madison et al., Gewald & Gellrich and Wang et al. (Lacity et al. 2010, Madison et al. 2006; Gewald & Gellrich 2008; Wang et al. 2008).

2) **The IT function:** Research in this category considers the impact of IT outsourcing on costs, service levels and other possible improvements to the services delivered by the IT function. Researchers such as Domberger et al., and Dibbern et al., have addressed this topic (Lacity et al. 2010, Domberger et al., 2000; Dibbern et al., 2008).

3) **The client and supplier relationship**: The quality of the relationship between the client and the suppliers have been analysed using measures such as the amount of trust, cooperation and conflict that exists between the parties. Research work in this category include McFarlan and Nolan, Grover et al. Lee and Kim (Lacity et al. 2010, McFarlan & Nolan 1995; Grover et al., 1994; Lee & Kim, 1999).

4) **IT outsourcing project:** Considering the outsourcing endeavour as a project is useful for analysing aspects such as actual costs of the IT outsourcing exercise compared to set budget, quality of outcomes against expectations, and time/resources to complete set milestones (Gopal et al., 2002).

Dibbern et al. (2004) identified five gaps in IT outsourcing knowledge, arguing that the field needs the following:

1) A better understanding of the dependent variable of success in IT outsourcing,
2) More research taken from the vendor perspective,
3) More research that considers the relationship between the client and suppliers,
4) More research on how outsourcing changes over time, and

5) Comparative studies, e.g., similarities and differences between industry sectors such as public and private sectors.

Lacity et al. (2010) studied recent IT outsourcing related research literature to observe that progress has been made on addressing the gaps in the above-mentioned research areas. The study revealed that between 1992 and 2010, around 36 dependent variables have been used by researchers to study IT outsourcing success; There were more studies from a vendor perspective such as those by Taylor, Levina and Ross (Lacity et al. 2010, Taylor 2007, Levina & Ross 2003); Recent research has also covered the topic of relationships between the client and the suppliers, such as work done by Beaumont & Costa and Klepper (Beaumont & Costa 2002, Klepper, 1995). Lacity et al, also observes that research is now available on the progression of IT outsourcing over time, particularly, how subsequent sourcing decisions undertaken by the organisation are influenced by the outcomes of the initial outsourcing attempt. Research work that address this area include Kishore et al., Whitten & Leidner, Willcocks & Reynolds, Olsson et al., Jayatilaka & Hirschheim and Dedrick et al. (Lacity et al. 2010, Kishore et al., 2004; Whitten & Leidner, 2006; Willcocks & Reynolds, 2007; Olsson et al., 2008; Jayatilaka & Hirschheim, 2009; Dedrick et al., 2010)

Lacity et al. confirm the need for more comparative studies. However, they suggest comparing IT outsourcing across countries and cultures would be more practical rather than studies across industry sectors as previously suggested by Dibbern et al. (Lacity et al. 2010, Dibbern et al. 2004). Lacity et al. suggest that it would be useful to understand more about IT outsourcing which involves partners in Western countries and countries other than India. Lacity et al observes that a significant amount of work has already been done on offshore outsourcing. However, of the 164 papers examined by the study, an overwhelming 77% of the papers dealt specifically with suppliers of outsourcing solutions based in India, such as work done by Oshri et al., Dibbern et al. and Rottman & Lacity (Lacity et al. 2010, Oshri et al. 2007, Dibbern et al. 2008, Rottman & Lacity 2008).

Lacity et al. (2008) identified five persistent gaps in knowledge relating to IT outsourcing. They argued that we still only have anecdotal answers to the following five questions:

1) How can back offices truly be aligned with the strategic objectives of the organisation?
2) How can suppliers' incentives truly be aligned with their clients' needs?
3) How can clients transfer knowledge to suppliers while at the same time protect intellectual property?
4) How can clients retain enough in-house capability and knowledge when engaging in large-scale outsourcing?
5) How can clients and suppliers maintain a mutually satisfactory, long term, relationship?

The research questions and gaps identified in published literature as described in this section have been used as a basis to create a set of sample interview questions. The sample interview questions are included in Appendix 3.

5.12 Chapter Summary And Conclusions

This chapter explores the IT outsourcing environment and the substantial internal and external pressures that are brought to bear on an IT outsourcing agreement. Success in IT outsourcing negotiation is explored and it is proposed that it must take into account the effectiveness of the contract established through the negotiation process. Hence the overall success of the IT outsourcing initiative also needs to be taken into account when building a tool for effectively negotiating an IT outsourcing agreement.

Although there is a substantial body of research in the domains of IT outsourcing and Negotiation, individually, published research literature does not currently cover the specific topic of negotiating IT outsourcing contracts. Other gaps in IT outsourcing research are also explored and described in this chapter.

6 NEGOTIATING IT OUTSOURCING AGREEMENTS

6.1 The Need To Negotiate And Govern IT Outsourcing Agreements

IT outsourcing is a widely recognised strategy for enhancing the overall organisation's business success (Cohen & Young 2006). However, currently available practices and methodologies for negotiating IT outsourcing agreements aren't delivering the desired outcome. Research indicates that more than half of IT outsourcing agreements fail within the first year of initiation (Cohen & Young 2006). The complexities of IT outsourcing and the dissatisfaction over outcomes are on the rise (Cohen & Young 2006). The failures of these arrangements have also been linked to poorly drafted contracts (Ang & Toh 1996, Bendor-Samuel 2002, Barthélemy 2003, Cohen & Young 2006). As indicated in previous chapters, there is currently no structured methodology or framework to effectively negotiate an IT outsourcing agreement. Developing such a framework is the focus of this research project. The framework focuses on the process of negotiating an IT outsourcing contract, rather than the management of the outsourcing relationship or governance of the contract through its various stages.

The framework consists of:

- Factors that need to be considered prior to the negotiation of IT outsourcing contracts.
- Guidelines on how to prepare for the negotiation
- Guidelines on a suitable negotiation style and techniques to use.
- Guidelines on how to structure the negotiation, who to involve, and how to develop a negotiation strategy.
- A checklist of considerations or discussion topics to aid dialogue during negotiation sessions.

- Guidelines on how to approach ongoing negotiations (or re-negotiations) once the contract is established.

The structure of the framework is based on gaps in knowledge as identified by published literature in Chapter 5.11. The structure of the research outcome, "The Framework for Negotiating IT Outsourcing Agreements", was further refined from feedback obtained from the academic community during the PhD Candidature Approval Process, as well as during the review of papers and discussions at the academic conference listed in Appendix 7.

The negotiation framework described above, will aid in providing decision support to improve the process of IT outsourcing contract negotiation. It will provide for the transparency of key factors affecting outcomes: such as the cost and quality of services delivered. Using this structured approach to negotiation also enables a greater degree of flexibility and resilience to be introduced into the resultant IT outsourcing contract. The negotiation framework improves the process of negotiation by anticipating changes, and introducing planned re-negotiation of terms and conditions during the life cycle of the outsourcing arrangement.

6.2 Current Industry Practices

IT outsourcing relationships are long-term alliances, which play a critical role in the overall organisation's business success. However, a study conducted by Gartner found most executives adopted IT outsourcing in an irrational manner, with no structured methodologies (Cohen & Young 2006). "To jump on the bandwagon of outsourcing" – perceived to be a trend within the IT industry, was alarmingly in the top three justifications for IT outsourcing in Willcocks and Lacity's study (Willcocks & Lacity 1998). "Playing good corporate citizen" and "outsourcing to solve a problematic IT function" were other common practices exposed in the IT industry (Willcocks & Lacity 1998). De-Loof also found that most practitioners use un-structured techniques when approaching IT outsourcing (De-Loof 1996).

Research conducted by Gartner found 84% of Australian companies chose outsourcing providers without any sourcing strategy, almost twice the global average (Cohen & Young 2006). A sourcing strategy needs to be developed prior to a decision to outsource IT. The strategy needs to be dictated by the most effective way to provide services to best achieve business goals and needs. A decision to outsource would then be taken after analysis of perceived benefits and risks.

Once the decision to outsource IT is made, careful evaluation and selection of service provider(s) are essential elements of establishing an outsourcing arrangement, as is effective negotiation of the contract.

Cohen and Young found that executives often treat the outsourcing of even the most critical IT services as a procurement exercise, where they negotiate only on price, with no consideration to the ability to deliver (Cohen & Young 2006). An organisation is most likely to benefit from outsourcing if it understands exactly how the outsourcing vendor will provide value and can use that knowledge to effectively negotiate an agreement.

The costs of reverting to an in-house option or to another supplier, should an outsourcing arrangement fail, can be prohibitive. Hence it is imperative that the contract is well structured. If the organisation lacks the expertise to negotiate a sound contract, the firm's dependency on the vendor could result in high costs or loss of control over technological direction and competitive advantage (Earl 1996).

Understanding the complex organisational, strategic and operational changes that need to take place in an outsourcing endeavour is also imperative to the negotiation process. The contract that is put in place needs to withstand changing internal and external landscapes. A sound contract can aid by giving some structure to how these changes are addressed. It should also define the steps to take in problem escalation and conflict resolution.

6.3 Summary Of The Gap Identified In Negotiating IT Outsourcing Agreements

Research indicates that success in IT outsourcing is dependent upon an effectively negotiated agreement (Cohen & Young 2006). Ang and Toh analysed failed IT outsourcing arrangements. Their diagnosis was that the failure was directly attributed to a poorly structured contract and the lack of active governance (Ang & Toh 1996).

Everest Group in its study of outsourcing agreements found that a poorly negotiated contract incorporating the following characteristics contributed to the high failure rate (Bendor-Samuel 2002):

- A rigid contract.
- Lack of clearly de-lineated boundaries of responsibility.
- Inadequate service level specifications and metrics.
- No meaningful mechanism for continuous improvement.
- Lack of clarity over roles and responsibilities.

Barthélemy in his in-depth study of 91 outsourcing arrangements found that the same mistakes underlie most failed outsourcing efforts. These mistakes have been termed the seven deadly sins of outsourcing (Barthélemy 2003). Of these seven sins, "Writing a poor contract" had the largest impact on the outcome of outsourcing efforts (Barthélemy 2003). These findings have been confirmed by Cohen and Young (Cohen & Young 2006).

Currently available practices and methodologies for negotiating IT outsourcing agreements aren’t delivering the desired outcome. The complexities of IT outsourcing and the dissatisfaction over outcomes are on the rise, rather than the opposite (Cohen & Young 2006). Research indicates that as many as 51% of IT outsourcing agreements fail within the first year of initiation (Cohen & Young 2006). As described above, failure has also been linked to a poorly drafted contract (Ang & Toh 1996, Bendor-Samuel 2002, Barthélemy

2003, Cohen & Young 2006). However, at present there is no structured methodology to effectively negotiate IT outsourcing agreements.

We believe that an effective method of structured reasoning incorporating a 'best-practice" model or framework for consistently negotiating IT outsourcing contracts would greatly enhance the likelihood of success in IT outsourcing.

The primary goal of this research project was to develop and assess the effectiveness of a structured framework for negotiating IT outsourcing agreements. This was done through examination of existing structured negotiation techniques in non-IT outsourcing domains, as well as analysis of industry best practices.

Whilst the research focuses on IT arrangements in particular, the research outcomes should prove an invaluable tool for any organisation contemplating entering into an outsourced arrangement regardless or not whether the deliverables of that arrangement is for the provision of IT services.

6.4 A Structured Approach to IT Outsourcing

In order for an organisation to maximise benefits from IT outsourcing, it is necessary to approach the whole exercise (not just the negotiation) in a structured manner. A sourcing strategy needs to be first created to evaluate how best to deliver/source each IT function under consideration. It is then necessary to invite and evaluate responses from potential suppliers. Negotiation of terms and condition follows these exercises. It is essential to understand how a particular supplier can add value to the organisation and use this knowledge to negotiate an effective agreement. The chapters below expand on this approach.

Lacity, Willcocks and Gottschalk identify six outsourcing phases (Lacity & Willcocks 2000, Gottschalk 2006).

Phase 1: Vision: This phase deals with the creation of a strategic sourcing plan. The two main activities in this phase are identifying core IT capabilities and identifying IT activities for potential outsourcing.

Phase 2: Evaluation: The customer's goal in this phase is to identify the best source for IT functions. The major activities during this phase include measuring baseline services and costs, creating a request for proposal, developing evaluation criteria, and inviting internal and external bids and evaluation of responses.

Phase 3: Negotiation: Skilled negotiation is necessary so that contracts reflect sourcing expectations. Activities need to include agreement on governance structures and methodology, particularly mechanisms for interaction, service level measurements, continuous improvement and contractual change.

Phase 4: Transition: The customer's goal in this phase is to establish precedents for operational performance. On large contracts, transition activities may last more than two years.

Phase 5: ***Improvement***: In this phase cost reduction, service improvement, and more strategic views of IT service delivery are sought. The major activities in this phase include benchmarking performance, realigning the contract, and involving the supplier in "value-added" areas.

Phase 6: ***Performance Maturity:*** Review and implementation of sourcing options and strategy, ensuring continued operational performance is typical in this phase. When contracts are extended or new deals are signed, past learning affords an excellent opportunity to negotiate better terms and conditions.

IT outsourcing is a long-term, ongoing relationship. How well the relationship works will depend on a number of factors including effective communication between parties, a well-drafted contract, successful governance of the agreement and active management of the relationship (Gottschalk & Solli-Sæther 2006). The type of relationship can be best termed an alliance where two or more organisations act together for each other's benefit (Graham 2003). The interests of each party involved in the relationship needs to be aligned towards this common purpose. It is therefore vital that negotiation considers the interests of all parties if the relationship is to be fruitful and enduring.

In the above phased approach to implementing IT outsourcing, negotiation is described as Phase 3. However, it is not necessary that a single supplier be chosen before the negotiation dialogue can begin. The evaluation process may simply identify the best suppliers with whom to enter negotiations. Furthermore, it could be advantageous to hold negotiations with more than one supplier concurrently – that way, strengthening ones BATNA (Best Alternative to a Negotiated Agreement) or fall-back position (Brams & Taylor 1999). Once a finite number of parties have been identified as potential suppliers, negotiation can begin in earnest on the scope, terms and conditions, including the costs of the agreement.

Overlooking hidden costs is one of the major risks of IT outsourcing (Barthélemy 2003). Barthélemy suggests hidden costs can be mitigated through additional care and effort during the early stages of establishing an IT outsourcing arrangement, particularly vendor selection and contract negotiation (Barthélemy 2001).

Structured analytical techniques during negotiation, i.e., the examination of each parties interests, constraints, issues and perceptions, will greatly mitigate the risks of hidden costs as well as unclear scope or gaps in responsibility (Gottschalk & Solli-Sæther 2006). Clearly stating what objectives the customer wants to achieve through outsourcing IT and what benefits the customer wants to gain, is imperative during negotiation. The supplier needs to evaluate the customer's needs against their own delivery capability and give a correct assessment of where they stand. A solution for mutual gain can then be drafted.

When building customer's service delivery requirements into a contract, it is common to use Service Level Agreements (SLAs). However, care should be taken to ensure the SLAs drive the right sort of behaviour in the supplier, and can be measured accurately. A typical SLA customers include is “customer satisfaction level”. However, the measurement of “customer satisfaction” can be very subjective. Do you measure how fast a problem was responded to? Or what satisfaction rating an end-user gave on problem resolution? Detailed analysis and discussion needs to take place on exactly what behaviour the customer wants to see and how best to achieve and confirm this in the supplier. The supplier should also take care that the SLAs are reasonable and the mechanisms to measure them reflect adequately the effort expended.

Dependency on a particular supplier is another risk that can be mitigated through careful negotiation. For instance, it can be specified during negotiations that the client and supplier create a set of documentation on operational activities and procedures, and the vendor then keeps it current throughout the term of the agreement. This would eliminate the risk of misunderstandings or gaps in scope during the term of the contract, and oversights during initial transition or after termination of contract.

Developing an exit strategy during the negotiation stages of an IT outsourcing agreement is also far easier, and much more effective than when notice for termination has already been given to the supplier.

The outsourcing opportunity can further be used to move to a more open technology platform, adopting industry best practices and current technology to avoid specificity to a particular supplier (Gottschalk & Solli-Sæther 2006). The costs of doing a major re-vamp of technology might be prohibitive during transition to an outsourcing provider, however, it is possible to negotiate how a gradual move towards more open architecture be achieved during the term of the agreement.

It is important to note that a satisfactory price is not pivotal to the success of an IT outsourcing negotiation. Though currently, industry practitioners seem to focus predominantly on price rather than other qualitative issues (Cohen & Young 2006). If the negotiation was focussed on achieving a low-cost option, the supplier may place less importance on the quality of staff made available, or be unable to invest in updating skills or technology during the term of the agreement. The risk of inferior skills or out-dated technology becomes higher in these cases. Negotiations centred on finding opportunities for mutual gain, rather than focussed on the lowest price for the customer, can greatly address this risk.

Since the value of the relationship between the client organisation and suppliers is of great importance in an IT outsourcing arrangement, personnel changes or changes to the organisations' structure do pose a significant challenge. This risk can be best addressed during the negotiation phase, by specifying roles with relationship management responsibilities for each role. A multi-layer communication strategy can also be set up where corporations interact at various organisational levels. A solid governance strategy is also vital to the overall success of the endeavour (Gottschalk & Solli-Sæther 2006).

Finally, the many internal and external pressures that affect the IT outsourcing environment make a rigid, poorly drafted contract largely ineffective. However, flexible or vague terms in the contract pave the way to conflicting interpretations. This may jeopardise the stability and predictability of the arrangement. One way to avoid being locked-in to a rigid contract, without the risk of vague terms, is to anticipate changes during the term of the agreement, and allow parties to re-negotiate a sub-set of terms and conditions at regular intervals (Gottschalk & Solli-Sæther 2006). This is of particular benefit when re-negotiation takes into account the interests of both parties and is geared toward mutual gain.

Current industry practices in negotiating IT outsourcing agreements are largely based on ideology, fashion and personal expectations instead of the employ of structured analytical techniques (De Loof 1996). The outsourcing relationship benefits both parties when negotiation is structured, and focuses on producing outcomes for mutual gain. The initial goals or interests might be different; Such as the customer wanting to get the best quality of services for the lowest price, and the supplier wanting to increase profit. Negotiation that do not consider the interests of both parties i.e., where the negotiation style is positional or power-based, could lead to an agreement where one or both parties need to abide by less than satisfactory terms and conditions. Due to the long-term nature of the contract, and the complexities and pressures that affect the IT outsourcing environment, the effect of these limitations may compound over time. The resultant problems can compromise the relationship. However, through principled negotiation, opportunities for mutual gain can be created.

6.5 Successfully Negotiating IT Outsourcing Agreements

Let us re-cap briefly on previous discussions on successfully using principled negotiations.

Fisher, Ury and Patton suggest a negotiation is principled when it:

1) Separates the people from the problem
2) Focuses on interests, not positions
3) Invents options for mutual gain and
4) Insists on objective criteria

To be considered successful, the negotiation should also adopt fair standards and there should be procedural fairness (Fisher, Ury & Patton 1994).

When negotiating information technology agreements, as in any negotiation between two organisations, the efforts may be considered successful if the parties have reached a consensus on the price, terms and conditions and nature of products and services to be delivered. If both parties have reached an agreement, then the negotiation can be deemed successful.

In IT outsourcing negotiations, success is a complex measurement. Whilst the success of the negotiation process itself may be measured using the above criteria, the strength of the agreement or contract that is drawn up during the negotiation process, could potentially have a substantial influence on the overall success of the IT outsourcing endeavour. Research indicates that effective negotiation of the IT outsourcing contract is a predicator for success (Ang & Toh 1996, Bendor-Samuel 2002, Barthélemy 2003, Cohen & Young 2006). Success cannot be measured in terms of a fair “price” as the IT outsourcing endeavour is much more than a procurement exercise. Success cannot also be determined by whether the IT outsourcing agreement endured a full term, or whether it was extended for a further term. These are most rudimentary measurements of success and do not consider the complex nature of the IT outsourced environment and the many internal and external factors that could influence aspects of the contract. Thus, it is important to consider a more robust measurement of success.

Since IT outsourcing is a long-term relationship, the measurement of success could differ at different stages of the contract. Particularly, the business environment or the levels of services needed to satisfy business requirements, may, change at different stages during the term of the agreement.

Success in IT outsourcing negotiation must therefore, take into account the effectiveness of the contract established through the negotiation process. The overall success of the IT outsourcing initiative thus established, also needs to be taken into account when building a tool for effectively negotiating an IT outsourcing agreement.

Some criteria for assessing the success of an IT outsourcing negotiation may include:

- Was the negotiation principled?
- Was there transparency of factors and issues (interests) affecting each party? Were they considered and addressed as part of IT outsourcing negotiation?
- Was the negotiation process aided by experts in IT outsourcing and negotiation?

  Often, those in the organisation who are intimately knowledgeable about the IT function being outsourced conduct the negotiation. They may not contain any knowledge about IT outsourcing or of negotiation. However, they will be keenly aware of business issues, needs and risks. It is important to support these key people by providing them with expertise in law, IT outsourcing and negotiation.

- Were costs that are commonly hidden, such as transition costs, costs of governance, costs of re-negotiation etc., explored and discussed?
- Were key risks, or areas of uncertainty explored and discussed? Does the resultant agreement define a process where these risks can be shared?
- Does the contract established as a result of negotiation, contain defined success criteria and mechanisms to measure these criteria objectively?
- Does the resultant contract contain flexibility? I.e., does it allow for the planned re-negotiation of certain terms and conditions? Does the contract allow for early termination under certain circumstances?
- Can the resultant contract cope with changes to the organisations' priorities, strategic direction and structure?
- Does the negotiated IT outsourcing agreement contain details about the governance of the IT outsourcing relationship and define roles and responsibilities to govern the agreement?

These criteria of success have been built into an evaluation tool, which was used to assess the efficacy of the research outcome: "A Structured Framework for Negotiating Information Technology Outsourcing Agreements". Please refer to Chapter 9 for more details on how the research outcome was evaluated for efficacy.

6.6 Chapter Summary And Conclusions

This chapter explores the need for a structured, methodology to negotiate an IT outsourcing agreement. IT outsourcing is a widely recognised strategy for enhancing the overall organisation's business success (Cohen & Young 2006). However, currently available industry practices for negotiating IT outsourcing agreements aren't delivering the desired outcome, as a significant proportion of these long-term agreements fail within the first year. Research shows that an effectively negotiated agreement is a predicator for success. However, there does not currently exist an effective, structured methodology to negotiate IT outsourcing agreements.

This chapter describes how the outsourcing relationship needs to endure long term, and needs to be able to withstand numerous internal and external pressures and changes. Negotiation that is structured, and focuses on producing outcomes for mutual gain could be the key to producing a more enduring agreement.

In IT outsourcing, success is a complex measurement. Success cannot be measured in terms of a fair "price" as it is not just a procurement process. Success cannot be determined by assessing whether the IT outsourcing agreement endured a full term, or whether it was extended for a further term. These are most rudimentary measurements of success and do not consider the complex nature of the IT outsourced environment, and the many internal and external factors that could influence the success of a contract. Thus, it is important to consider a more robust measurement of success. The chapter discusses criteria that could be used to measure success of an IT outsourcing negotiation. These criteria are used in Chapter 9 to build an evaluation tool to assess the efficacy of the research outcome.

7 QUALITATIVE ANALYSIS OF INDUSTRY-BASED CASE STUDIES

7.1 Industry-Based Case Studies Examined In This Research

There were 14 case studies examined for this PhD study. Of these, four had to be eliminated due to incomplete or un-verified information. The remaining 10 IT outsourcing case studies were used for the qualitative investigation for this PhD research project.

The qualitative analysis of these case studies involved interviews with industry-based experts and the examination of contractual agreements and governance documents. Meeting minutes of negotiations or governance meetings, invoices for variations, records of re-negotiation or attempts at re-negotiation, dispute resolution etc., were also examined, where available. The information gleaned from the inspection of these documents was discussed with the relevant industry-based experts. Each expert interviewed had direct involvement in the negotiation or management of the IT outsourcing agreement being examined, either at the onset of the negotiation or in the management and re-negotiation of the contractual agreement. Where contractual documents were not available for review, the examination was conducted solely through the conduct of interviews with industry-based experts.

A summary of each case study has been included in Appendix 5. This includes information gleaned from documents as well as from the transcript of each discussion. It also includes some observations made by the research student. However, because there were multiple participants for each case study, the transcript of each discussion has not been included in this thesis dissertation. Furthermore, there was a lot of information repeated by different participants pertaining to each outsourcing agreement. This duplication of information has been eliminated in the summary. Common themes and emerging industry best practices are analysed in Chapter 7.3 in more detail.

Each Case Study summary has been reviewed and approved by the participants involved. The contractual agreements and governance documents were not released for publication here.

7.1.1 Questions Used to Interview Participants

A set of interview questions was used to interview industry experts involved in IT outsourcing negotiations. These questions are listed in Appendix 3, and were used as a guide rather than a definitive list of questions. The questions were derived from gaps in knowledge identified by published literature as presented in Chapter 5.11. The literature review presented in Chapter 5.11 highlights a significant gap in knowledge in industry practices that lead to a successful IT outsourcing outcome. The interview questions therefore explored this area in detail. The interview questions were also designed to extract any information on the negotiation of the IT outsourcing contract and what influences these practices may have had on the eventual outcome of the IT outsourcing endeavour.

The discussion format was dictated by the experience and the knowledge of the participant being interviewed. The questions were merely a tool to explore the relevance of different aspects of the IT outsourcing situation, or the participants' experience, to the practice of negotiating an IT outsourcing agreement. The questions focussed on drawing out any lessons learnt through the participants experience in negotiating IT outsourcing agreements. Also explored were methods or practices that would produce an effective IT outsourcing agreement, and any specific pitfalls to be aware of and avoid.

7.1.2 Industry Experts Interviewed for this Study

For each of the 14 case studies examined for this PhD research study, there were multiple people interviewed. At least one executive of the client organisation was interviewed. This included either the Chief Information Officer (CIO), Director of Information Technology or a member of the senior staff with equivalent decision making capability and strategic control to a CIO. A senior member of the supplier organisation was also interviewed for each case study. In some cases the Chief Executive Officer, Managing Director or General Manager of the supplier organisation was available for an interview. However, in most cases, a Sales Executive or Account manager from the supplier organisation, who was directly involved in the negotiation of the outsourcing agreement, was interviewed.

Operational managers and staff in charge of day-to-day operations or integration of the outsourced IT services, from both the client and supplier organisations were also interviewed for each case study.

Individuals interviewed have not been identified in any way. Participants' names, titles or positions held, or the organisations involved have not been revealed in this thesis dissertation.

7.1.3 Organisations Involved in this Study

Organisations involved in each of the outsourcing arrangements have not been specifically identified. Their names have been suppressed and each organisation has been assigned a broad category. The categories used are listed below, with a shortened acronym given beside each category, within brackets. This shortened name is used in Chapter 7.1.3 to identify organisations involved in each case study. The research project has not used any industry-standard grouping methods or definitions to arrive at these categories.

- Government Department: (Govt)
- Small Privately Owned Limited Liability Company < 100 Staff: (Small Org)
- Medium Sized Privately Owned Limited Liability Company 100 - 500 Staff: (Med Org)
- Large Privately Owned Limited Liability Company > 500 Staff: (Large Org)
- Publicly Listed Company – Australian: (Public Australian)
- Publicly Listed Company – Overseas: (Public Overseas)

7.1.4 Categorisation of Outsourcing Agreements

The outsourcing agreements have been broadly categorised in terms of the length of the contractual agreement, and the approximate value of the contractual agreement.

The following table describes the mix of case studies examined.

Case study Identifier Client & Suppliers	**Term of Outsourcing Contract In number of years**	**Value/Cost of Outsourcing In Australian Dollars**	**Examination Method**
Case Study 1 Supplier: Large Org Clients: Large and Med Orgs	3-5	> 100 million	Interviews
Case Study 2 Client: Large Org Supplier: Large Org	3-5	> 100 million	Interviews
Case Study 3 Client: Govt Supplier: Large Org	5-7	> 35 million	Interviews and Review of Documents
Case Study 4 Client: Govt Supplier: Multiple Public Australian	5-7	> 30 million	Interviews and Review of Documents
Case Study 5 Client: Govt Supplier: Public Overseas	3-5	>100 million	Interviews and Review of Documents
Case Study 6 Client: Govt Supplier: Multiple Public Australian and one Small Org	3-5	>100 million	Interviews and Review of Documents
Case Study 7 Client: Govt Supplier: Public Overseas	3-5	> 10 million	Interviews and Review of Documents

Case study Identifier Client & Suppliers	**Term of Outsourcing Contract In number of years**	**Value/Cost of Outsourcing In Australian Dollars**	**Examination Method**
Case Study 8 Client: Med Org Supplier: Large Org	3-5	> 2 million	Interviews and Review of Documents
Case Study 9 Client: Public Australian Supplier: Public Australian		> 40 million	Not Used: Incomplete Information. Please see Chapter 7.2
Case Study 10 Client: Public Australian Supplier: Public Australian	3-5	> 5 million	Interviews and Review of Documents
Case Study 11 Client: Public Australian Supplier: Public Overseas	3-5	> 3 million	Interviews and Review of Documents
Case Study 12 Client: Public Australian Supplier: Public Overseas	3-5	> 2 million	Not Used: Information documented was unable to be confirmed. Please see Chapter 7.2
Case Study 13 Client: Large Org Supplier: Public Australian	3-5	> 25 million	Not Used: Information documented was unable to be confirmed. Please see Chapter 7.2

Case study Identifier Client & Suppliers	Term of Outsourcing Contract In number of years	Value/Cost of Outsourcing In Australian Dollars	Examination Method
Case Study 14 Client: Large Org Supplier: Large Org	3-5	> 25 million	Not Used: Information documented was unable to be confirmed. Please see Chapter 7.2

Table 2: Categorisation of Outsourcing Agreements

7.2 How Interviews Were Conducted For This Study

There was significant difficulty in securing an in-depth interview, with busy Information Technology executives, and furthermore, each case study required several (not just one) of these executives to be interviewed. Further time and effort was required from the participants to check and verify the information gleaned from interviews. Due to difficulties in obtaining such a commitment from participants, the sample size was restricted to 10. During the course of the PhD study, a total of 14 case studies were examined. However, of these, four needed to be eliminated due to one or more of the following constraints:

- The interview with the industry expert was not thorough or could not be completed satisfactorily, due to the participants' constraints on available time.
- Information gleaned from documents or interviews was incomplete and the missing information could not be obtained at the time of publication of this thesis.
- Participants were unable to verify the accuracy of information recorded from the interviews, at the time of publication of this thesis.

A resultant sample size of 10 case studies was used for this research study. Each industry-expert involved in the study was contacted by the researcher, and the necessary consent forms and information forms were sent to the potential participant, via email, before an interview was secured. A copy of these information forms and consent forms are included in Appendix 1 and 2. The interview was conducted in person, either at a public place or at the premises of the organisations involved. The researcher briefly introduced the background of the research topic, the aim of the PhD study and the reason for the interview. The format of the discussion was also discussed.

The set of interview questions, as listed in Appendix 3, was used as a guide. Section 7.1.1 describes how and why these questions were used to guide the conversation. The experiences and the knowledge of the participant being interviewed dictated the questions that were used from this set. The discussions focussed on lessons learnt through the participants experience in negotiating IT outsourcing agreements. Also explored were methods or practices that would produce an effective IT outsourcing agreement, and any specific pitfalls to be aware of and avoid. After each interview, a follow up discussion was also necessary to finalise details that were not available at the time of the interview, or to clarify missing information or further explore subjects/questions that were overlooked during the initial discussion.

Each participant was assured of anonymity, and it was noted that the organisations being discussed would only be identified using a broad category.

Once each initial discussion with the industry expert had been completed, a detailed transcript was sent via email to the participant. The participant was then asked to confirm the accuracy of the transcript via email or via a telephone discussion. In most cases, the transcript was amended and re-sent via email between the Researcher and the research participant a number of times until each participant was comfortable with the accuracy of the information recorded.

7.3 In-Depth Analysis of Case Studies

The study involved the review of contractual documents and in-depth interviews with industry experts involved in the negotiation and management of each IT outsourcing agreement. The summary of each case study is included in Appendix 5. The analysis of each case study is based on qualitative methods and is included below.

7.3.1 Analysis of Case Study # 1:

The study shows that suppliers can benefit significantly by leveraging long-standing relationships with repeat customers, and convert multiple, distinct IT services engagements to an outsourcing type relationship.

Having a long-term outsourcing relationship with a client can benefit the supplier by ensuring continuity of income; provide ease of management of resources; allow effective planning and forecasting of workload.

Having several of these long-term relationships will compound the above benefits. Additionally, by providing the services to several clients, it is also possible to gain cost efficiencies through economies of scale.

The case study highlights that the supplier and the client could jointly capitalise on the intrinsic knowledge the supplier had gained (through previous work), of the client's business and IT environment.

The study also shows that the client can benefit in many ways by converting from an ad-hoc engagement model to an outsourcing model. It is possible to streamline IT functions through one trusted partner, instead of seeking the best supplier for each distinct service requirement, as the need arises. The administrative burden of securing and managing services from several suppliers, in an ad-hoc fashion, is also eliminated. Further benefits include consistency of services, and an opportunity to gain cost efficiencies through economies of scale.

The study highlights that the business landscape and economic climate has changed significantly since the late ‘80s. IT Outsourcing contracts and negotiation practices are far more sophisticated now in the 2010/2011 compared to the late ‘80s.

In the late 80’s little or no formal methods were used to negotiate an IT outsourcing contract. The resultant IT outsourcing contract may not have formal mechanisms like SLAs, dispute resolution mechanisms, re-negotiation terms, sophisticated pricing structures or governance methodologies. The IT outsourcing relationships operated on a high level of trust.

If the outsourcing contract does not address pricing structures for new services to be added or the potential for growth in the volume of services needed, this poses additional risks to the both the client and the service provider.

The study demonstrates that a client who is heavily reliant on the outsourced provider, would have little, or no choice but to accept the price quoted by the provider for any additional ‘out of scope’ services, or for the growth in volumes of services. If there is a marked decrease in the volume of certain services, the client may still be required to pay the same price.

If the contract does not contain pricing structures that accommodate future growth, the supplier may be severely disadvantaged, if the volume in services or the underlying cost of services being rendered increases significantly. The supplier would need to provide services stipulated in the contract, at the price that was set when the contract was negotiated. If the underlying cost or the volume (workload) increases, the supplier may suffer diminished profits or operate at a loss.

Thus, potential future changes and flexibility to accommodate changes in demand need to be considered when negotiating IT outsourcing contract.

It may be beneficial to involve experts during the negotiation of contract, such as IT operational experts, domain experts in the services being outsourced, outsourcing experts and practitioners experienced with negotiation/business relationship management.

7.3.2 Analysis of Case Study # 2:

The case study illustrates that when un-structured methods are used to approach the outsourcing endeavour or to negotiate the IT outsourcing contract, the resultant arrangement relies heavily on the strength of the relationship between the client and the services provider.

If the resultant IT outsourcing contract does not have formal mechanisms like SLAs, dispute resolution mechanisms, etc. the, parties involved need to be a lot more flexible and rely on each other to act with integrity and compassion.

When informal methods are used to negotiate an IT outsourcing arrangement, or when the arrangement 'evolves' over time, original expectations of benefits might not be clearly understood by either party, as was evident in this case.

Expected benefits of IT outsourcing, as described in this case study, include increased focus on core competencies, reduced cost, better service levels, moving away from legacy/out-dated systems to newer technology; In order for these expected benefits to be realised, they first need to be translated to measurable outcomes and included in the negotiation discussion.

In this case, the supplier saw an opportunity to provide a wider breadth of services (get more business) and to take over the out-dated hardware/infrastructure from the client, update it, and thereby reduce costs and improve services. The client saw an opportunity to off-load legacy infrastructure and eliminate the burden of focusing resources on the IT function which was not a core part of the organisation.

Improvements in service levels may be an expectation at the onset of the IT outsourcing agreement, but it is hard to define objectives or prove delivery against objectives when SLAs are not discussed during negotiation.

Even if SLAs are discussed, as it was briefly done during this particular negotiation, the contract needs to define these specifically and address how these SLAs are measured. It is difficult to measure delivery against unclear SLAs.

A comprehensive assessment of the benefits, risks and hidden costs need to be undertaken by both parties. In this case, such an assessment was not done. However, the strength of the pre-existing relationship and flexibility from both parties enabled the arrangement to function.

The case study also raises the concern that too many organisations focus heavily on one aspect of the IT outsourcing during negotiation, such as SLAs, and lose focus of such things as governance mechanisms and overall objectives. It is therefore important to consider all interests during an IT outsourcing negotiation.

When a decision to outsource IT is not based purely on price, other aspects can be given prominence during negotiation; Such as how transition of services is handled, pre-existing issues that need to be resolved before transition and the transfer of assets or personnel.

In this case, the supplier's familiarity with the client's business environment facilitated the creation of a robust business proposal. Thus, it is beneficial if the supplier invests some effort prior to the outsourcing negotiation, in understanding the client's interests.

The client had confidence in the supplier's ability to deliver services, in this particular case, built through a previous track record in similar services being delivered. Thus, any uncertainty in a supplier's ability to deliver services can be reduced, if a client can test the ability of the service provider. This can be done by creating individual services engagements for similar services, and engaging potential suppliers to deliver these prior to a long-term outsourcing arrangement being considered.

The case highlights that relationships play a very important role in the success of an IT outsourcing endeavour and that the strength of the relationship may overcome in-efficiencies in the negotiation process or the resultant contract.

7.3.3 Analysis of Case Study # 3:

The case study illustrates that outsourcing a problematic function does not necessarily address the underlying issues.

There was a mandate to outsource from senior executives. A comprehensive assessment of the benefits, risks and hidden costs need to be undertaken by both parties. In this case, such an assessment was not done. The negotiation, although following a formal tender process, focussed heavily on price.

In this case, the IT department was in a state of disrepair, and potential suppliers had to spend significant effort to understand the environment, in order to create their proposals and bid for the outsourcing business. The upfront effort in this particular case study, was not governed by a 'memorandum of understanding' (MOU), or other methods. Nor was any compensation afforded to the supplier during the pre-negotiation, 'discovery' phase. The lack of governance of pre-contract activities presented significant risks to both parties. The supplier would be "out of pocket" if the decision was made to reject the supplier's proposal; The client did not protect their IP and prevent possible liabilities during this period. Thus, it is useful to govern any pre-negotiation or "discovery" work using a MOU.

As a result of significant efforts spent in understanding the client's environment, the suppliers were focussed heavily, during negotiation, on recouping costs incurred.

This promoted the supplier to focus on winning the outsourcing business, even if the arrangement was untenable. Due consideration was not given to quality and service level expectations and governance mechanisms.

Each supplier who bid for the business, invested heavily to gain an understanding of the client's environment, pre-negotiations. However, SLAs and quality expectations were not clearly understood by the suppliers. This ambiguity was transferred to the contractual agreement.

The case highlights that setting the price for services is a non-trivial, complex task. If the environment is complex or in a state of disrepair, significant effort may be involved to understand the ongoing management aspects required.

An interesting observation drawn using this case study was that the client formed an alliance with several other clients and negotiated with more than one potential supplier.

This could have made the outsourcing deal more attractive to the supplier. It would have also improved the BATNAs for the client.

This case highlights that when un-structured methods are used to approach the outsourcing endeavour or when negotiation is focussed predominantly on price, the resultant arrangement may not address other aspects of the outsourcing arrangement.

The resultant IT outsourcing contract, in this case, did not have formal mechanisms for ongoing management like comprehensive SLAs, dispute resolution mechanisms, re-negotiation terms, pricing structures, flexibility to accommodate future changes or other governance methodologies.

Since service levels were not clearly defined in this case, the client may have left these open for interpretation by the supplier. If the supplier is going to make profits, they may elect to provide a lower level of service to the client.

The case illustrates that what may be reasonable at the start of the engagement may not be sustainable year after year.

Changing needs of the client was also not considered during negotiation, so the resultant contract did not address the need to review aspects of the relationship during the term of the agreement.

The price based negotiation and poorly structured contract led to significant issues (for both parties) from the onset of the outsourcing relationship. The IT outsourcing relationship further deteriorated over time.

The case study provides insight that vital information (intellectual property) relating to the outsourcing operations, needs to be available – and kept current – in a readily acceptable and secure format/location. The absence of this, as in the current case study, any reluctance of the incumbent to "hand-over" services to the new supplier, may introduce significant issues and costs.

7.3.4 Analysis of Case Study # 4:

The case study dealt with a renewal of an existing outsourcing relationship, which was approaching the end of term of the IT outsourcing arrangement.

A comprehensive assessment of the benefits, risks and hidden costs need to be undertaken by both parties, regardless of whether it is a new contract or the renewal of the contract for a further term. In this case, such an assessment was not done at the onset of the initial contract. The negotiation at that time, although following a formal tender process, focussed heavily on price. Thus, options, hidden costs, and overall effects of IT Outsourcing were not considered when the initial contract was drafted.

The initial contract did not contain comprehensive SLA's or mechanisms to measure delivery against SLAs. Quality expectations of the client were not fully understood by the supplier at the time of negotiation. The contract did not address the changing needs of the client.

There were no formal processes of governance discussed during negotiation or detailed in the contract. Thus, the relationship was poorly governed and had deteriorated over time.

The case study highlights what previous research has confirmed, which is that an unstructured contract and poor governance of an IT outsourcing arrangement, lead to the relationship between the client and the supplier deteriorating over time with significant risks and costs for all parties concerned. (Ang & Toh 1996, Bendor-Samuel 2002, Barthelemy 2003).

From the client's perspective, the services rendered by the supplier were deemed unsatisfactory (even though the SLAs were being met). And the supplier was being opportunistic on pricing discretionary work and contract variations.

From the outsourcer's perspective, the outsourcing agreement had costed more than anticipated – and did not deliver the expected profits. The supplier had strictly adhered to the contract – yet the client maintained that there was a mismatch in customer's expectations and service levels delivered. The client was also being unreasonable with expectation of the pricing of 'out of contract' services.

The case study demonstrates that SLAs need to be precise and have specific measurement criteria. The quality of output and continuous improvement should be factors that are measured

The case illustrates that when the client and supplier are negotiating the IT outsourcing contract for the second time, the contracts are more sophisticated and structured.   We could infer by this that when those experienced in IT outsourcing are involved during negotiation, the contract produced would be better structured.

When the negotiation was approached, for the renewal of the IT outsourcing agreement, the negotiation process was structured; based on understanding the interests of both parties; and did not focus predominantly on price. Aspects such as flexibility to address the changing needs of the customer, and governance mechanisms were discussed during negotiation.

However, in a focus to address previous limitations, i.e., the lack of comprehensive service delivery objectives, the new SLAs were based on service delivery objectives. Not enough emphasis was placed on maintaining technological currency, innovation, continuous improvement in services and reduced costs.

The client benefited greatly in having multiple outsourcing vendors. A best of breed outsourcing was used to reduce the potential for monopoly/ heavy dependency on one single supplier. However, the overhead in managing multiple vendors was a hidden cost that was overlooked. When dealing with multi-vendor relationships, more care needs to be taken to eliminate confusion / overlapping areas of responsibilities.

The need to specifically address sub-contracting was also raised by participants of this case study. Many suppliers sub-contract part of the services awarded to them, to third parties. Sub-contracting of services by the supplier could have unexpected consequences to the client's business outcomes. The client organisation may lose control over specific services – or have limited ability to influence outcomes relating to the sub-contractor. Because there is no direct relationship or legal contract between that third party and the customer there may be limited mechanisms for overseeing the business conduct and outcomes from the third party supplier. It is therefore necessary to be aware of the supplier's intent to sub-contract, when negotiating an IT Outsourcing agreement. The requirement that the supplier needs to be completely transparent to the client, about any intent to subcontract should be stipulated at negotiation and should be included in the IT outsourcing contractual agreement. In this particular case, the client avoided significant regulatory compliance issues by making sure any sub-contracting by intended suppliers was declared upfront.

7.3.5 Analysis of Case Study # 5:

The case study involved the re-negotiation of an existing IT outsourcing arrangement, which was a complex, multi-vendor arrangement.

There were overlapping areas of responsibilities, which resulted in significant effort and resources to manage and integrate service delivery outcomes from the various providers.

The aim of the re-negotiation was to simplify the management of the services, optimise workforce, improve business processes and ultimately reduce cost.

There was also significant growth predicted in the client's business – so having a competent outsourcing provider as a partner was expected to facilitate this growth.

Negotiation was approached in a formal manner. However, it did not involve experts in the IT outsourcing negotiation field.

A comprehensive assessment of the benefits, risks and hidden costs need to be undertaken by both parties, regardless of whether it is a new contract or the renewal of the contract for a further term. In this case, such an assessment was not done. Although during negotiation a formal tender process was adopted, the discussions focussed heavily on SLAs.

The case study also raises the concern that too many organisations focus heavily on one aspect of the IT outsourcing during negotiation, such as SLAs, and lose focus of such things as governance mechanisms, cost of governing the contract, cost of ongoing maintenance, impact of technology choices on business processes etc. It is therefore important to involve experts in IT outsourcing and consider all interests during an IT outsourcing negotiation.

There were positive aspects demonstrated by this case study. The client and suppliers had possibly learnt from previous experiences or had a better understanding of the environment they needed to operate under. The client protected all intellectual property that was needed for the delivery of the services with a copyright (business rules, manuals, etc.). There were comprehensive governance mechanisms discussed during negotiation, and these were used to tightly manage the outsourcing arrangement. Issues and changes were dealt with through a formal dispute resolution process, which was designed at the time of negotiation.

The agreement was considered a success as it was extended several times for a new term.

The above highlights that when negotiation is structured, when it involves those experienced in IT outsourcing and when negotiation considers interests of both parties rather than focussing on price alone, the resultant contract is better structured. It also demonstrates what research literature has confirmed which is that a well-structured IT outsourcing contract leads to a successful IT outsourcing outcome. (Ang & Toh 1996, Bendor-Samuel 2002, Barthelemy 2003).

7.3.6 Analysis of Case Study # 6:

This case study involves a formalised tender process adopted during the negotiation of existing outsourced arrangements.

The participants in the negotiation process were experienced in IT outsourcing. The client had quite an in-depth understanding of the challenges and risks – having been through the outsourcing negotiation previously, and seen the arrangement evolve through to end of term. Benefits, risks and hidden costs were considered during negotiation. The resultant contract was well structured and had robust mechanisms for ongoing governance.

A best of breed approach was taken, to award services to several successful bidders. In this case, the splitting of the outsourcing services between several, “best of breed”, suppliers was a positive move. It reduced the monopoly held by the main supplier and introduced a higher level of accountability. However, the governance of the multi supplier agreement does require more effort.

The client needed to ensure that none of the services were sub contracted to off-shore companies due to compliance with regulatory requirements. Thus, the suppliers were required to be absolutely transparent about their intent to outsource. This requirement was discussed during negotiation.

Risks were considered during negotiation, and alternatives to a negotiated agreement (even though limited) were considered. The client opted to keep the incumbent supplier and introduce new suppliers to create a multi-vendor arrangement.

Even though the negotiation considered several interests, too much emphasis placed on technology rather than the delivery of services. The technology at the time of negotiation was soon out-dated by newer, cheaper technology available in the market. The client was unable to keep pace with the rapidly evolving technology, because the contract did not have any provisions for maintaining technology currency. There were also no mechanisms for continuous improvement or innovation.

The case study highlights that even when experts are involved, IT outsourcing is a complex undertaking. Negotiating an IT outsourcing arrangement needs to take into account many operational issues and organisational implications as well as the rapidly evolving nature of IT.

7.3.7 Analysis of Case Study # 7:

This case study relates to an existing, mature, outsourcing relationship. Contract renewal negotiations were aimed at driving down costs and addressing inflexibility in the contract.

The contract was well-structured and contained comprehensive SLAs, which were being adhered to by the supplier. However, the focus during the re-negotiation was on reducing costs.

Client invited proposal from several suppliers as well as incumbent supplier. This strategy was advantages during re-negotiation, as it improved the client's BATNA. The successful supplier was expected to provide increase services at the same level, if not better quality, at a reduced cost. The successful supplier had to severely compromise on profits to sustain the arrangement. The supplier in this case did not consider alternatives to a negotiated agreement. The supplier's only consideration was signing up for another term. Even though the incumbent was re-engaged for a further 5 years, the negotiation was not considered a success by the participants involved in this case study.

The case study highlights that when a negotiation is heavily focussed on price, even if it the renewal of a successful arrangement, the results can be less than optimal. In this case, the services suffered in the long term, the reduction in price meant that the supplier had to reduce the amount of resources dedicated to the client. This was the only way they could make any profits. The reduction in staff had the overall effect of a reduction in the quality of services.

When unreasonable expectations are placed on the supplier, such as increased level of services at a reduced cost, the overall relationship and the IT outsourcing agreement is at a threat of failing in the longer term. The case study demonstrates that a mutually beneficial agreement is more likely to endure to the full term and produce better results rather than an agreement that unfairly disadvantages one party.

7.3.8 Analysis of Case Study # 8:

The case study deals with the outsourcing of IT application development services.

The negotiation/selection process was not structured. It was based on a pre-existing personal relationship rather than structured methodologies. There was a broad understanding of what was required and how success was going to be measured. Even costs were not specifically discussed and agreed.

The case study illustrates that when un-structured methods are used to approach the outsourcing endeavour or to negotiate the IT outsourcing contract, the resultant arrangement relies heavily on the strength of the relationship between the client and the services provider.

A comprehensive assessment of the benefits, risks and hidden costs need to be undertaken by both parties. In this case, such an assessment was not done. The case demonstrates that the strength of the pre-existing relationship can be severely tested during such an arrangement.

The un-structured arrangement did not deal with the changing needs of the client. The changes in scope and the evolving refinement/understanding of the original requirement severely altered the cost of services and the effort/time required.

The case study illustrates that the contract formulated needs to specify expectations clearly, with specific deliverables and time frames as well as the expected quality of services to be rendered and other measures of success critical to both the customer and the supplier.

The contract also needs to specify how disputes will be resolved and how the relationship will be managed.

There needs to be an agreement on how scope changes will be handled and the price of such changes. The contract needs to deal with financial and other terms and how risks will be handled. Delays and non-delivery of expected results should also elicit penalties – and these should be clearly stipulated in the contract. If issues are discovered during the up-take of responsibilities, the supplier should have mechanisms to renegotiate terms and conditions of the contract.

The case clearly demonstrates that relying solely on the relationship, without a contract to support the endeavour, significantly increases the likelihood of the IT outsourcing agreement failing.

7.3.9 *Analysis of Case Study # 10:*

The case study illustrates that you cannot eliminate a problematic business function by outsourcing it to an external provider. Outsourcing a function does not necessarily address the underlying issues.

There was a senior executive directive to outsource the IT function. A comprehensive assessment of the benefits, risks and hidden costs need to be undertaken by both parties. In this case, such an assessment was not done.

The negotiation/selection process was not structured. It was based on a pre-existing personal relationship rather than structured methodologies. There was a broad understanding of what was required and how success was going to be measured.

Experts in IT outsourcing were not involved in the negotiation. The client did not understand or communicate their operational challenges. The supplier also did not have any understanding of the client's environment.

Options, hidden costs, and overall effects of IT Outsourcing were not considered. The supplier took over the operations without fully understanding operational requirements and quality expectations; The client did not fully understand the impact on the organisation and the costs involved.

Because costs were not fully understood, the customer had to pay a fee that far exceeded initial expectations and previous internal operating costs. The supplier had several hidden costs including the amount of effort, time and resources to establish and transition to the outsourcing arrangement.

This study illustrates key risks for both the supplier and the client, when IT outsourcing and the negotiation of the contract is approached in such an ad-hoc, unstructured manner.

As confirmed by research literature, the resultant IT outsourcing contract that is formed through an unstructured negotiation process, may not have formal mechanisms like SLAs, dispute resolution mechanisms, re-negotiation terms, sophisticated pricing structures or governance methodologies. Also confirmed by research literature, and as observed in this case, the ill formed contract led to an unsuccessful IT outsourcing arrangement. (Ang & Toh 1996, Bendor-Samuel 2002, Barthelemy 2003)

The study emphasises particular difficulties that may occur when personnel issues are not handled properly. Knowledge transfer was particularly difficult and wrought with several complications due to human factors. The damaging influences of the outsourcing endeavour, including how staff and transition of services are handled needs to be carefully considered during negotiation.

The contract needs to deal with, in financial and other terms, how risks will be handled. The risks to the supplier and to the client were only partially addressed by a MOU, when operations were transitioned before an outsourcing agreement was finalised.

It may have been more beneficial for the client to address the problematic IT function, by implementing industry best practices, and addressing human resources issues. When the issues were bedded down, a robust cost vs. benefits analysis could have been undertaken to consider the outsourcing option. Significant problems and costs could have been avoided by approaching the outsourcing in the above manner.

The negotiation process, the contract established and the outsourcing arrangement were not successful. This is because, the negotiation was not based on structured methods; key factors such as how risks will be shared, how much services will cost, how transition will be handled and how the damaging influence of the outsourcing endeavour will be addressed were all ignored during negotiations.

7.3.10 Analysis of Case Study # 11:

This case study deals with the renewal of an existing outsourcing arrangement at the end of term. The client wanted to take the opportunity to review the decision to outsource.

The negotiation was semi-structured; the client did not approach any other suppliers for a proposal and only entered into negotiation with the incumbent supplier. However, the process for negotiation and the format of discussions were structured and were agreed to by both parties.

The vendor organisation had a good understanding of the client organisation's general needs and operations, having been in the existing outsourcing relationship for nearly 3 years. Furthermore, the supplier was also aware that the outsourced services being rendered were critical to the success of the client's organisation.

The discussions were heavily based on price, despite both parties being cognisant of interests of the other party. The supplier had capability to deliver services and the client was reasonably satisfied to sign for another 3 year term as long as the price came down significantly.

The agreement was not actively governed. There were no significant issues outstanding for the client or the supplier, but there were several underlying perceptions of the supplier's performance, which were not based on actual measurement of service delivery data. The supplier was un-aware that any negative perceptions existed in the client's wider business-user community. Service delivery objectives were not being measured or actively reported on, and did not reflect the changing needs of the client.

Even though the negotiation did not result in the signing of a deal, the process was well executed. However, options for mutual gain were not considered and the dominant focus of the discussions was price. The relationship between the parties did not deteriorate as a result of the contract being terminated. Perhaps this was because the negotiation process was based on structured methods rather than being dictated by power, politics and personal aspects.

The services were in-sourced and the focus was shifted from an ongoing outsourced arrangement to working together to ensure a smooth transition to an in-house team.

It is unclear from the information presented in this case study, whether the decision to in-source was the most appropriate decision. Had the client known the true capability of the supplier, or if the supplier had understood underlying issues or perceptions and addressed these, then the outcome may have been different. If the personnel involved in negotiation had been aware that the client organisations had the intention to dramatically shift its strategic focus in the near future, then decision to in-source may have been considered too risky at the current time. Human factors / Personnel issues did play a role in the negotiation / transition process. The effect of these issues was severely underestimated.

The case study illustrates that when the damaging influence of an IT outsourcing endeavour is underestimated or not addressed during negotiation, it could impact the transition of services and these may affect the client, the supplier and the whole IT outsourcing arrangement.

The negotiation depicted in this case study failed in the following key areas. The negotiation was heavily focussed on price, without other aspects being considered; those involved in the negotiation did not have knowledge of the strategic direction of the wider organisation; even though the parties involved, had negotiated an IT outsourcing agreement prior to this instance, key considerations such as how risks will be shared and how transition/human resource aspects will be handled etc. were not addressed during negotiation.

The case illustrates what research literature has previously stated, that even when experienced IT outsourcing experts are involved in negotiating an agreement, the process can be complex, non-intuitive, and most importantly not a straight forward procurement exercise. (Gottschalk & Solli- Sæther 2006).

7.3.11 Summary of Best Practices from Cases Studied

	Best Practice Methodology **Derived from Qualitative Analysis of Case Studies**	**Cases that Demonstrate Best Practice Method**	**Literature that Support Best Practice Method**
1	IT Outsourcing: When IT Outsourcing is approached in a structured manner, it increases the likelihood of a successful outcome.	2, 3, 4, 5,6. 8,10	Gottschalk 2006, Lacity & Willcocks 2000, Cohen & Young 2006
2	Outsourcing the IT function to get rid of a problematic division does not necessarily address underlying issues and could turn into a complex, costly, exercise. The client might be better placed to implement best practices and address human resource issues before considering IT outsourcing.	3,10	
3	When the IT outsourcing agreement is well structured, the IT outsourcing endeavour has more likelihood of succeeding. This assertion is also supported by published literature. Studies show that the lack of a well-structured agreement is likely to lead to issues, and contribute to the failure of the relationship and the IT outsourcing arrangement.	1, 2, 3, 4, 5, 8,11	Ang & Toh 1996, Bendor-Samuel 2002, Barthelemy 2003
4	IT outsourcing negotiation: When IT Outsourcing negotiation is approached in a structured manner, using principled negotiations, it increases the likelihood of the resultant IT outsourcing contract being well structured.	4, 5,6	De-Loof 1996, Gottschalk 2006, Lacity & Willcocks 2000, Kock et. al 1996

	Best Practice Methodology Derived from Qualitative Analysis of Case Studies	Cases that Demonstrate Best Practice Method	Literature that Support Best Practice Method
5	Prepare for the negotiation. Negotiation of an IT outsourcing agreement is not intuitive and is not a price-focussed procurement exercise. Careful consideration needs to be given to several organisational, technological and operational aspects, as well as external factors such as global and economic considerations.	3,4,5,6,7,8,10, 11	Gottschalk 2006, Lacity & Willcocks 2000, Kock et. al 1996
6	The case studies show that instead of taking risks on the capability of the service provider to deliver services or the quality of services, the client can engage potential suppliers prior to entering into a long term agreement, by awarding them similar, short term services contracts. This also benefits the supplier as it provides an opportunity to better understand the client's environment, challenges and priorities.	1,2	Gottschalk & Solli-Sæther 2006
7	Strengthen BATNAs The case studies highlight that by holding negotiations with several potential suppliers, the client can improve their BATNAs.	4, 5,6,7	Gottschalk 2006, Lacity & Willcocks 2000, Kock et. al 1996

	Best Practice Methodology Derived from Qualitative Analysis of Case Studies	Cases that Demonstrate Best Practice Method	Literature that Support Best Practice Method
8	The case studies also demonstrate that a supplier who forms an alliance with other service providers, is able to strengthen their position at the negotiating table and also able to bid for a bigger selection of services.	1,2	Graham 2003
9	Clients can also strengthen their position at the negotiation table by collaborating with other clients.	3	
10	A change in the strategic focus of an organisation may alter the options that need to be considered during an IT outsourcing endeavour. Thus when negotiating an IT outsourcing agreement, people with visibility of each involved organisation's future strategic direction need to be involved. The case studies demonstrate that using people who are experienced in IT outsourcing and involving experts in the IT function being outsourced, increases the likelihood of a successful IT outsourcing agreement.	2, 4,5, 8,11	Gottschalk 2006, Lacity & Willcocks 2000, Kock et. al 1996
11	The case studies show that when the negotiation is based on principled techniques, where interests of both parties are considered and the focus is on developing mutually beneficial options, the IT outsourcing arrangement is more likely to be successful.	1,2,11	Kock et.al 1996, Lacity & Willcocks 2000, Gottschalk 2006, Cohen & Young 2006

	Best Practice Methodology Derived from Qualitative Analysis of Case Studies	Cases that Demonstrate Best Practice Method	Literature that Support Best Practice Method
12	Case Study 3 and 7 demonstrate that if either party is severely disadvantaged during pre-negotiation activities, or enters into an untenable agreement, the resultant IT outsourcing arrangement may not endure, or be successful longer term. Negotiations that focus on options for mutual gain and which consider interests of both parties are more likely to be successful.	3, 7	Graham 2003
13	The cases investigated in this research raise the concern that too many organisations focus on one aspect of the IT outsourcing arrangement, during negotiations. 4 out of the 10 cases studied focussed heavily on price; case 6 focussed heavily on technology; and cases 4, 5 and 7 focussed too heavily on SLAs. The studies show that for an IT outsourcing arrangement to function well, the resultant contract needs to be well formed.	1, 3,4, 5,6, 7	Barthélemy 2003, Cohen & Young 2006
14	There are many benefits, risks and hidden costs involved in outsourcing IT, these need to be understood and assessed by both parties during negotiation. Negotiation of an IT outsourcing contract needs to address; how these will be measured; how changing needs of the client are handled; how the supplier is adequately compensated for changes in that affect the outsourcing arrangement; how risks will be shared; how services will be transitioned; how the relationship will be managed, the term of the contract and how unanticipated or hidden costs will be handled.	All	Earl 1996, Kock et. al 1996, Elitzur & Wensley 1996, Lacity & Willcocks 2000, Barthélemy 2003, Gottschalk & Solli-Sæther 2006

	Best Practice Methodology Derived from Qualitative Analysis of Case Studies	Cases that Demonstrate Best Practice Method	Literature that Support Best Practice Method
15	Negotiation of an IT outsourcing contract needs to address what services will be required for the desired outcomes to be achieved. This can be achieved by including a detailed statement of work (SOW). If additional services are to be added after the agreement is signed, a clear definition of what is in scope and what is out of scope will be crucial.	All	Bendor-Samuel 2002
16	The IT outsourcing contracts considered in these case studies could have been significantly improved by the inclusion of comprehensive SOW, SLAs to define and measure desired outcomes, governance mechanisms, dispute resolution mechanisms, flexible pricing structures, re-negotiation terms, etc. The cases where the above aspects were considered in the IT outsourcing negotiation and drafted in the resultant contract, had more favourable outcomes, such as the contract being renewed for a further term.	1, 2,3, 4,8, 10, 11	
17	The studies show that the IT outsourcing contract needs to be designed with a certain degree of flexibility. The contract needs to contain mechanisms to address the changing needs of the customer, and mechanisms to protect the supplier when changes affect the IT outsourcing arrangement or operational aspects of the arrangement.	5, 6, 7	Clark, Zmud & McCray 1996, Barthélemy 2003

	Best Practice Methodology Derived from Qualitative Analysis of Case Studies	Cases that Demonstrate Best Practice Method	Literature that Support Best Practice Method
18	The studies show that the contract needs to stipulate conditions that enable the technological currency to be maintained. The rapidly evolving nature of technology means that the technology at the time of contract signing may become out-dated during the long-term contract. If there are no terms addressing the need to keep technology updated, the client may be disadvantaged or the supplier may be expected to provide this without adequate compensation.	4, 6	Bendor Samuel 2002
19	Even with a certain degree of flexibility, substantial changes in the internal or external environment relating to either the supplier or the client may render the contract untenable. The studies show that a periodic review and re-negotiation is useful to address unforseen changes during a long-term agreement.	8	Barthélemy 2003
20	The case studies demonstrate that dispute resolution mechanisms need to be included in the contract. Disputes, whether technology relation, procedural or cost related could be resolved amicably without impacting the relationship, if escalation procedures, alternative methods, and referral to a mediation party are agreed upfront and included in the contract.	3, 8, 10, 11	Gottschalk & Solli-Sæther 2006
21	The cases illustrate from a comprehensive governance methodology to be discussed during negotiation and drafted in the contract. Once the contract is drafted, active management of the relationship is necessary by both parties to ensure a successful outcome.	3, 4, 5, 7, 8, 10, 11	Gottschalk & Solli-Sæther 2006

	Best Practice Methodology Derived from Qualitative Analysis of Case Studies	Cases that Demonstrate Best Practice Method	Literature that Support Best Practice Method
22	The cases show that knowledge transfer and transitional activities need to be discussed and agreed during the negotiation of an IT outsourcing contract.	6, 10, 11	
23	Multi vendor agreements; The case studies illustrate that a client who is heavily reliant on an outsourced provider, would be severely disadvantaged during re-negotiations of the contract. The client could reduce the reliance on one party by outsourcing to multiple vendors in a 'best-of-breed' fashion. Best of breed outsourcing means choosing the best-suited service provider for each section of the services being outsourced.	3,4, 5, 6	Gottschalk & Solli-Sæther 2006
24	The cases show that even though a multi-vendor IT outsourcing arrangement can reduce the reliance the client may have on one single supplier, management of such an arrangement is complex. It is possible to severely underestimate the administrative burden of managing several vendors and the amount of effort required to integrate the service delivery outcomes to achieve business benefits.	4, 5, 6	
25	The studies show that detailed non-overlapping roles and responsibilities need to be defined when dealing with a complex arrangement with several vendors and in-house teams collaborating to produce service delivery outcomes. These should be included in the IT outsourcing contract.	4, 5, 6	

	Best Practice Methodology Derived from Qualitative Analysis of Case Studies	Cases that Demonstrate Best Practice Method	Literature that Support Best Practice Method
26	The case studies also clarify that relationships play an important role in the success of IT outsourcing. Thus, every opportunity should be taken to strengthen the relationship prior to entering into the IT outsourcing negotiation, during the negotiating process and once the arrangement is in place. Cohen & Young also confirm that relationship problems between the supplier and the client can lead to costly litigation or early termination of the contract.	All	Cohen & Young 2006
27	Risks . The studies clearly highlight the potential damaging influences of IT outsourcing. Recognising the potential for personnel or transition related issues, and planning for these could be effectively done during negotiation. This would significantly reduce the risk for both client and suppliers.	10, 11	Barthélemy 2003
28	When significant work needs to be done prior to an agreement being signed, drafting an MOU indemnifies the client against various liability and protects the supplier from significant damages and incurred costs.	3, 10	Bendor-Samuel 2002, Lacity & Willcocks 2000, Gottschalk & Solli-Sæther 2006
29	The study shows that it is important for the client to protect intellectual property (IP) associated with operational aspects of the IT outsourcing agreement.	5, 11	Doyle & Llewelyn 2005

	Best Practice Methodology Derived from Qualitative Analysis of Case Studies	Cases that Demonstrate Best Practice Method	Literature that Support Best Practice Method
30	Sub contracting: The case studies highlight the need for the client and supplier to be cognisant of the effects that subcontracting can have on the IT outsourcing arrangement. The client organisation's compliance requirements may prevent a supplier's ability to subcontract part of the services to another party. These requirements need to be highlighted during negotiation.	5, 6	
31	Exit Strategy The studies uncover a need for exit strategies to be included in the IT outsourcing contract. Considerations during negotiation could include when services could be terminated due to an untenable or unsatisfactory agreement. Even if the contract matures to full term, the exit strategy may define how the services will be transitioned form the current provider to a new provider or an in-house team and what resources and assets will be transferred. This could avoid significant disputes towards end of term.	All	

Table 3: Summary of Industry Best Practices in IT Outsourcing Negotiation

These emerging themes and successful industry practices have been incorporated into the research outcome, the "Framework for Negotiating IT Outsourcing Agreements". The framework is included in Chapter 8.

7.4 Simulation of IT Outsourcing Negotiations

In addition to the examination of industry-based case studies and interviews with industry experts directly involved in the negotiation of IT outsourcing agreements, a simulation was conducted in 2009, using a group of university students taking the graduate subject BCO6672, The Information Systems Professional as part of a Master of Information Systems degree in the faculty of Business and Law, Victoria University, Melbourne, Australia. The simulation was repeated in 2010 and 2011using different students. The simulation was conducted as an exploratory evaluation rather than an exercise aimed at verification and validation of research outcomes.

A group of 35 post-graduate students (105 in total over three years) were asked to participate in a simulated IT outsourcing negotiation. The students were coached on negotiation theory, principled negotiation and taken through the steps of negotiating an IT outsourcing agreement before embarking on the simulation. These students had also completed courses specifically on IT outsourcing, which covered such topics as IT outsourcing practices, challenges and factors influencing success. Some of these students were also practitioners in IT outsourcing.

At the end of the simulation, each student was asked to submit a paper on their observations of the simulation, and their perception on the practices and techniques that were most effective. An independent observer, who was either a practising lawyer, a professor from the Faculty of Business and Law, or an industry expert in IT outsourcing negotiations, was asked to assess each student as they modelled the IT outsourcing negotiation.

During the simulation, which lasted approximately two hours, these post-graduate students considered a fictional scenario to model the negotiation of an IT outsourcing agreement. Each student was assigned to a group of three and assigned one of three roles. The roles were: a supplier of outsourced IT services, a client looking to outsource an IT function, and a negotiation facilitator/mediator. The same fictional scenario was presented to each group. This fictional scenario is included in Appendix 4. Additional information was also presented to each participant, based on which role they were playing. Information pertaining to the client's business environment and challenges was given to the participant acting in the role of a client and was not given to any other participant. Similarly, the supplier also had confidential information. The confidential information provided to each role is also included in Appendix 4.

The papers submitted by each student are not included in this PhD thesis dissertation. Instead, the observations and challenges noted in the papers have been summarised. Although the participants in the simulation were knowledgeable in negotiation theory and the benefits of adopting principled negotiations, the simulations identified a propensity for the client and supplier to negotiate predominantly on price. It should be noted however, that the participants involved in the negotiation simulation were not experts or industry practitioners in negotiating IT outsourcing agreements.

The negotiation simulations started with the intent of seeking to understand the other party's interest. The participants, having been coached on the benefits of employing principled negotiation techniques had an unstated awareness that seeking a mutually beneficial agreement was the intent of the exercise. However, as the simulation progressed, there was an increased awareness by participants of their own challenges and objectives. The participant, in an effort to manipulate the discussion to engineer the most advantageous circumstance to meet his or her objectives, seemed to loose track of the other party's interests.

In a real-life situation, the role of the negotiation facilitator or mediator could have been most effective in bringing to the discussion, practical alternatives that both parties could have explored further, to create a mutually beneficial contractual agreement. However, during the simulations, the mediator's role was limited. Some of the mediators misunderstood their role, and assumed that they should silently observe the discussions and only step in when there was a "dispute". Others treated it as a coordinating role, where they structured the negotiation discussion and steered it to the conclusion, without influencing the content of the discussion in any way. This was not surprising, given that the mediators were not seasoned professionals in the domain of either negotiation or IT outsourcing. One aspect that mediators or facilitators should focus on, in an IT outsourcing negotiation, is to try and improve the quality of the relationship between the parties. These simulations brought to light, how useful or conversely how ineffective the role of the mediator could be, in an IT outsourcing negotiation, depending on the mediator's level of expertise in the domains of negotiation and IT outsourcing.

A summary of the results of the simulations is given below:

- Discussion predominantly focused on price: > 95%
- Discussion influenced by power or personal interests: > 90%
- Discussion heavily focussed on the technology and technical aspects to the exclusion of other important considerations: > 50%
- Evidence of proper preparation for negotiation, which includes, clearly articulated BATNAs and an awareness of ZOPAs: < 1%
- Unstructured negotiation techniques: < 5%
- Discussion using principled negotiation techniques, arriving at a mutually beneficial agreement: < 10%

The above results were not used in the development of the research outcome. The main purpose of these simulations was to observe participants and the way they approach IT outsourcing negotiations and whether the use of principled negotiation techniques would produce a more successful result. It was interesting to note that participants considered the reaching of an agreement as "success". There was one simulation where the client and the supplier decided not to enter into an agreement. The client decided that maintaining his in-sourced IT operations was less risky and more beneficial in the long-term to signing up with the supplier. When asked to reflect on the success of the negotiation process, the participants concluded that the negotiation had failed because no agreement was reached. However, one could argue that the negotiation process was successful, because neither party compromised on their requirements. The BATNAs and ZOPAs were well understood and parties had not entered into an agreement that was un-sustainable in the longer term. In more than 90% of simulated cases, the agreement reached between the client and the supplier was not mutually beneficial. Hence, in the long-term, with the several pressures and challenges affecting the IT outsourcing environment, these arrangements may have failed, with dire consequences to the organisations involved.

Where principled negotiation techniques were employed, in less than 10% of cases, the agreement that was produced, although fictional, appeared mutually beneficial and better suited to withstand the challenges facing an IT Outsourced environment. One could assume that with proper governance, a strong focus on maintaining a mutually beneficial relationship, and robust communication, these agreements would have endured long term.

7.5 Chapter Summary And Conclusions

This chapter describes the industry-based case studies that were examined for the PhD research study. It describes how the case studies were examined, provides detailed analysis for each and lists best practice methods demonstrated by each case study. A summary of these best practices and the cases that illustrate the best practice methods, as well as published literature that support the finding have been included in Table 3: Summary of Industry Best Practices in IT Outsourcing Negotiation. The Chapter also describes a number of simulated IT outsourcing negotiations conducted in 2009, 2010 and 2011. Results of these simulations have also have also been discussed in this chapter. Industry best practices in negotiating IT outsourcing agreements that were gleaned from the examination of the 10 case studies are encapsulated in a framework in Chapter 8.

8 THE RESEARCH OUTCOME: A STRUCTURED FRAMEWORK BASED ON PRINCIPLED NEGOTIATION AND INDUSTRY BEST PRACTICES

8.1 Why Principled Negotiation Techniques Are Suited To IT Outsourcing

IT outsourcing is a long-term, ongoing relationship. The success of an IT outsourcing endeavour is underpinned by a well-drafted contract. However, the success of the relationship also depends on a number of other factors, including, effective communication between parties, successful governance of the agreement and active management of the relationship (Gottschalk & Solli-Sæther 2006).

Negotiation of an IT outsourcing agreement can begin with a supplier identifying a customer's issues / needs and proposing an outsourced arrangement as the solution. It could also begin with a structured tender process, with the client advertising the intent to outsource specific IT services, and inviting a proposal from interested suppliers on how they would fulfil the needs of the client. (Gottschalk & Solli-Sæther 2006). During this tender process, it is customary for the client to hold briefing sessions with interested parties, with an aim to clearly articulate and confirm understanding of the client's requirements and priorities. Once potential suppliers have responded to a tender with their proposals, and an evaluation of their proposals has begun, negotiation can also begin. It is not necessary that a single supplier be chosen before the negotiation dialogue can occur. The evaluation process may simply identify the best suppliers with whom to enter negotiations. Gottschalk 2006, Lacity & Willcocks 2000, Cohen & Young 2006).

The outsourcing relationship benefits both parties when negotiation focuses on producing outcomes for mutual gain. The initial goals or interests might be different; such as the customer wanting to get the best quality of services for the lowest price, and the supplier wanting to increase profit. Negotiations that do not consider the interests of both parties - i.e., where the negotiation style is positional or power-based, could lead to an agreement where one or both parties need to abide by less than satisfactory terms and conditions. Due to the long-term nature of the contract, and the complexities and pressures that affect the IT outsourcing environment, the effect of these limitations may compound over time. (Cohen & Young 2006) The resultant problems can severely compromise the relationship and impact the organisation as a whole. Gottschalk 2006, Lacity & Willcocks 2000, Cohen & Young 2006). However, through principled negotiation, opportunities for mutual gain can be created.

The analysis of industry based case studies which is included in Chapter 7 and the review of literature included in Chapters 2-6 have led to the development of a number of key aspects that need to be considered as part of any principled negotiation of an IT outsourcing agreement. While every IT outsourcing agreement may have many unique aspects to consider, the research project has collated the most important, broadly applicable considerations and presented these as a framework for negotiating IT outsourcing agreements. These key aspects are detailed in Chapter 8.2.

8.2 A Framework For Negotiating IT Outsourcing Agreements

Industry Best Practices emerging from the analysis of case studies, and any supporting published literature were listed in Table 3 in Chapter 7. The Industry Best Practices have been represented as a Framework for Negotiating IT Outsourcing Agreements below.

8.2.1 Factors that need to be considered prior to negotiation.

1) A structured Approach to IT Outsourcing is recommended

The case studies examined in this research study show that when the whole IT outsourcing endeavour, not just the negotiation, is approached in a structured manner, it contributes to a successful outcome. A phased approach such as the one prescribed by Lacity and Willcocks or Gottschalk is recommended. Before outsourcing, it is best to create a strategic sourcing plan, identifying the core capabilities of the organisation as well as the potential functions that may be suitable to outsource (Gottschalk 2006, Lacity & Willcocks 2000). Once this has been done, parties involved can explore how an outsourcing arrangement can add value. This relates to Best Practice #1 of Table 3, and is supported by published literature. (Gottschalk 2006, Lacity & Willcocks 2000, Cohen & Young 2006).

2) The development and validation of a comprehensive business case aids IT Outsourcing

The studies highlight the importance of a comprehensive review of the benefits of IT outsourcing along with potential risks and hidden costs. These are discussed in more detail in Chapters 5.8 and 5.9 as well as in the analysis of case studies in Chapter 7. It is important that the business case is objective, financially sound and expectations of benefits are demonstrable. The case studies demonstrate that it can be helpful to involve experts in IT outsourcing to test the viability of the decision before embarking on the endeavour. This relates to Best Practices #1, #5 and #14 of Table 3, and is supported by published literature. (Earl 1996, Barthélemy 2003, Gottschalk & Solli-Sæther 2006).

3) Addressing a problematic IT function before outsourcing it may improve outcomes

As in other types of outsourcing, IT outsourcing becomes costly and complicated when the functions that are being outsourced are in a state of disrepair. The case studies that demonstrate this are cases #3 and #10. The client might be better placed to implement industry best practices and address human resource related issues before considering IT outsourcing.

4) There are benefits in being involved in smaller, short-term engagements prior to IT Outsourcing

Case studies show that both parties can benefit from engaging in short term contractual arrangements prior to considering a longer-term IT Outsourcing arrangement. This is summarised in Table 3, Best Practice #6, highlighted by case studies 1,2 and supported by literature (Gottschalk & Solli-Sæther 2006).

Smaller, short-term contracts enable the prospective suppliers and the clients to have the opportunity to build good relationships at multiple organisational levels prior to an outsourcing arrangement. This can give both parties the confidence and comfort that they could work well together. The suggested approach also gives prospective suppliers the opportunity to undertake some short-term, but significant, project work for the client as a way to prove and demonstrate capability, and understand the client’s environment and challenges. This method could also be used by the client’s to short-list suppliers, and restrict the tender process to those suppliers with proven ability (by using a “closed” tender).

5) A “best of breed”, multi-vendor IT outsourcing arrangement may be useful

The terminology “Best of Breed” refers to identifying and implementing the best suited IT software/hardware/tool or solution to address each specific need, rather than adopting one overall solution that addresses many varying needs. The overall solution may provide broader services, but may not be the best available technology or service for each specific category. Selecting the best-suited technology provider for each specific need, would prevent dependency on a single vendor and avoid being locked in, longer term, to a solution that cannot be de-coupled and improved when superior technology becomes available. As highlighted by the case studies 3, 4, 5 & 6, multi vendor agreements can be complex. It is possible to severely underestimate the administrating burden of managing multiple vendors and the integration of distributed service delivery outcomes. (Gottschalk & Solli-Sæther 2006).

Careful considerations need to be given to how the negotiation should be structured for a multi-vendor scenario. Things to consider are whether joint negotiation sessions, with several possible vendors should be held, or whether each specific category of technology/service is to be negotiated separately with each qualifying vendor.

6) A Memorandum of Understanding (MOU) can be useful

When significant work needs to be undertaken by the supplier before a formal contract can be signed, a MOU can be useful as summarised by Best Practice #28, and cases 3 and 10. This approach is also supported by literature. (Lacity & Willcocks 2000, Bendor-Samuel 2002, Gottschalk & Solli-Sæther 2006).

7) Damaging influences of outsourcing need to be anticipated

The case studies 10 and 11 demonstrate how the intent to outsource IT can produce significant averse reactions. A decision to outsource can produce unexpected reactions from staff even if they are not directly affected by the decision. It can result in widespread reluctance to assist with the transfer of knowledge to the supplier and hamper transition of services. Any transfer of staff to the outsourcing provider is fraught with issues and needs to be handled with extreme care (Barthelemy 2003). Negotiation must address terms for transfer of employees, and management of employees that may have dotted reporting lines to both organisations. Employees should also be offered incentives for co-operating and delivering on specific outcomes that aid transition of services to the new supplier. Factors to measure could include employee turnover and level of engagement with outsourced functions by retained staff (Greaver 1999).

When an organisation reveals its intent to outsource a previously internally handled function, it is not only internal employees that may view this change negatively. Negative market perceptions, pessimism exhibited by shareholders/customers, and instability or confusion within the organisation caused by significant changes, are just *some* of the possible fallouts of outsourcing. Careful planning and communication is needed to contain these detrimental impacts (Barthelemy 2003).

8.2.2 *Guidelines on how to prepare for the negotiation*

8) Being prepared for an IT outsourcing negotiation has benefits

Case studies examined for this research highlight that parties underestimate the complexity of negotiating an IT outsourcing agreement and how it will affect the organisation as a whole. Being prepared with the financial imperatives of the organisation is not enough. Participants need to be quite specific about operational requirements and strategic priorities of the organisation as a whole, as well as the IT department, when negotiating an IT outsourcing agreement. Careful consideration needs to be given to several internal and external factors when negotiating an IT Outsourcing agreement. The benefits of being well prepared for an IT outsourcing negotiation and the risks of being un-prepared, are demonstrated by cases 3,4,5,6,7,8,10,11. It is also supported by literature (Kock et.al 1996, Lacity & Willcocks 2000,Gottschalk 2006).

Parties can invest effort in developing “Best Alternative to a Negotiated Agreement” (BATNA), understanding the “Zone Of Possible Agreement” (ZOPA) and considering options and alternatives that could be proposed at the negotiation table. It would be further beneficial to understand the strategic priorities of the organisation; Understand the operational and business imperatives; Understand current challenges, issues and problems and how an outsourced arrangement could possibly add value.

9) A client’s BATNA can be improved by negotiating with more than one supplier

It could be advantageous to hold negotiations with more than one supplier concurrently, that way, strengthening the client’s BATNA. Once a finite number of parties have been identified as potential suppliers in the tender process, negotiation can begin in earnest, on the scope, terms and conditions, including the costs of the agreement. This is highlighted by cases #4-7 and summarised in Table 3, Best Practice #7. The best practice method is also supported by literature. (Kock et.al 1996, Lacity & Willcocks 2000, Gottschalk 2006).

10) Suppliers can strengthen their position by building an alliance with other suppliers

The method is demonstrated in cases #1 and #2 and supported by literature. (Graham 2003).

11) Clients can improve their position by building an alliance with other clients

The method is demonstrated in case #3, where the Government department built an alliance with other Government departments and bid together for a joint outsourced arrangement.

8.2.3 Guidelines on a suitable negotiation style and techniques

12) Using a structured approach aids IT outsourcing negotiation

Chapter 6 investigates the importance of a structured approach to IT outsourcing negotiation. The importance of structure is also stressed in published literature (De-Loof 1996, Kock et.al 1996, Lacity & Willcocks 2000, Gottschalk 2006). As in other types of outsourcing, a structured IT outsourcing negotiation is more likely to produce a well-formed contract, which then contributes to success (Ang & Toh 1996, Bendor-Samuel 2002). This is summarised in Best Practice #3 in Table 3.

13) Using principled negotiation techniques aids IT outsourcing

Chapter 8.1 also describes why principled negotiation is suited to IT Outsourcing negotiations. The importance of considering mutually beneficial outcomes is also established in published literature (Kock et.al 1996, Lacity & Willcocks 2000, Gottschalk 2006, Cohen & Young 2006). As demonstrated by the case studies, the IT outsourcing arrangement is more likely to endure to full term and produce desired outcomes when both parties benefit from the arrangement. This is summarised in Best Practice #4 in Table 3.

Kock et. al prescribe the following:

- Clearly determine your own needs and priorities, constraints and resources,
- Establish these for other parties, through a process of encouraging each party to present their perspectives, openly and honestly,
- Work together to find areas of common ground or mutual gain,
- Review the interest of each party and create options to meet the needs of all parties,
- Do not pursue an option that leaves one party severely disadvantaged or which compromises the sustainability of the agreement longer term, such as an un-sustainable low price,
- Agree on an outcome that mutually satisfies both supplier(s) and the client (Kock et. al 1996).

Chapter 3 describes in detail the techniques used in principled negotiation and the steps required.

8.2.4 Guidelines on how to structure the negotiation, who to involve, and how to develop a negotiation strategy.

14) Relationships play an important role in the success of an IT outsourcing arrangement

All the cases described in this study highlight that relationships play an important role in the success of an IT outsourcing agreement. This assertion is also supported by literature (Cohen & Young). Parties involved would benefit from building and strengthening the relationship at every opportunity, including prior to and during negotiations as well as during the term of the contract.

Participants involved in the negotiation process can inadvertently focus solely on making sure that their own interests and concerns are met and thus miss the opportunity to get to know the other party's interests, strategic goals and concerns. A good negotiator would think of ways to make all parties understand each other's interests and perspectives and thus focus the discussions towards building and strengthening the relationship between the parties involved. While this strategy facilitates participants to work towards a mutually beneficial arrangement, it also sets the foundation for a long-term, successful working relationship.

15) Uncertainty at the time of negotiation can be approached collaboratively

The case studies demonstrate the need for uncertainties to be discussed and risks shared. Business uncertainty, uncertainty caused by global economic influences or changes in the industry sector, uncertain effects of planned, upcoming changes in the supplier's or client's organisations are areas where precise information may not be available at the time of negotiation of an IT outsourcing agreement. How the supplier and the outsourcer will be disposed to taking risks and how they will share risks during the term of the agreement must be addressed. Factors that influence discussion include the size of the organisations, opportunities available and prior outsourcing experience. Financial, business and technical risks are the different types of risks (Elitzur & Wensley 1996).

16) There is a need to involve experts and those with knowledge of future strategic direction

As summarised in Best Practice #10 in Table 3, and demonstrated in cases 2, 4, 5, 8 and 11, there is a need to involved domain experts and those who have strategic knowledge of the organisations considering the IT outsourcing arrangement.

- Executives from both supplier and client organisations need to be involved, at least for the initial or final parts of the negotiation.
- Involve executives or staff that have knowledge of the organisation's strategic priorities.

- Technical and operational experts need to be consulted.
- Operational management from both the supplier and client sides need to be involved in negotiations.
- IT outsourcing experts, negotiation and legal experts should also be involved in the negotiation.

If the decision to outsource, or negotiations involve people with deficiencies in skills or breadth of knowledge, the outsourcing agreement could be created on unsound principles and contain ambiguities that have long-term damaging effects on the organisation.

Un-sound judgements include a decision to outsource based on costs alone. These include, an attempt to reduce headcount through outsourcing, or using outsourcing to move capital expenditure out of the balance sheet to a smaller operating expense. These poor decisions can result in significant costs to the client organisation, in terms of reduced customer satisfaction levels, inferior quality/technology, lack of alignment with business strategies, and weakened market competitiveness.

This best practice method is supported by literature. (Kock et.al 1996, Lacity & Willcocks 2000, Gottschalk 2006).

17) If either party at the negotiating table is severely disadvantaged, the resultant agreement may be untenable

As summarised in Best Practice #12 in Table 3, and demonstrated in cases 3 & 7, if either the supplier or client is severely disadvantaged during negotiation activities, o the IT outsourcing arrangement may not endure or be successful longer term. Negotiations that focus on options for mutual gain and which consider interests of both parties are more likely to be successful.

8.2.5 A checklist of considerations or discussion topics to aid dialogue during negotiation sessions.

18) Intellectual Property (IP)

As elaborated in cases 5 and 11, it is important to secure intellectual property when outsourcing involves sharing or developing proprietary information or system,

It is vital, for example, to protect confidential information that impacts market competitiveness.

Insist that intellectual property relating to the delivery of services is securely stored, readily accessible by the client and is kept current. In the event of an early termination or transition of services to other vendors at the end of term, this information will be vital for smooth operations.

Doyle and Llewelyn, prescribe the following checklist for protecting intellectual property.

- Define the intellectual property to be protected.
- Obtain an assurance from the vendor on adherence to applicable laws.
- Define the parties that will be subject to a non-disclosure agreement.
- Specify exactly which activities are prohibited under the non-disclosure agreement.
- Include strong penalties for breach of the IP provisions.
- In the case of one party having off-shore activities, specify which country's laws govern the agreement (Doyle & Llewelyn 2005).

19) Statement of Work (SOW)

In the procurement phase of outsourcing, many clients make the mistake of focusing primarily on getting a suitable price for the supplier's service. However, it is more important to define the scope of the services. As demonstrated by all the case studies, detailed services, including scope and boundaries, need to be defined so that each party will know where its responsibilities begin and end. If additional services are to be added later during the term of the agreement, this definition of what is in-scope and what is out-of-scope from the outset will be crucial (Bendor-Samuel 2002). The cases also show the need for the detailed SOW to match the business objectives set forth in the business case (particularly case 8).

20) Pricing schedules and structures

Detailed and flexible pricing schedules and structures need to be addressed by the negotiation. Issues such as whether prices for services are fixed, variable on volume or incentive-based need to be discussed and agreed during negotiation. How fee adjustments and apportioning of savings etc., are handled need to be discussed as well. The parties should also address how discretionary and ongoing work outside the scope of the contract will be handled. The cases all demonstrate this need but case 8 clearly demonstrates the negative effects when pricing structures are not discussed during negotiations)

21) Meaningful Service-Level Agreements (SLAs)

Case studies 1, 2, 3, 4, 8, 10 & 11 show the need for meaningful SLAs to be included in the IT outsourcing contract. Agreements must stipulate service delivery in detail with performance indicators, mechanisms for measuring performance and penalties for failure to meet agreed levels of performance. However, it is possible to place too much emphasis on SLAs with either too many SLAs or undue complexity in measurement and reporting requirements. This may result in the management focus being skewed towards "reporting" and analysing the SLAs rather than focusing on the overall health of the relationship. Focus may also be diluted on whether the outcomes achieved are still aligned with the strategic priorities of the organisations involved. Care must be taken to construct SLAs that are meaningful, measureable and aligned with business objectives. For example, it is more important to measure quality of services rendered in an outsourced IT helpdesk arrangement and not just how quickly a request was responded to or how quickly a solution was given.

The framework described here does not prescribe specific SLAs, however it sets broad guidelines on the approach to setting SLAs. The case studies examined as part of this research study uncovered some common measures of success. However, parties negotiating an IT outsourcing agreement should be aware that each outsourcing agreement is unique. There are particular distinctions in each organisation, irrespective of its business capabilities, industry sector, or market presence. When negotiations are initiated, there is a lot of imprecise knowledge. The true complexity of the eventual agreement is not fully known at the time when parties first get together. It is therefore important that the SLAs set forth at the time of contract negotiation uniquely reflect the current priorities of the customer and are a reflection on the success criteria with which deliverables will be judged. More importantly, these SLAs must be periodically reviewed and updated to reflect the changing needs of the customer (as demonstrated by case 11). The SLAs can therefore differ from customer to customer depending on the maturity and history of the outsourcing arrangement, the specific customer's business environment, the nature of the work to be undertaken under the outsourcing arrangement, and the customer's current priorities.

22) Meaningful mechanisms for continuous improvement

As with cases 5, 6, and 7, problems arise when the client expects to receive continuous improvement but did not set forth a written stipulation for this expectation during contract negotiations. Customers that anticipate needing a mechanism for continuous improvement must define, measure and price it before the contract is signed (Bendor-Samuel 2002).

23) Flexibility

As demonstrated by cases 5, 6, and 7, the contract needs to be designed with a certain degree of flexibility. Success of the outsourcing arrangement depends on the client's ability to change the service requirements and flexibility for the provider to alter the means by which service requirements are met (Clark, Zmud & McCray 1996). However detailed the contract or favourable the terms, most contracts cannot anticipate the changes in an evolving environment. Longer-term contracts that lack flexibility tend to increase the likelihood of dissatisfaction among parties involved.

It may not be possible for the initial measures of success and initial priorities or interests to remain constant whilst the IT outsourcing environment is exposed to the multiple changes and pressures that it typically undergoes. One way to circumvent the damaging influence of these factors is to build in periodic review and adjustments into the governance regime. Periodic review could include identifying specific terms and conditions for re-negotiation. This is not a new technique in managing a long-term relationship, but very pertinent to an IT outsourcing agreement.

"The only man who behaved sensibly was my tailor; he took my measurement anew every time he saw me, while all the rest went on with their old measurements and expected them to fit me," George Bernard Shaw.

24) Detailed (non-overlapping) roles and responsibilities

Governance of an IT outsourcing agreement becomes extremely complex when multiple vendors and in-house teams are working together to deliver outcomes. The integration of outcomes to meet business mandates becomes non-trivial when this happens. A detailed delineation of roles and responsibilities as well as a detailed SOW should alleviate any confusion on accountability.

Parties should be encouraged to work together, however, there should be a clear understanding of where each party's responsibility begins and ends. This should prevent any instances of "passing the buck" when things go wrong.

25) Knowledge transfer and transition activities

Cases 6, 10 and 11 show that knowledge transfer and transitional activities need to be discussed and agreed during the negotiation of an IT outsourcing agreement. The client needs to ensure that the supplier is armed with the proper tools and knowledge to successfully deliver services. Incomplete or inefficient knowledge transfer places the in-coming supplier at a severe disadvantage.

26) Maintenance of technological currency

As demonstrated by cases 4 & 6, the contract needs to be structured in a manner that motivates the supplier to use the most productive technology, i.e., upgrade technology and train staff as necessary. As technology changes at a rapid pace, ensuring technological relevance in a long-term agreement is vital.

27) Strategies to prevent the loss of innovative capacity

Parties should discuss, during negotiation, how the supplier would be rewarded for innovation and what incentives were available for continuous improvement. Some mechanisms, such as sharing the costs of improvements or sharing profits can be tabled for discussion.

28) Technology direction

As demonstrated by cases 5 and 6, there should be provisions in the contract for the client to be appraised of the supplier's changes in strategy and significant technology based decisions. If the deliverables stipulated in the contract are still being met, the client may not have any recourse but to accept these changes. However, if achieving delivery through specific technologies is an important aspect for the customer, the contract needs to stipulate this need.

29) Quality of staff and technology

When delivering a function internally, the organisation has full control over the quality and skills of the staff it employs to deliver that function. It also has control over the technology solutions it adopts. However, once the function has been outsourced to a third party, the organisation, generally, ceases to have control over the people and technology used to deliver that function as demonstrated in case 8. It is important to create Service Level

Agreements (SLAs) that specifically measure quality as well as delivery of outcomes. Discussions during the negotiation of the outsourcing contract needs to focus on mechanisms, such as escalation points, to address issues relating to poor quality or out-dated/inferior technology.

30) A governance methodology

As clearly demonstrated in cases 3-11, a comprehensive governance methodology, and active management of the arrangement is necessary by both parties to ensure a successful outcome.

The IT outsourcing contract needs to specify how the relationship is going to be managed, including authority structures, customer-supplier responsibility matrices for all defined roles and responsibilities, standard operating procedures, nature and frequency of interactions, etc. The best practice method prescribed is supported by literature. (Gottschalk & Solli-Sæther 2006).

In order to prevent lack of alignment of outsourced functions with business priorities, it is important that the client's corporate values, knowledge, strategic objectives are imbued in the supplier's deliverables. Sub-optimal relationships can result in the supplier losing focus of the client's strategic priorities. Active governance of the IT outsourcing agreement is necessary to ensure the alignment of strategic objectives that were articulated at the start of the term are sustained throughout the term of the contract.

31) Dispute resolution mechanisms

Cases that demonstrate the need for dispute resolution mechanisms to be included in the contract are 3, 8, 10 and 11. These cases demonstrate that disputes and litigation can be extremely costly and disruptive. Alternative dispute resolution procedures to court action need to be agreed upon and clearly articulated. Disputes may be technical or procedural in nature or relate to defaulting of contractual terms and conditions. They may be due to a supplier's degree of expertise in IT operations, or either party's degree of expertise in outsourcing contracts. Alternative methods of dispute resolution could include employment of escalation procedures, referral to a technical expert, mediation and arbitration (Gottschalk & Solli-Sæther 2006).

32) Indemnity

Doyle and Llewelyn prescribe including an indemnity provision in an IT outsourcing agreement. This should prevent the client from being liable for the acts or omissions of the supplier. It should also provide broad insulation for both organisations, if any third parties instigate a civil / criminal proceeding against the other party (Doyle & Llewelyn 2005).

However, having an attractive liability clause in the agreement, in terms of a high financial damages payment, does not fully indemnify the client organisation. For example, if a financial institution has paid out the wrong amount to thousands of customers due to a software glitch, the penalty payments from the outsourcing software services provider do not address the intangible losses such as the loss of credibility with the client's customers and the damage to the client's brand.

33) Sub-contracting

As demonstrated by cases 5 & 6, the effects of sub-contracting by the service provider need to be understood and managed by both parties. There may be compliance related implications for the client, if the outsourcing provider subcontracts part of the services to another party. During the negotiation, parties should agree that the supplier is transparent of any intent to subcontract any of the services being outsourced. The contract should provide some mechanism for reviewing and influencing any subcontracting of services by the supplier.

Doyle and Llewelyn prescribe the following checklist:

- Make sure the vendor can only subcontract with your written consent.

- Retain the right to review the terms of a subcontracting arrangement before it is entered into.
- Require the vendor to remain contractually liable for the functions that are subcontracted.
- Require that, at the very least, the subcontractor's level of service, systems, and control must be on par with that of the vendor.
- Retain the right to establish specific parameters or prerequisites for any subcontractor, such as those you might create if you were to hire the subcontractor yourself.
- Require the subcontractor to be subject to the terms and conditions of the IP provisions of the outsourcing agreement.
- Require that the subcontractor hold you harmless and indemnify you for any acts or omissions of the subcontractor (Doyle & Llewelyn 2005).

34) An exit strategy

The case studies uncover a need for exit strategies to be included in IT outsourcing contracts. The contract should include a provision for early termination under certain conditions such as, non-compliance to terms and conditions and non-performance. Parties should seek to understand how long it will take to transition out of the current IT outsourcing agreement, for whatever reason, either to an in-house team or another supplier. During negotiations, parties should discuss and agree the resources and assets that will be required to transition out of the current arrangement upon the end of the contract.

8.2.6 Guidelines on how to approach ongoing negotiations (or re-negotiations) once the contract is established.

35) Renegotiation of an IT outsourcing arrangement

As described earlier, in a long-term IT outsourcing contract, it may not be possible for the initial terms and conditions to remain valid whilst the IT outsourcing environment is exposed to the multiple changes and pressures that it typically undergoes. The increase in duration of the contract increases the risk of being “locked-in” to an un-productive arrangement. One way to circumvent the damaging influence of these factors is to build in periodic review and adjustments into the governance regime. Periodic review could include identifying specific terms and conditions for re-negotiation.

Re-negotiation of in-effective terms and conditions, during the term of the agreement can vastly improve the outcomes as demonstrated by case 8. When the contract is drafted, parties need to agree on where (which terms and conditions) and how often re-negotiation can take place. The cost of contractual amendments could be high and could introduce uncertainty and unanticipated changes. However, being willing to pay for flexibility may be better than specifying tight performance contracts with penalty clauses, followed by litigation.

8.3 Chapter Summary And Conclusions

This Chapter details the findings of the PhD research project. It details key strategies when negotiating IT outsourcing agreements. It provides guidelines on how to approach IT outsourcing in a structured manner and includes recommendation on the techniques to use during negotiation. The framework also discusses factors that need to be considered during an IT outsourcing negotiation. Finally, it also includes strategies to minimise risks. These have all been collated to form a Framework for the Negotiation of IT Outsourcing Contracts.

Industry experts have evaluated the research methodology and the framework (i.e., the research outcome). The evaluation process determined whether the framework was a useful tool in negotiating IT outsourcing agreements, whether the tool promoted effective practices and whether the information and guidance it offered was comprehensive. The forthcoming chapter discusses the evaluation process and results.

9 EVALUATION OF RESEARCH OUTCOMES

Evaluation is the systematic assessment of the worth or merit of some outcome or product (Trochim 2006). In any project, regardless of the scale, significance, industry sector or people involved, it is important to evaluate the outcomes or products of the endeavour and the process by which they were produced. The process of evaluation is also essential in assessing how the outcomes produced match up with the initial needs and expectations. Evaluation is an important step in any academic research project because it establishes the validity of the research process adopted and the significance of the results obtained. In the case of this particular research study, the evaluation process also determines the efficacy of the research outcome “A Framework for Negotiating IT Outsourcing Agreements” in addressing the gaps identified in academic research and in industry practice.

9.1 The Research Process Adopted in this PhD Study

The PhD study adopted qualitative research techniques to examine published literature in the domains of negotiation, IT outsourcing agreements, and specifically, IT outsourcing negotiations. The purpose of the literature review was to glean a suitable techniques or strategies to use when negotiating IT outsourcing agreements. The literature survey was also used to develop criteria for assessing the success of an IT outsourcing negotiation. The study also conducted an in-depth, qualitative, review of industry-based case studies to glean industry best practices in IT outsourcing negotiations. This included a review of legal documents and interviews with key decision makers and several experts involved in each case study. The industry best practices thus gleaned have been incorporated into a “Framework”, which consists of a set of guidelines for negotiating IT outsourcing agreements. This framework, or set of guidelines, appears in Chapter 8 of this thesis dissertation.

9.1.1 Why the above Research Process was adopted

Due to a dearth of published literature on negotiating IT outsourcing agreements, the researcher has conducted a detailed study of literature on negotiations in general, as well as a study of literature on IT outsourcing and used these literature surveys to identify any negotiation techniques that would be useful in the IT outsourcing domain.

However, the survey of published literature was not exhaustive enough to cover all aspects of negotiating an IT outsourcing agreement. There were several practices prevalent in industry, which needed to be examined more thoroughly. In particular, industry practices that consistently led to the success or failure of IT outsourcing negotiations needed to be identified and scrutinised. This was only possible through the thorough examination of industry-based case studies in IT outsourcing negotiations.

Thus, 14 case studies in IT outsourcing negotiation were gathered and examined to glean industry best practices in negotiating IT outsourcing agreements. The examination included the review of contractual documents pertaining to each agreement (where available), and the conduct of in-depth interviews with practitioners, key decision makers and experts involved in the negotiation of each agreement.

In the review of each case study, the Researcher conducted in-depth interviews with practitioners from all aspect of the IT outsourcing negotiation process – from senior executives of the supplier organisation and client organisation, to day-to-day operational managers, administrative staff in-charge of ensuring contractual compliance and external consultants involved in the negotiation. This was to ensure that the information gathered was not tainted by personal opinions and subjective data.

A total of 14 case studies were examined. However, only 10 were included in this research study, as the information from 4 of these case studies was either insufficient or insufficiently verified, as previously described in Chapter 7.2. A discussion on the adequacy of this sample size is included in Chapter 9.2.

Practices in the negotiation of IT outsourcing agreements that consistently produced effective results were then incorporated into the framework. Lessons learnt from un-successful practices were also included in the framework under guidelines on pitfalls to avoid.

The framework for negotiating IT outsourcing agreements was then evaluated by industry experts for its efficacy and completeness. The evaluation process determined whether the framework was an useful tool in negotiating IT outsourcing agreements, whether the tool promoted effective practices and whether the information and guidance it offered was comprehensive. The evaluation form used for this purpose is included in Appendix 5.

9.1.2 Evaluation of the Research Process

The research approach described above has been discussed in several research papers, and presented at a number of academic conferences. The details of these papers and conferences are included in Appendix 7. The papers were circulated to industry practitioners for their comment. The purpose was to gain feedback from the academic community, and industry practitioners, on the suitability, efficacy and completeness of the research approach and techniques used, to address the gap in the theory and practice of IT outsourcing negotiations.

The particular challenge in requesting industry practitioners to evaluate the research process is that when presenting a study based on stringent academic standards to industry practitioners, it was evident that industry practitioners were not focussed on the justification for the research process adopted and the methodologies used. Rather, they concentrated on the end result, and effectively communicating this is in a concise manner. Therefore, academic conferences, internal student forums and presentations, and consultation with academic staff were the only means employed in evaluating the research process and methodologies adopted in this PhD study. The end result was evaluated by industry practitioners as described in Chapter 9.2.

9.1.3 Adequacy of the Sample Size used for the Study.

"Determining an adequate sample size in qualitative research is ultimately a matter of judgment and experience in evaluating the quality of the information collected against the uses to which it will be put, the particular research method and sampling strategy employed, and the research product intended." Sandelowski (1995)

In a qualitative study, a specific number of case studies , (as a minimum), can be deemed necessary for an accurate reflection of characteristics of the "whole". McCracken suggests a sample of eight is enough for intensive interviews that are designed to explore a topic in-depth (McCracken 1988). Morse suggests that around six participants are enough for a philosophical investigation of experiences (Morse 1994). The PhD study described in this thesis explored 14 case studies , of which 10 were used for analysis, with the review of contractual documents and several in-depth interviews for each case study. Each interview lasted an hour and was followed by verification and further discussions. This process satisfies the criteria suggested by Morse and McCracken for a sample size of 6-8.

Morse also suggests that if participants in the interview process are not willing to fully share their thoughts with the interviewee, such as in interviews dealing with sensitive information, or personal topics, then a bigger sample size is required. If interviews deal with issues that are not sensitive, then a smaller sample size is required (Morse 2000).

This particular research study has assured participants of complete anonymity. The participants' personal details or details of their organisation has not been recorded in this thesis dissertation. The participants also had the opportunity to review and modify the transcripts of the interview once discussions have concluded. Hence, each participant was most willing to share his or her knowledge and experiences with the researcher.

A total of 14 industry-based case studies were reviewed, but not all were included in the study due to various deficiencies discussed in Chapter 7.2. The resultant sample size used for this research study was 10. This sample size is considered adequate to use to develop a set of industry best practices on IT outsourcing negotiations.

9.2 Evaluation Of Research Outcome

9.2.1 How the Evaluation of the Research Outcome was Conducted

The outcome of this PhD research project is a decision support tool in the form of a framework for negotiating IT outsourcing contracts. The efficacy of this tool or framework was measured using the criteria listed in Chapter 6.5, for evaluating the success of an IT outsourcing negotiation.

Hall, Hall and Zeleznikow state that “For the evaluation to proceed, appropriate criteria must to be chosen with suitable metrics and minimal acceptable levels of attainment, which should be agreed upon in advance of measurement. This choice of criteria is guided by an understanding of the contexts of system use and of the evaluation, particularly its goals and objectives.” (Hall, Hall & Zeleznikow 2003a; Hall, Hall & Zeleznikow 2003b). The evaluation criteria was developed using published literature on IT outsourcing best practices and using the information gleaned from the case study review on how industry experts measure the success of an IT outsourcing negotiation.

CEO's and Managing Directors of several companies (both clients and suppliers) participated in the evaluation, as well as managers / leaders of outsourced divisions. The measure of success against each criterion was obtained by recording responses from participants directly involved in the negotiation of the IT outsourcing arrangement being investigated. Hall, Hall and Zeleznikow state that for an evaluator to understand a decision support tool, its benefits, and its constraints, it is necessary to be fully aware of the context in which the tool operates. They state that among other things, the skills, experience and training of the evaluator are also important. Hall, Hall and Zeleznikow also state that an understanding of the decision-making environment is particularly significant. (Hall, Hall &

Zeleznikow 2003a; Hall, Hall & Zeleznikow 2003b). Each industry expert invited to evaluate the research outcome namely, “A Framework for Negotiating IT Outsourcing Agreements”, had specifically negotiated IT outsourcing agreements and seen the repercussions of negotiation practices adopted, on the outsourcing agreement in question, and on the rest of the organisation. Only experienced industry practitioners in the IT outsourcing negotiation field, were chosen to evaluate the research study, so that they may be cognisant of trends and best practices, and have the appropriate in-depth knowledge to assess the framework’s efficacy.

Using the Likert Scale Method, for each criterion, the participants were given the option of choosing a number indicating the level of success that can be achieved by using the framework in the IT outsourcing negotiation. This is explained in more detail below.

There were three methods adopted to evaluate the research outcome, namely, the framework:

1. The “Framework for Negotiating IT Outsourcing Agreements” was used in real-life IT outsourcing negotiations, by industry experts, and the results of these negotiations and observations made, were shared with the Researcher.

2. The “Framework for Negotiating IT Outsourcing Agreements” was reviewed and assessed by industry experts, by considering its potential use in IT outsourcing negotiations in which they had been previously involved. The industry experts recalled specific issues, and contemplated whether the framework would have aided negotiations.
3. The industry experts considered case studies included in this thesis and considered whether the use of the framework in those negotiations would have improved the negotiation process or added value to the final agreements.

The seven success criteria specified in 9.2.2 was used to assess the efficacy of the framework. The Likert Scale method was used in this research study to measure each evaluator's assessment of how the framework satisfied each of the seven criterion listed in Chapter 9.2.2.

9.2.2 Success Criteria used for the Evaluation of Research Outcomes

The following criteria were used for evaluating the efficacy and completeness of the "Framework for Negotiating IT Outsourcing Agreements". The seven criteria listed below were used to assess whether the framework was a useful tool in negotiating IT outsourcing agreements, whether the tool promoted effective practices and whether the information and guidance it offered was comprehensive.

- Was there a significant level of improvement to the IT outsourcing negotiation process as a result of using this framework?
- Did the framework facilitate the transparency of factors that need to be considered prior to conducting an IT outsourcing negotiation?
- Does the framework provide guidelines about a suitable negotiation style and techniques to use when negotiating IT outsourcing agreements?
- Does the use of the framework aid preparation for negotiating IT outsourcing agreements? Does the framework provide topics or factors to be considered for discussion during the negotiation? Does the use of the framework provide structure to the process of negotiation?
- Does the contract established as a result of using the framework, contain defined success criteria and mechanisms to measure these criteria objectively?
- Is the resultant contract contains flexible? I.e., does it allow for the planned re-negotiation of certain terms and conditions? Does the contract allow for early termination under certain circumstances?
- Does the resultant contract effectively cope with changes to the organisations' priorities, strategic direction and structure?

These set of success criteria were developed using the survey of published literature in the domain of IT outsourcing, particularly relating to measuring success and successful practices in IT outsourcing.

9.2.3 Constraints in Measuring the Success of the Framework

The research outcome, the “Framework for Negotiating IT Outsourcing Agreements”, was evaluated by directly applying the framework in several industry-based, IT outsourcing negotiations. However, not all parties involved in these negotiations used the framework. It would have been ideal to have all participants of every negotiation using the framework produced by this research. For any one negotiation, there are several different organisations, and several different participants involved at the various stages of the process. Therefore, it was difficult in a real, industry-based, IT Outsourcing negotiation, with real participants and consequences, to gain the support of all the parties involved. Thus only one party (the person who was also evaluating the framework) had access to the framework. The influence of the framework would have been greater and its success measured more accurately, if all parties had equal access to the framework and agreed to use it.

Sometimes a direct application of the framework was not possible, i.e., at times, it was not possible to use the framework in a real, industry-based, negotiation of an IT outsourcing agreement. In these instances, the evaluator had to use past experiences to gauge what the effect of using the framework might have been. It would have been clearly much more accurate to record observations made on the direct application of the framework.

The PhD researcher had limited time and resources to measure the efficacy of the framework using real, industry based application. Even in the direct application of the framework, there were a few areas that were not assessed by the current evaluation process. These occurred when the evaluator was:

- Unable to assess the long-term effects of the negotiation.
- Unable to verify if the outsourcing endeavour was successful in the longer term.
- Unable to assess if the contract endured to full term and whether at the time of operation the outsourcing agreement was mutually beneficial to all parties.

Section 10.2 discusses how future research might aid in addressing the above limitations.

9.3 Results of the Evaluation

Industry experts were invited to evaluate the research outcome: “A Framework for Negotiating IT Outsourcing Agreements”. Each evaluator had specifically negotiated IT outsourcing agreements and seen the repercussions of negotiation practices adopted, on the outsourcing agreement in question, and on the rest of the organisation. Only experienced industry practitioners, in the field of IT Outsourcing Negotiation, were chosen to evaluate the research study, so that they may be cognisant of trends and best practices, and have the appropriate in-depth knowledge to assess the framework’s efficacy. CEO's and Managing Directors of several companies (both clients and suppliers) participated in the evaluation, as well as managers / leaders of outsourced divisions.

There were six evaluators used in this PhD research study. Their responses against seven questions were recorded. The seven questions, or success criteria are included in Chapter 9.2.2 above. In academic research, various kinds of rating scales have been developed to measure the attitudes of people directly (i.e. when the person knows their attitude is being studied). The Likert Scale method was used in this PhD research study to measure each evaluator’s response to the questions posed.

Likert developed the principle of measuring attitudes by asking people to respond to a series of statements about a topic, in terms of the extent to which they agree with them, and so tapping into the cognitive and affective components of their attitudes (Likert 1932). A

Likert-type scale assumes that the intensity of experience can be represented in a linear scale and makes the assumption that attitudes of participants can be measured. Respondents may be offered a choice of five to seven or even nine pre-coded responses with the neutral point being neither agree nor disagree. The Likert scale was used in this PhD research to record the responses in a quantifiable way, and limit the range of responses possible.

In this PhD study, four fixed choice responses were used to record a range of attitudes to each question. These fixed choices were:

1 - None
2 - Negligible
3 - Some
4 - Considerable

The above choices were used to measure the framework's ability to meet each specific criterion. There were seven criterion designed to measure the effectiveness of the framework. The criterion, responses and results of the evaluations have been summarised in Table 4 below.

The seven questions posed have been recorded in Table 4, under "Assessment Criterion". Each of the responses from the six evaluators has been recorded under "Individual Scores". Finally, the overall score for each criterion has been calculated using an average of the individual scores.

Assessment Criterion	**Individual Scores**	**Average Score**
1. Level of improvement to the process of negotiation, as a result of using this framework	4, 4, 4, 4, 4, 3	4
2. Usefulness of the framework in highlighting factors that need to be considered prior to conducting IT outsourcing negotiation.	4, 4, 4, 4, 4, 4	4

Assessment Criterion	Individual Scores	Average Score
3. Usefulness of the framework in providing guidelines on a suitable negotiation style and techniques to use when negotiating IT outsourcing agreements.	4, 4, 3, 4, 4, 3	4
4. Usefulness of the framework in preparing for negotiating IT outsourcing agreements. (Such as, providing topics or factors to be considered for discussion during the negotiation; providing structure to the process of negotiation etc.)	4, 4, 4, 4, 4, 4	4
5. Usefulness of the framework in establishing a contract with success criteria and mechanisms to measure these criteria objectively.	4, 4, 4, 4, 4, 3	4
6. Usefulness of the framework in creating flexibility in the contractual arrangement. (I.e., the resultant contract allows for the planned re-negotiation of certain terms and conditions; it allows for early termination under certain circumstances).	4, 4, 4, 3, 4, 3	4
7. Indicate how the resultant contract copes with changes to the organisations' priorities, strategic direction and structure.	4, 4, 4, 3, 3, 3	3

Table 4: Evaluation Results

The participating evaluators received the framework most positively. Two of the evaluators commented that they were unable to gauge the resultant contract's ability to cope with changes to organisational priorities and structure. This was because, the instances where the framework had been applied, related to IT outsourcing agreements where the organisations involved, had not undergone significant shifts in strategic priorities or structure at the time of evaluation; or the participants had not been involved at the time when these changes occurred. It was therefore difficult to assess, with a great degree of confidence, how the resultant contract would have accommodated (or did accommodate) such changes. Thus, in these specific instances, the evaluators made a score based on conjecture rather than facts for question 7. The evaluators in both these specific instances could only infer that "the resultant contract allows some useful changes to cope with changes to the organisation's priorities, strategic direction and structure". Thus, a score of 3 was afforded to question 7 for both these cases.

The results tabulated in Table 4, suggest that the framework was considered very useful by IT outsourcing industry practitioners. Their accompanying comments (included in Chapter 10), also suggest that the framework offers a structured approach to negotiating IT outsourcing agreements. The individual results have been combined into an average result for each of the success criteria and included in Table 4 above.

The results are summarised here:

1. Level of improvement to the process of negotiation, as a result of using this framework.

   Result: 4: Considerable. (Success criteria met - Highest possible score)

2. Usefulness of the framework in highlighting factors that need to be considered prior to conducting IT outsourcing negotiation.

   Result: 4: Considerable. (Success criteria met - Highest possible score)

3. Usefulness of the framework in providing guidelines on a suitable negotiation style and techniques to use when negotiating IT outsourcing agreements.

   Result: 4: Considerable. (Success criteria met - Highest possible score)

4. Usefulness of the framework in preparing for negotiating IT outsourcing agreements.

   Result: 4: Considerable. (Success criteria met - Highest possible score)

5. Usefulness of the framework in establishing a contract with success criteria and mechanisms to measure these criteria objectively.

   Result: 4: Considerable. (Success criteria met - Highest possible score)

6. Usefulness of the framework in creating flexibility in the contractual arrangement.

Result: 4: Considerable. (Success criteria met - Highest possible score)

7. Indicate how the resultant contract copes with changes to the organisations' priorities, strategic direction and structure.

   Result: 3: Allows for some useful changes. (Success criteria met)

The above success criteria were developed to test and ensure that the framework was an effective tool to employ in the negotiation of IT outsourcing agreements and that it the framework was also comprehensive. On the basis of the above evaluations, table in Table 4 and summarised above, all the listed success criteria have been met. It is therefore possible to conclude that the framework is an effective tool to employ in the negotiation of an IT outsourcing negotiation and that the information and guidance it offers is comprehensive. A wider application is recommended to gain a more general industry perspective and, a more accurate reflection, of the framework's efficacy and completeness. Repeating the evaluation several times, during the term of several long-term IT outsourcing agreements, would give a more valid indication of the long-term impacts of using this framework.

9.4 Chapter Summary And Conclusions

This chapter describes the methodology used to evaluate the research process and the research outcome, "The Framework for Negotiating IT Outsourcing Agreements". It describes the qualitative techniques employed to gather information, the sample size of case studies reviewed, and explains how the research approach was validated during the research study. The chapter also discusses the adequacy of the sample size used for the case study studies.

The chapter describes the evaluation process used to assess the efficacy and comprehensiveness of the research outcome: "A Framework for Negotiating IT Outsourcing Agreements". The success criteria used to measure the results of the research outcome, any constraints or limitations, how the evaluation was done, and who was involved in the evaluation of the framework are also detailed in this chapter. These success criteria were developed using information from the literature survey and based on information gleaned from the case studies on how industry experts measure success.

There were six industry experts involved in assessing the efficacy of the research outcome. Three of these were interviewed as part of the case studies, and three were completely independent of the case studies.

The results of the evaluation by industry experts are included in this chapter in a tabular form. Each individual score against each success criteria is tabulated in Table 4 above. The results are summarised to indicate the average score for each evaluation criteria. The average scores for 6 of the 7 evaluation criteria were the highest score possible. The 7th evaluation criterion assessed whether the use of the framework during the negotiation, resulted in a contract that accommodates changes in the organisations' priorities, strategic direction and structure. The overall result against this evaluation criterion was "Allows some useful changes, which is considered satisfactory for the purpose of this evaluation.

The listed success criteria were used to evaluate the framework for its usefulness in negotiating IT outsourcing agreements, measure the efficacy of the tool and evaluate the completeness of the information and guidance the framework offers. According to the results tabled above, the "Framework for negotiating IT outsourcing agreements" has met all evaluation criteria, with 6 of the 7 criteria scoring the highest possible score, and one scoring a satisfactory result. This provides evidence that "The Framework for Negotiating IT Outsourcing Agreements" is an effective and useful tool in negotiating IT outsourcing agreements, and that the information and guidance the framework offers is comprehensive.

10 CONCLUSION

10.1 Summary Of The Thesis

Through the review of published research, and the conduct of qualitative analysis of industry-based case studies, the PhD research study described by this thesis, identified a need for an effective, structured methodology for negotiating information technology outsourcing agreements. To address this need, a structured framework for negotiating IT outsourcing agreements was developed. The framework uses principled negotiation techniques and incorporates industry best practices. The PhD research project is briefly summarised below.

Carefully negotiated IT outsourcing agreements can deliver substantial benefits to the organisation as a whole. However, this PhD study has shown that current industry practices in negotiating IT outsourcing agreements produce sub-optimal outcomes. A large proportion of IT outsourcing agreements either fail to deliver expected results or terminate abruptly, with severe consequences to the organisation. This failure has been directly attributed to poorly constructed contracts, as a result of using unstructured and un-principled negotiations.

The review of literature, conducted as part of this research project, identified that negotiation of an IT outsourcing agreement is not an intuitive, ad-hoc process. Nor should it be a procurement process, where negotiation can occur predominantly on price. The literature review and the analysis of industry based case studies identified that understanding the complex organisational, strategic and operational changes that need to take place in an outsourcing endeavour is imperative to the negotiation process. The PhD research noted that an organisation is most likely to benefit from outsourcing if it understands exactly how the outsourcing vendor will provide value and can use that knowledge to effectively negotiate an agreement.

The PhD study has also reviewed literature on negotiation theory and its application to IT outsourcing practices. It assessed the applicability of various negotiation styles and techniques to negotiating long-term IT outsourcing agreements. The research concluded that the use of principled techniques was suitable in an IT outsourcing negotiation.

A major part of this research project was the in-depth qualitative analysis of 10 industry-based, case studies , used to understand the challenges and glean industry best practices in negotiating IT outsourcing agreements. The case studies included the review of contractual documents and in-depth interviews with several key decision makers and negotiators involved in each IT outsourcing agreement.

The information gleaned from both literature survey and qualitative review of industry based case studies were then analysed and used to build a body of knowledge that has been represented in Chapter 7. There are two broad categories of best practices.

Category 1: Where industry practices have been consistently shown to produce successful results in IT outsourcing, these practices have been represented as “successful industry best-practices”.

Category 2: Where factors, techniques, practices or indeed the lack of attention to a specific area have produced negative results, these have captured as “pitfalls to avoid”.

Finally, a series of simulated IT outsourcing negotiation sessions were used to augment the information gathered and test any assumptions made.

The resulting body of knowledge was then used to develop a set of guidelines for use in preparing for, and conducting, structured, principled negotiations of IT outsourcing agreements. These set of guidelines include instructions on how to approach IT outsourcing in a structured manner. They include recommendations on how to prepare for the negotiation and the styles and techniques to use during negotiation. It also contains a substantial list of considerations that need to be made when negotiating IT outsourcing agreements. Finally, it includes various strategies to minimise the significant risks of IT outsourcing. This set of guidelines, “The Framework for Negotiating IT Outsourcing Agreements”, is the principal outcome of the research study and is described in detail in Chapter 8.

Significant effort was made to evaluate the framework in terms of contribution to theory and practice. The evaluation of the research process, analysis of the sample size and discussion on the success criteria used for the evaluation of the framework is detailed in Chapter 9. Chapter 9 also discusses some limitations of this study.

Six industry experts have evaluated this framework for efficacy and completeness. Industry experts invited to evaluate the research outcome, had specifically negotiated IT outsourcing agreements and had seen the repercussions of negotiation practices adopted, on the outsourcing agreement in question, and on the rest of the organisation. Only those industry practitioners that had repeatedly conducted and reflected upon IT outsourcing negotiations over a number of years were requested to evaluate the research study, so that they may be cognisant of trends and best practices, and have the appropriate in-depth knowledge to assess the framework’s efficacy. CEO's and Managing Directors of several companies (both clients and suppliers) participated in the evaluation, as well as managers / leaders of outsourced divisions. Chapter 9 also details the results of the evaluation. The research outcome was assessed against seven success criteria. These success criteria were developed using information from the literature survey and based on information gleaned from the case studies on how industry experts measure success of an IT outsourcing negotiation. The success criteria were used to determine whether the framework was useful in negotiating IT outsourcing agreements, whether it promoted effective practices in ensuring success of the overall IT outsourcing endeavour, and assessed whether the information and guidance it provided was comprehensive. The overall result of the evaluation was that the framework met all the success criteria specified to measure the efficacy and completeness of the framework. It was also positively viewed and considered very useful by the industry experts.

Implications for Theory:

The PhD research identified a dearth in published literature specifically dealing with the negotiation of IT outsourcing agreements. It also identified that there was no widely accepted methodology or framework available, for negotiating IT outsourcing agreements.

The research study revealed that industry practices in negotiating IT outsourcing agreements were sub-optimal and what is really needed is a structured method to negotiate these agreements more effectively.

The study has developed a structured "Framework for Negotiating IT Outsourcing Agreements". It has evaluated the use of this framework by application in industry-based negotiations and simulations. The study thus contributes to the body of knowledge on IT Outsourcing Negotiations and may aid future research in related domains.

Implications for Practice:

The PhD research revealed that current industry practices in negotiating IT outsourcing agreements were sub-optimal, producing relationships that either fail or terminate abruptly, causing significant problems to organisations as a whole.

Part of the motive of this research study was to have IT executives and service providers approach IT outsourcing negotiations in a principled manner, to think about various issues that might be important for the organisation, rather than focusing on price alone. Industry practitioners have evaluated the outcome of the research study, "The Framework for Negotiating IT Outsourcing Agreements", for efficacy and completeness. The evaluation process determined whether the framework was an useful tool in negotiating IT outsourcing agreements, whether the tool promoted effective practices and whether the information and guidance it offered was comprehensive. The results of the evaluation were very positive, satisfying all of the success criteria registered to test the usefulness and comprehensiveness of the framework.

This gives some assurance of the research outcome's applicability to current industry needs.

Below are selected quotes from industry experts who have participated in the evaluation of the framework.

"Happy to have helped. It is a great framework so I am pleased to see it being published" CEO of an Outsourced Services Provider.

"This is a great framework, I wish I had it when I was negotiating the outsourcing deals when I was at ***. I rated it very highly as it is very useful!!"*** CEO of a consumer of Outsourced Services.

"This is a very useful and concise framework that could be taken into consideration especially when considering entering into an IT outsourcing agreement." Manager of Outsourced Contracts.

"This framework provides a valuable approach to IT outsourcing, especially in this day and age when outsourcing deals have become more complex than ever, again especially relating to IT outsourcing." *Manager of an Outsourced Division.*

In conclusion, this PhD thesis describes a research study to explore negotiation, IT outsourcing and specifically IT outsourcing negotiations. The Outcome of the research study is a structured "Framework for Negotiating IT Outsourcing Agreements".

The framework consists of:

- A list of factors that need to be considered prior to the negotiation of IT outsourcing contracts.
- Guidelines on how to prepare for the negotiation, such as, what information needs to be gathered.
- Guidelines on a suitable negotiation style and technique to use.

- Guidelines on how to structure the negotiation, who to involve, and how to develop a negotiation strategy.
- A checklist of considerations or discussion topics to aid dialogue during negotiation sessions.
- Guidelines on how to approach ongoing negotiations (or re-negotiations) once the contract is established.

This framework addresses a significant gap in published literature. It also satisfies the industry requirement for a consistent, effective, structured methodology for negotiating IT outsourcing agreements.

Industry practitioners have assessed the efficacy and completeness of the research outcome: a structured "Framework for Negotiating IT Outsourcing Agreements". The evaluation proved the usefulness of the framework in approaching IT outsourcing negotiations in a structured and principled manner. It determined that the tool promoted effective practices and the concluded that the information and guidance it offered was comprehensive.

10.2 Future Research

The research study described in this thesis was conducted over approximately three years. The term of each of the outsourcing agreements investigated was at a minimum three years but often lengthier. Thus, it was impossible to assess the long-term efficacy and completeness of the framework.

Future research should investigate the long-term effects of using this framework to negotiate IT outsourcing agreements, and improve the framework accordingly.

The concept of off-shore outsourcing (or off-shoring) has not been specifically addressed by the research outcome. The scope was explicitly limited to local outsourcing. Off-shore outsourcing is significantly more complex, and to include it in the scope of this PhD study, would have made this project unviable. It would be of great use to the industry, to investigate the challenges and industry best practices of off-shoring IT and develop a framework for negotiating offshore IT outsourcing agreements.

Measuring the success of an IT outsourcing agreement and the success of the *negotiation* of an IT outsourcing agreement are inter-related. If the negotiation of an IT outsourcing agreement is flawed, it may result in a contractual agreement that does not support optimal outcomes. What objective measures can be used to ascertain success in the negotiation of an IT outsourcing agreement and the endeavour as a whole? How can largely qualitative aspects of measurements be consistently and repeatedly used to gauge success at different stages of the IT outsourcing life-cycle? While these topics have been discussed briefly in this thesis, a more comprehensive study of these aspects is needed. As Lacity et.al. observes, we still only have anecdotal answers to these questions (Lacity et. al 2010).

Future research is planned following on from this PhD project, to examine more case studies and explore additional guidelines for negotiating IT outsourcing contracts. It would have been desirable to examine more case studies for inclusion in this project, but due to time and other constraints described in earlier chapters, it was not possible to do so. Future research should address this limitation.

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APPENDIX 1: INFORMATION FOR PARTICIPANTS

INFORMATION
TO PARTICIPANTS
INVOLVED IN RESEARCH

You are invited to participate

You are invited to participate in a research project entitled "Framework for Negotiating Information Technology Outsourcing Agreements".

This project is being conducted by a student researcher ***Subha Chandar*** *as part of a PhD study at* ***Victoria University*** *under the supervision of* ***Prof. John Zeleznikow*** *from the Faculty of Business & Law.*

Project explanation

The aim of this PhD research project is to develop and prove the effectiveness of a structured framework for the negotiation of Information Technology (IT) Outsourcing agreements. This framework will be based on existing structured negotiation techniques and industry best practices.

The PhD study will examine industry-based case studies by conducting to determine best practice methodologies.

What will I be asked to do?

Your voluntary contribution is requested. There will be a face-face discussion for approximately two hours, in which the student will request details of any IT outsourcing negotiations you have been involved in. Sample questions are provided as an appendix to this document. Please note that neither you, nor your organisation will be specifically *identified in any document or transcript. Your name and contact details will not appear in any transcript or be stored in any way.*

After the interview has concluded, a transcript of the discussion will be emailed to you. You can confirm or modify any details included in the transcript at this stage. The transcript will then be stored, after your name, contact details, and any information that specifically identifies either you or your organisation has been deleted.

Your involvement is entirely voluntary, and you have the opportunity to pull out any time, including after the interviews have concluded.

What will I gain from participating?

Your voluntary contribution would be greatly valued. The outcome of this research project will be a structured framework to aid negotiations in the IT Outsourcing Domain. The research thesis will be published, and be available for your perusal.

How will the information I give be used?

The researcher will use the information you give to glean industry best practices in the domain of negotiating IT outsourcing agreements. The guidelines will be incorporated into a structured framework to aid industry practitioners.

What are the potential risks of participating in this project?

Victoria University's Postgraduate Research Committee and the Human Research Ethics Committee have reviewed the proposed research and fully support this project. Risks to participants are considered minimal.

How will this project be conducted?

Using interviews with industry experts, replicable common factors associated with the negotiation of successful IT outsourcing agreements will be extracted. These industry best practices along with existing research on structured negotiation techniques will be combined to develop a structured framework for negotiating IT outsourcing agreements.

Who is conducting the study?

Victoria University, Faculty of Business & Law

Title	*First Name*	*Surname*	*Faculty*	*Phone Number*	*Mobile Number*	*VU E-Mail Address*
Prof	John	Zeleznikow	Business & Law	9505 3323	0432 154 217	john.zeleznikow@vu.edu.au
Mrs	Subha	Chandar	Business & Law	9557 2002	0400 685 688	subha.chandar@live.vu.edu.au

Any queries about your participation in this project may be directed to the Principal Researcher listed above.

If you have any queries or complaints about the way you have been treated, you may contact the Ethics and Biosafety Coordinator, Victoria University Human Research Ethics Committee, Victoria University, PO Box 14428, Melbourne, VIC, 8001 phone (03) 9919 4148.

APPENDIX 2: CONSENT FORM FOR PARTICIPANTS

CONSENT FORM

FOR PARTICIPANTS INVOLVED IN RESEARCH

INFORMATION TO PARTICIPANTS:

We would like to invite you to be a part of a study into Information Technology (IT) Outsourcing Negotiations.

The aim of this PhD Thesis research project is to develop and prove the effectiveness of a structured framework for the negotiation of Information Technology (IT) Outsourcing agreements. This framework will be based on existing structured negotiation techniques and industry best practices.

CERTIFICATION BY SUBJECT

I, "[Click here & type participant's name]"

of "[Click here & type participant's suburb]"

certify that I am at least 18 years old* and that I am voluntarily giving my consent to participate in the study:

Framework for Negotiating Information Technology Outsourcing Agreements being conducted at Victoria University by: ***Prof. John Zeleznikow.***

I certify that the objectives of the study, together with any risks and safeguards associated with the procedures listed hereunder to be carried out in the research, have been fully explained to me by:

Subha Chandar

and that I freely consent to participation involving the below mentioned procedures:

- Meet with the Student for approximately one hour and answer questions pertaining to the Negotiation of IT Outsourcing Agreements.
- Confirm via email that the information gathered via this meeting has been recorded correctly by reviewing a transcript of the discussion.

I certify that I have had the opportunity to have any questions answered and that I understand that I can withdraw from this study at any time and that this withdrawal will not jeopardise me in any way.

I have been informed that the information I provide will be kept confidential.

Signed: Date:

Any queries about your participation in this project may be directed to the researcher

Prof John Zeleznikow, phone (03) 9505 3323. If you have any queries or complaints about the way you have been treated, you may contact the Ethics & Biosafety Coordinator, Victoria University Human Research Ethics Committee, Victoria University, PO Box 14428, Melbourne, VIC, 8001 phone (03) 9919 4148.

APPENDIX 3: SAMPLE INTERVIEW QUESTIONS

- Who was involved in the IT outsourcing negotiation?
- What was the professional background/training of each of the actors in the IT outsourcing negotiation? (e.g. Lawyer, IT Manager etc.).
- What was their skill level in conducting commercial contract negotiations?
- What was there skill level in negotiating IT outsourcing contracts?
- What was the authority level of parties involved in negotiating the IT outsourcing contract?
- What is the nature of IT services being outsourced?
- What is the term of the deal?
- Are there multiple IT service towers/functions considered for this deal?
- Are there multiple providers under one agreement?
- How many vendors are providing services under the main agreement?
- Are any of the providers outsourcing any of their capabilities to other organisations?
- Are any of these services being directly consumed by the client?
- What is the annual capital and operating expenditures on the outsourcing relationship?
- What are the core responsibilities of the outsourcing company (client) under the agreement?
- What are the core responsibilities of the provider(s)?
- What was the main impetus to outsource?
- Was cost-reduction the only aim? If not, was it the most important goal?
- Were all aims clearly communicated to providers during negotiation?
- How was negotiation/selection of providers conducted?
- Was there a conscious or structured negotiation process?
- Did you invite proposals to a tender? Did you prepare a detailed Request for Proposal (RFP)?

- When did negotiation start in earnest and with how many providers? (Was a single provider selected before negotiations began, or were a number of providers selected for negotiation before a final decision was taken?

- Were the outcomes of negotiation affected by the possible influence or power held by each of the parties involved in the negotiation?

- Did the parties to the negotiation consider each other's interests? Did they seek an outcome based on mutual gain?

- What factors influenced the negotiation? (Such as personal factors, economic factors, the global business climate etc)

- Were important factors /needs decided before the negotiation process?

- Were alternatives to important needs discussed internally before negotiation?

- Were participants in the negotiation aware of their' party's and the other side's best alternative to an agreement?

- Did the parties trade-off alternatives?

- Did the cost of services overshadow other aspects of the deal?

- Was capability to deliver outcomes established prior to negotiation with the provider? If so, how?

- How was the successful provider chosen?

- Was there discussion and agreement on how the relationship would be managed?

- Was there consensus on governance structures and methods?

- What key aspects of the contract were initially put in place?

- How did these aspects change over time?

- What were the changes in the contract? Why did these changes occur? How were these changes treated under the negotiated agreement?

- What were the known risks of the outsourcing agreement – and what were mitigation strategies for these risks?

- In hindsight, what was left out of the negotiated agreement that should be included in this process?

- What was unknown / uncertain at the time the negotiation process was held? Which items were on the consumer's side? Which items were on the provider's side?

- Were there any areas that should have been discussed in more detail?
- Was there a need to re-negotiate any terms and conditions? If so when?
- Was re-negotiation a process that was expected to take place? Was it scheduled at regular intervals?
- Are there renewal/termination clauses – if so what are they?
- How were these clauses determined?
- What alternative dispute resolution mechanisms were discussed?
- How do they work in practice?
- If you knew when you conducted negotiation what you know now, how would the process of negotiation have changed?
- Was the scenario we are examining a successful negotiation? What were the criteria used to classify this as a successful negotiation?
- Is/was the IT outsourcing arrangement successful? What were the criteria used to classify success in this IT outsourcing arrangement?
- Would you (did you) renew / terminate at end-of-term or earlier? Why?

APPENDIX 4: SIMULATION STUDY

A4.1 INSTRUCTIONS TO SIMULATION EVALUATORS

A two hour time limit has been allocated for each negotiation. The negotiations will be conducted in groups of 3, consisting of a supplier, client and a mediator.

The Grades awarded will be out of 15, using the following criteria:

- **7** for preparation:

  Evidence of knowledge of negotiation theory,

  Evidence of being prepared with the simulation requirements and information supplied,

  Being ready for negotiation with details such as strategy, alternatives etc. Knowledge of IT outsourcing

- **5** for practice:

  Do they practice principled negotiation,

  Do they engage in positional bargaining,

  Is the negotiation influenced by power or personal tactics,

  Are they focused upon interest based negotiation or only haggling over price

- **3** for finishing:

  The negotiation does not have to eventuate in an agreement but participants need to record how the negotiation has concluded and what further action might be needed.

A4.2 INSTRUCTIONS TO ALL SIMULATION PARTICIPANTS

Each student will be allocated to a group of 3 and asked to perform one of the following roles:

The Client (WeRunIt), Supplier (OutSoftware) or the Mediator.

Each group will be given two hours to try and conduct the IT outsourcing negotiation.

Marks will be allocated for understanding and following principled negotiation techniques.

Students will need to write up a 750 word report which should be submitted by < Time and Date Specified >.

The Scenario

WeRunIt is a private company run by the client. It markets and organises sporting events, such as, distance runs, cycle races, swimming races and triathlons. Their skills are in marketing, financing and conducting races.

Since its inception, five years ago, the client organisation have had an in-house IT team to deal with IT tasks such as creating spread-sheets for financial projections, maintaining databases for recording entrants details and race details and designing, maintaining and operating a web site to both publicise events and take entry fees. All IT infrastructure, systems, and applications are owned, housed and operated internally.

The Client believes he can make significant savings by outsourcing the provision of IT services for WeRunIt. Currently WeRunIt spends $500,000 per annum on its three IT specialists and Infrastructure & Systems operating costs.

The Client has approached the Supplier of OutSoftware services with a view to the Supplier being able to provide outsourced services to meet the client's ongoing IT needs. In particular, the client wants a contract where:

a) OutSoftware creates and maintains a new web-site advertising WeRunIt's events;

b) The Website has mechanisms whereby event participants can get information about an event and sign up for it. Event participants are encouraged to enter their details and pay online.

c) OutSoftware maintains Infrastructure, Systems & Databases.

d) OutSoftware maintains a database of entrants and their results in specific events.

e) OutSoftware provides support for financial reporting.

The Write-Up

As well as discussing how the negotiation was conducted, including its issues and challenges, the final outcome needs to be specified. Students are requested to explicitly comment on how their viewpoint on negotiation and how this has changed because of their participation in IT outsourcing and Other Negotiations during the past 3 months.

The write up should be no more than 750 words. It should include references and appropriate theory from the negotiation lecture notes.

The write-up should be handed in to Professor Zeleznikow by < Time and Date Specified >.

A4.2 INSTRUCTIONS TO ALL SIMULATION PARTICIPANTS

A4.3 INSTRUCTIONS TO MEDIATORS IN THE SIMULATION

The mediator should provide structure and run (manage / co-ordinate) the Negotiation session. Your role is to improve the quality of the negotiation and assist the supplier and client to gain a better understanding of the other's interests and achieve the best outcome.

A rough guide for the structure of the negotiation session is:

Evaluator introduction (5 mins)

Mediator introduction (10 mins)

Client and Supplier Party statements (10 min each) – 20 mins in total.

Discussions (up to 90 mins)

A4.4 CONFIDENTIAL INFORMATION RELATING TO THE CLIENT

The Client's Interests:

- To get the best products out in the market (They have investigated doing this by themselves, but are constrained by budget).
- WeRunIt, being a SME, prefers to choose the supplier through personal contacts rather than by tender.
- WeRunIt needs to outsource all aspects of IT infrastructure, systems, applications including the databases and web sites. The client anticipates paying a fee based on services utilisation.
- WeRunIt also has a small budget set aside for technology improvements.
- WeRunIt is hoping to get the new website up and running in 3 months (September this year).
- The website is critical to WeRunIt's business and significantly impacts its annual revenue. The website must be operational by September, in time for the new triathlon season. Hence there is no time to go to market and do an elaborate tender process.
- WeRunIt prefers to pay a flat fee to OutSoftware of $200,000 per annum and $2 per event registrant. In 2008/2009 season, 50,000 people entered WeRunIt's race events.

A4.5 CONFIDENTIAL INFORMATION RELATING TO THE SUPPLIER

The Supplier – OutSoftware's Interests:

- OutSoftware does not have a presence in the sporting industry, but would like to infiltrate this market.
- It would like to convince other customers with similar IT environments to WeRunIt, to outsource their IT infrastructure, operations and systems development & maintenance to them.
- OutSoftware is cash-strapped and would like to increase annual revenue.
- The account manager who is conducting the negotiation is heavily compensated based on the sale amount (a percentage of the sale amount is awarded to the sales account manager as commission).
- The sales account manager is also keen to secure future revenue through annual software license renewals.
- Given the client's requirements, Outoftware believes, it should charge $450,000 per annum, for the endeavour to be profitable.
- OutSoftware wants to charge a flat annual fee, not based on utilisation.
- OutSoftware is worried that there are other competitors in the marketplace, able to readily meet the client's needs.

APPENDIX 5: CASE STUDY SUMMARIES

A5.1 Case Study 1

The organisation, an IT company, was in the business of providing IT services to several, medium to large organisations in Australia in the late ‘80s. The services rendered to the clients were through specific, standalone, contracts covering IT products and services. Although several of these clients were repeat customers, each contract was serviced separately. The strength and value of the long-term relationships that existed between the supplier and its various customers were not fully exploited by conducting business in this manner.

The Head of Sales and Marketing of the organisation was responsible for identifying an opportunity to leverage the multiple strong relationships the supplier organisation had, with several of its clients. A decision was made by the supplier to migrate from a “switch-on”, “switch-off” kind of interaction with its clients, to become more of a long-term, value-added partner.

By providing IT services in an “outsourcing” mode, it was possible for the supplier to secure a long-term, ongoing stream of work giving a more stable, steady flow of income and predictable demands on their resources. The supplier and the clients could also capitalise on the intrinsic knowledge the supplier had gained (through previous work), of the client’s business and IT environment.

It was also advantageous for the client to operate in this mode, to streamline its IT functions through one trusted partner, instead of seeking the best supplier for each requirement as it arises, and going through the administrative burden of securing services from several suppliers in an ad-hoc fashion. Further benefits were consistency of services, and an opportunity to gain cost efficiencies through economies of scale.

An Outsourcing Services division was created and a strategy was initiated to bid for long-term contracts with existing clients. Negotiations held with potential customers were not structured and were heavily based on price. The services bid for, was for IT Infrastructure services. The cost structures used were very simplistic – they were based on a price per head. All discretionary services outside the scope of the contract were not priced upfront, or discussed during negotiation. The organisation was able to supply a quote to the client when additional work was required, and the client had little choice but to agree to the quote. But the strength of the existing relationship meant that the supplier did not try to seek an unfair advantage over the client by proposing an unreasonable price for discretionary work, and the client trusted the supplier enough so that they did not question the integrity of the quotes.

The parties involved in the initial contract negotiation had no specific expertise in IT outsourcing, however had substantial experience in IT infrastructure operational management, IT sales & marketing, and management of business relationships in general.

There was no formal agreement on SLAs, dispute resolution mechanisms, re-negotiation terms, complicated pricing structures or governance methodology.

➔ Learnings:

- Outsourcing practices and arrangements are much more sophisticated in 2010/2011 than in the late 80s.
- In the 80s, Outsourcing arrangements were largely based on trust, and relied on a sound (pre-existing) relationship between client and supplier.
- Issues and changes were dealt with informally – not using formalised dispute resolution mechanisms or contractual/legal arrangements.
- Issues were dealt through informal discussions - by exploring options and finding mutually beneficial outcomes.

- Maintaining a good, strong relationship was considered more valuable than seizing opportunities for financial gain.

A5.2 Case Study 2

This outsourcing endeavour was not approached in a structured manner. The negotiation was also not structured, and did not adhere to any formal process. The Client and Supplier had a pre-existing relationship based on the sale and procurement of goods and services.

The Supplier was providing ICT (hardware/infrastructure) services to the client under standalone contracts.

The hardware / infrastructure was owned by the client and resided in the client's premises. The supplier provided limited services on an ad-hoc basis under several distinct contracts.

The supplier saw an opportunity to do more – to provide wider services (get more business) and to take over the out-dated hardware/infrastructure from the client, update it, and thereby reduce costs and improve services. The client saw an opportunity to off-load legacy infrastructure and eliminate the burden of focusing on the IT function which was not a core part of the organisation.

The arrangement "evolved" into an outsourced arrangement through several discussions.

Initial arrangement was formed without a sophisticated contractual arrangement.

As the outsourced arrangement evolved, service level agreements (SLAs) were formulated.

The negotiation was not conducted in a formal way.

An existing supplier saw an opportunity, and presented the idea of an outsourced arrangement to the client.

After a series of discussions, the supplier was asked to issue a proposal/quote, which was accepted and the outsourcing arrangement began.

The mandate was to take over ICT infrastructure and improve service levels.

However, service levels were not clearly understood or formally documented during the negotiation process.

The price/quote for the outsourcing arrangement was based on a “price per head” basis.

The supplier elected to be entirely transparent with pricing margins. This is an unusual practice, not widely adopted in the industry. However, the strength of the relationship between the supplier and the client meant that there was a lot of trust and a genuine focus on making sure the other party equally benefitted from the arrangement.

So, the supplier and client agreed that the supplier could charge 20% on top of the supplier’s cost.

The decision to outsource and the eventual selection of the supplier was thus, not based on price.

There was a lot of trust between the parties.

The supplier had built up a certain level of credibility with the client.

The sound, pre-existing relationship enabled a very simple contract to be drafted initially.

The arrangement evolved and became more sophisticated with time.

The transition was discussed and drafted in detail in a formalised agreement.

The transition was over a weekend, with nil user impact. This was a mandate from the client.

During transition, the end user services were taken off-line. The hardware was moved out of the client’s premises and into the supplier’s premises and the end-user services were switched back on.

There were some transfer of employees – but these were transferred to the supplier before transition of services. The supplier hand-picked the best performing employees from the client's team and helped the client let go of the remainder of employees. Because of the strong working relationship between the two organisations and the thorough understanding the supplier had of the client's environment, a lot of potential issues were circumvented. The ease of transition and the reliability/improvements in services resulted in the client issuing the supplier with a letter of appreciation 3 months into the Outsourcing contract.

➔ Learnings:

- Trust, credibility and the strength of the relationship were significant factors in the success of the relationship.
- The supplier did a lot of work, invested a lot of effort, in gaining a thorough understanding of the client's needs and the client's business environment.
- The supplier's familiarity with the client's business environment facilitated the creation of a robust business proposal.
- Client and Supplier sought to understand what was important to each party.
- Pre-existing issues such as service continuity issues were flagged. The supplier undertook to fix these within the first 3 months.
- The client's aim in outsourcing the ICT services was to focus the organisation more on core competencies. (Outsource legacy systems, focus on new billing system).
- There was also an expectation that outsourcing would render better services.
- In hindsight, comprehensive SLAs should have been part of the initial contract.
- However, too many organisations focus heavily on SLAs and dilute the focus on the governance of the relationship and the overall expected outcomes.
- Relationships are very important – and even though the marketplace has changed significantly since the 80s, relationships remain very important in outsourcing.

A5.3 Case Study 3

There was an executive mandate for the client to outsource their IT function within 6 months.

There was no examination done on the state of the IT department or an understanding of what consequences will result, and what effect it will have on the client's overall priorities, if the IT function was to be outsourced.

The IT department was in a state of disrepair. There was no time to undertake a thorough audit of what the issues were, let alone fix the problems. Hence, the problematic functions were passed on to the outsourcing provider – in the hope that the problems will get fixed by outsourcing.

There was a formal tender process and several organisations were invited to respond with proposals. Of these, two suppliers were selected and negotiations started with both companies.

The two short-listed suppliers had to spend significant resources to get to the short-list. The higher than normal investment was partly due to the chaotic state of the IT department, and partly due to the client's urgency in getting the function outsourced. The supplier had to invest heavily in understanding the clients' business and IT environments; they needed to understand what options existed to provide services and add-value; and they also needed to understand specific issues that existed that would affect transition and ongoing operations after transition, so that they could set the price/profit margins appropriately. The resources utilised included business analysts, operational experts, technical staff, negotiators, and other specific expertise relating to bidding for a tender. So, both short-listed suppliers had spent significant amount of dollars by the time they got selected for the short list. It was vitally important for each of the suppliers to "win" the business – so that they could recoup some of this sunk cost. Walking away or losing the business was not a good alternative.

If the terms and conditions were less than satisfactory, and the supplier did elect to walk away – all the sunk cost would need to be counted as an unrecoverable loss.

The client consisting of several Government Departments and agencies, formed an alliance and then negotiated with the potential suppliers on price alone.

The "successful" bidder, the supplier that was eventually chosen, decided to meet the price the customer was insisting upon – but did not fully understand the quality and service levels expected by the customer.

In hindsight, the supplier had signed an untenable agreement with the customer under the misconception that this was the best alternative going forward to recoup sunk costs.

From day one the outsourcing relationship ran into issues. There were no specific SLAs discussed or agreed to during the negotiation process. The level of services the customer thought they were getting was different to what the supplier was hoping to provide.

Also, the sales person (from the outsourcing provider) was incentivised on winning deals (as per standard industry practice). The sales person was not rewarded for the strength of the ongoing relationship or the success of the outsourcing arrangement in the longer term. The focus (for the sales person) was to beat the competition on key decision points (in this case the price) and win the deal.

The quality of services during the term of the agreement or expectations of the customer were not carefully considered or managed with the same care as the dollar value or the commission that the supplier's sales executive was about to receive.

Some SLAs were established during the initial drafting of the contract – but these were not comprehensive and did not clearly articulate the expectations of the client or address the client's current/ changing business needs.

So the supplier was able to achieve the SLAs – despite the client being dissatisfied with the level of services being rendered.

The governance of the relationship and aspects such as periodic review and re-negotiation of terms and conditions, were not discussed during the negotiation. The relationship was not properly managed. The initial contract was strictly adhered to, and did not evolve with the changing needs of the client.

No formal process for management of services existed, including, the quoting for variations or handling new service requirements.

The relationship steadily deteriorated.

In this particular case, in the 5 year outsourcing arrangement, the supplier was able to sustain low levels of services up to the 4th year. At that time, the customer had reached their endurance "limit" on putting up with bad services and decided to re-issue the tender (invite new proposals) for the next term of the outsourcing arrangement.

The suppliers realised that they were in danger of losing the client, and invested heavily on account management teams in the final year. As the tender process progressed, the incumbent supplier realised they were going to lose at least part of the services to a competitor. So, they tried their best to protect their turf and contain the "slice of the pie" they were going to lose. They assembled a new account management team and invested heavily in bidding for the new term against other vendors and made significant concessions on price. However, they failed to understand and address the issues the customer was currently facing.

At the end of the term, the incumbent supplier had to re-bid against several other potential suppliers for the new term of the outsourcing contract. The resultant arrangement for the new term consisted of a multi-vendor outsourcing arrangement. The single outsourcing arrangement changed to a multi-vendor outsourcing arrangement.

The pre-existing supplier still had a big piece of the pie (infrastructure operations), and had a one-month warranty period on the services being transitioned to the new supplier.

Services relating to applications support and development were offered to a new supplier, with clear delineation of roles and responsibilities and specific SLAs. Other aspects that were addressed during the negotiation for a new term were the governance of the agreement including regular review and re-negotiation.

➔ Learnings:

- Focusing on price alone guarantees issues later on in an IT outsourcing agreement. The vendor may be already trying to claw back on costs incurred during the tender process – and if costs were the only focus during the negotiation, the service levels may have been left open for interpretation by the supplier. If the supplier is going to make profits, they may elect to provide a lower level of service to the client.
- Setting the price for services is a non-trivial, complex task.
- What may be reasonable at the start of the engagement may not be sustainable year after year.
- The total cost of ownership needs to be understood by both the client and the supplier, as there are many hidden costs that are never highlighted/considered until the services are outsourced.
- Vital information (intellectual property) needed to transition out of the existing supplier needs to be available – and kept current – in a readily acceptable and secure format/location. The absence of this, and the reluctance of the incumbent to "hand-over" services to the new supplier, introduced significant issues and costs.

A5.4 Case Study 4

Client had an existing, mature, outsourcing relationship with the supplier.

The Supplier was providing ICT services to the client under an outsourcing arrangement that was nearly the end of term.

The outsourcing arrangement had run into a number of issues.

The initial contract negotiation had been driven by price alone and other aspects of the outsourcing arrangement had not been carefully considered. The resultant agreement was less than robust in meeting the changing needs of the customer.

SLAs were established during the initial drafting of the contract – but these were not comprehensive and did not articulate the expectations of the client or address the client's current/ changing business needs.

So the supplier was able to achieve the SLAs – despite the client being dissatisfied with the level of services being rendered. Also the contract was rigid and did not allow for changes to meet the client's changing business landscape.

Due to these problems and the poor management of the relationship, the relationship between the Supplier and the Client's had deteriorated.

From the client's perspective, the services rendered by the supplier were deemed unsatisfactory (even though the SLAs were being met). And the supplier was being opportunistic on pricing discretionary work and contract variations.

From the outsourcer's perspective, the outsourcing agreement had costed more than anticipated – and did not deliver the expected profits. The supplier had strictly adhered to the contract – yet the client maintained that there was a mis-match in customer's expectations and service levels delivered. The client was also being unreasonable with pricing of services – expecting platinum/gold level services while paying for aluminium.

Both sides did not properly manage the relationship. There were no regular governance meetings at different operating levels, there was no awareness of issues/problems. There was no communication, expect on the reporting of SLAs.

No formal process for management of services existed, including, quoting for variations or handling new service requirements.

The client engaged several external consultants to audit the agreement and formulate a strategy for moving forward.

The new strategy recommended was to go to market and invite proposals for a multi-vendor outsourcing agreement.

The current issues were tabled to the incumbent supplier – and an agreement reached on when these issues will be rectified.

The aim of the new outsourcing arrangement was to reduce 10% in overall cost.

Also clearly articulated, was the intent for efficiency gains to be shared by both the client and the supplier.

The negotiation was conducted in a structured manner.

The people involved in the negotiation 2nd time around – operation managers, executives of both organisation, legal and negotiation experts and experts in IT outsourcing.

The negotiation and transition phases were carefully planed.

Negotiation focussed on business outcomes as well as cost reduction.

The customer still considered "value for money" as an important aspect of the negotiation / selection process but was always cognisant that while it was a priority, that it was not the only consideration.

Services that the client was getting from current provider were un-satisfactory, so, they wanted an improvement on these. The negotiation focussed on a number of specific SLAs where a certain % of improvement was needed – and the supplier had to achieve this improvement within a set time frame.

As a result of the negotiations, a best of breed approach was taken to create a multi-vendor outsourcing environment. However, in the focus to get specific issues addressed, there was a loss of focus on ongoing improvements and innovation.

➔ Learnings:

- Engage appropriate experts in the outsourcing decision and negotiation.
- Stick to the business outcome – not just the price.
- In hindsight there was over-emphasis on SLAs – and the contract was extremely complex to manage. The complexity was amplified, since services from several suppliers had to be integrated to achieve business outcomes. Balance SLA with need for flexibility and innovation.
- Create SLAs to measure quality of output and continuous improvement.
- Maintenance and maintaining technology currency needs to be built into the contract.
- Innovation – new ways of providing services was considered as an add-on to existing services – customer considered each opportunity and paid for it separately. The cost of innovation was fully absorbed by the customer. Each supplier was able to present several options to the client – which would then benefit the supplier as well.
- The client benefited greatly in having multiple outsourcing vendors.
- Best of breed outsourcing is highly recommended.
- There is less potential for monopoly/ heavy dependency on one single supplier.
- When a new requirement comes in, the existing vendors had to put in competitive quotes for the new business.
- The client provided potential future business prospects as incentives for current suppliers to deliver services (and work together) more effectively.
- A cautionary observation regarding sub-contracting: Many suppliers sub-contract part of the services awarded to them, to third parties. Sub-contracting of services by the supplier could have unexpected consequences to the client's business outcomes. The client organisation may lose control over specific services – or have limited ability to

influence outcomes relating to the sub-contractor. Because there is no direct relationship or legal contract between that third party and the customer there may be limited mechanisms for overseeing the business conduct and outcomes from the third party supplier. It is therefore necessary to be aware of (and have some control over) such sub-contracting (or the intent to sub-contract) when negotiating an agreement with a particular supplier. The requirement that the supplier needs to be completely transparent to the client, about any intent to subcontract should be stipulated at negotiation and should be included in the IT outsourcing contractual agreement. In this particular case, the client avoided significant regulatory compliance issues by making sure any sub-contracting my intended suppliers was declared upfront.

- SLAs should not focus entirely on services provided – but also on improvements to business processes.
- Traditional SLAs such as 90% availability of network etc. can form the foundation, but more sophisticated measures are necessary to capture opportunities for innovation and "value-add".
- With technology evolving at a rapid rate, and possible cost reduction in technology as the agreement progresses, how do you capture these savings?
- When dealing with multi-vendor relationships, more care needs to be taken to eliminate confusion / overlapping areas of responsibilities.
- Multiple vendors cannot share a responsibility – and this is also true with in-house services/teams. They should be encouraged to help each other – but there should be clear differentiation in accountability.
- To keep both parties honest and working together cohesively, there should be specific warranties associated with services rendered.

A5.5 Case Study 5

Client had a complex arrangement with multiple vendors, in-house teams and sub-contractors providing a suite of services.

There were several areas of duplicated effort (such as financial management, customer service centre, technical helpdesk etc).

There was also a lot of confusion on accountability as several suppliers and the in-house team had overlapping areas of responsibility which presented confusion on the boundaries of where one party's responsibilities ended and where the other party's responsibilities began. Integration of these separate service delivery outcomes to achieve business mandates was also highly complicated.

The aim was to simplify the management of the services, optimise workforce, improve business processes and ultimately reduce cost.

There was also significant growth predicted in the client's business – so having a competent outsourcing provider as a partner was expected to facilitate this growth.

A formalised tender process was adopted. However, most decision makers did not have pre-existing experience in IT outsourcing – it was in the early 90s and outsourcing as a concept, in Australia, was still at an embryonic stage. However, participants in the IT outsourcing negotiation process possessed significant operational and management experience. There were external management consultants involved in the outsourcing negotiation process to ensure probity. There were also operational experts, legal experts and technical experts.

The resultant outsourcing contract focussed heavily on the delivery of services. In hindsight, there was too much emphasis on SLAs – even though these services were tightly woven with ICT systems, there was no provision in the contract for technology innovation.

The solution offered by the successful bidder for the outsourcing services was reliant on an old, stable system – but this system was not purpose built – it was a pre-existing solution that the supplier had been successful in offering to other customers overseas. The solution was retro-fitted, with customised modules built on top of the existing system, to meet the client's needs.

The cost of the successful bidder was lower – given that it did not include the cost of building a new purpose-built system (as proposed by some un-successful bidders). However, the hidden cost of maintenance over the years needs to be taken into account, including, cost of customisations and sub-optimal business processes introduced by the constraints of the pre-existing systems solution. When the client's business requirements changed – or even small changes such as name changes – required significant modifications or customisations to the pre-existing system. The cost of these modifications added up to be quite significant over the term of the agreement. In hindsight, it would have been cheaper to build a new system from scratch.

The contract allowed for subcontracting of services by the service provider. However, there were complex issues to be considered such as regulatory compliance and data integrity issues. The client mandated that the supplier be transparent with their intent to subcontract.

A number of internal client teams had to work cohesively with the outsourcing provider. A comprehensive governance plan needed to be created (along with a team of experts) to ensure there were no overlapping of responsibilities, and to ensure contractual compliance (including all the services levels were met and variations for services were properly managed).

➔ Learnings:

- Outsourcing practices and arrangements are much more sophisticated in 2010/2011 than in the early 90s.

- Some of the hidden costs of outsourcing only became apparent during the outsourcing endeavour.
- Work practices and business processes were sub-optimal with a retro-fitted systems solution and the costs of tailoring this to fit the customer's need were severely underestimated.
- The cost of governing the outsourcing relationship was also underestimated.
- The client protected all intellectual property that was needed for the delivery of the services with a copyright (business rules, manuals, etc.)
- The agreement was extended several times for a new term.
- Issues and changes were dealt with through a formal dispute resolution process which was designed at the time of negotiation.
- However, the client became heavily reliant on the supplier and the initial contractual arrangement in place did not support the evolving needs of the customer.

A5.6 Case Study 6

Client had a pre-existing outsourcing relationship with one of the suppliers.

There was a strategic decision made to invite proposals from other parties when the existing contractual term was nearly up for renewal.

A formalised tender process was adopted. Technical experts, operational experts as well as strategic management personnel were involved in key decisions. Experts on IT outsourcing, negotiation and the law were also involved.

Due to the specialised field, very few suppliers could deliver services to satisfy the entire suite of customer requirements.

A best of breed approach was taken, to award services to several successful bidders.

The resultant arrangement was two main suppliers (including the pre-existing supplier), with several services sub-contracted to third parties. However, the client needed to ensure that none of the services were sub contracted to off-shore companies due to compliance with regulatory requirements. Thus, the suppliers were required to be absolutely transparent about their intent to outsource.

The participants in the negotiation process were experienced in IT outsourcing. The client had quite an in-depth understanding of the challenges and risks – having been through the outsourcing negotiation previously, and seen the arrangement evolve through to end of term. There were several external experts involved as well. However, there was too much emphasis placed on the technology (as opposed to the delivery of services) in the contractual agreement.

With so much focus on specific technology – technology which rapidly changed during the term of the agreement, the contract that was formed grew out-dated very rapidly. What were relevant and attractive options at the time of contract negotiation was soon out-dated by newer technology available in the market. The client was unable to keep pace with the rapidly evolving technology, because the contract did not have any provisions for maintaining technology currency. There were also no mechanisms for continuous improvement or innovation.

What was needed during negotiation was a more holistic approach, with the resultant contract supporting optimal work practices, continuous innovation, streamlining of business processes, capitalising opportunities for cost reduction and increased service levels.

➔ Learnings:

- There were more stringent KPIs / service level agreements in the contract than the first time the services were outsourced by the client.
- Significant effort was required to manage the transition from a single vendor to a multiple vendor arrangement.

- The transition was planned step by step and took over six months to plan and execute.
- However, one of the suppliers, the small firm, was heavily reliant on the client to sustain their business. This posed a significant risk to both parties. The risk was discussed at the negotiating table and options explored to share the risk between the client and the supplier.
- The client was also, now several years into the initial outsourcing arrangement, heavily reliant on the existing supplier – having no capability or expertise to do the same function in-house. So, the client had limited alternatives to a negotiated agreement.
- As well as being cost-prohibitive to transition services completely away from the initial supplier, it is also not feasible at other levels. The only option was to keep the initial supplier – but to introduce a new supplier (or suppliers) into the mix – and have a multi-vendor outsourcing arrangement, with some of the services taken away from the initial supplier and spread across several vendors.
- Because of the number of suppliers involved in the resultant outsourced arrangement, governance of the relationships consumes a lot of resources.
- Improvements in service levels, accountability for innovation – lost in the current set of SLAs / KPIs, which focussed heavily on technology.
- The growth the client has had in the past few years has been supported by the outsourcing arrangements – it would not have been possible to sustain this growth if the services were provided internally.
- The splitting of the outsourcing services between several, "best of breed", suppliers was a positive move. It reduced the monopoly held by the main supplier and introduced a higher level of accountability.
- However, the governance of the multi supplier agreement does require more effort.

A5.7 Case Study 7

Client had an existing, mature, outsourcing relationship with the supplier.

The Supplier was providing ICT services to the client under an outsourcing arrangement that was nearing the end of term.

Contract renewal negotiations were aimed at driving down costs.

The supplier was maintaining an average level of performance – customer was mostly satisfied. The supplier was performing against agreed SLAs, and these adequately aligned with the organisations priorities. However the client had experienced a change of strategic direction – there was an increased focus on reducing operational costs. When the tender was up for renewal, the customer went to market to test the market for pricing for similar services provided by the incumbent supplier. The incumbent was invited to apply for the renewal as well.

The successful supplier was expected to perform the same service at a reduced cost with increased reporting regime on SLAs. From the initial set of 100 odd SLAs, the requirement had changed to encompass over 200 complex SLAs, which now required to be reported against, on a monthly basis. The incumbent was re-engaged for a further 5 years. However, the supplier had to severely compromise on price to keep the business. They agreed to increase workload and maintain the same (if not higher) level of quality of services. The supplier did not consider the consequences of agreeing to such a deal. The supplier did not consider any other alternatives to a negotiated agreement. Walking away from the outsourcing arrangement was not considered as an option.

As a result, the services suffered in the long term, the reduction in price meant that the supplier had to reduce the amount of resources dedicated to the client. This was the only way they could make any profits. The reduction in staff had the overall effect of a reduction in the quality of services. The supplier’s personnel also had to do more with less – more

SLAs to report on, less people to do the work, staff being made redundant due to less $$ coming in from the client, more expected from those left behind, so morale was low. The quality of services delivered to the client began to suffer. The customer satisfaction level began to degrade. The relationship began to deteriorate – further compounding the problems.

➔ Learnings:

- When unreasonable expectations are placed on the supplier, such as increased level of services at a reduced cost, the overall relationship and the IT outsourcing agreement is at a threat of failing in the longer term.
- No matter how attractive the potential profits may be, or how un-attractive “walking away” seems to be, signing up to conditions that are un-sustainable in the longer term is not wise.
- An unreasonable price may force the supplier to reduce the quality of services to sustain profits.
- Forcing the supplier to agree to a compromise on price may seem like a “win” to the customer. However, in the longer term – both organisations will suffer.
- A mutually beneficial agreement is more likely to endure to the full term and produce better results rather than an agreement that unfairly disadvantages one party.

A5.8 Case Study 8

The client anticipated growth in future business opportunities. The client’s current IT environment did not support this growth. By outsourcing a specific IT function (application development), the customer wanted to take advantage of superior skills of a reliable industry partner. The client did not want to invest on creating this capability in house. IT application development was part of the core objectives of the client. The client was in the financial services industry and it did not align with business objectives to spend on IT application development. There was no need for ongoing IT application development. The decision was made to outsource IT application development.

The client had some knowledge in applications development – having built a system at the early stages of the organisation's growth. But this capability was not currently present in the organisation. The client wanted to seek an external organisation to design, build and operate a new system for a number of years. The requirements were loosely articulated. The negotiation/selection process was also not structured. One of the executives of the client organisation, knew an executive at the supplier organisation – and this friendship enabled a deal to be struck based on a broad understanding of the requirements. Specific details of what were required, how success was going to be measured or the eventual price was not specifically discussed.

The expected value of the outsourcing arrangement was $2milion.

Subsequent scope changes, and the evolving understanding of what the customer really required, meant that the original "expected" cost was substantially exceeded.

As a result of the continuous change in expectations and scope of services, the supplier kept missing target dates of completion. The cost to the customer also kept climbing.

Thus, the relationship between the client and the supplier started to deteriorate.

Eventually, this led to a lengthy legal dispute – when the intervention by lawyers from both parties failed to resolve disputed claims and formulate a rectification plan, a legal proceeding was initiated. The legal proceedings came at a significant additional (and unexpected) cost to both parties. And the relationship was irreparably damaged. The friendship of the two executives could not withstand litigation.

The IT system that the customer was so keen to put in place was vital for bidding for new business opportunities. The customer could not bid for these opportunities with the existing

IT system. The new system was not delivered in time, (not delivered at all), which severely disadvantaged the client. The client's competitors in the marketplace were able to grasp opportunities that the customer was not yet ready to bid for, causing further losses to the customer.

➔ Learnings:

- It is not wise to rely solely on the strength of the relationship when embarking on an IT outsourcing agreement.
- The contract formulated needs to specify expectations clearly, with specific deliverables and time-frames as well as the expected quality of services to be rendered and other measures of success critical to the outcomes of the customer.
- The contract also needs to specify how disputes will be resolved and how the relationship will be managed.
- There needs to be an agreement on how scope changes will be handled and the price of such changes.
- The contract needs to deal with financial and other terms and how risks will be handled.
- Delays and non-delivery of expected results should also elicit penalties – and these should be clearly stipulated in the contract.
- If issues are discovered during the up-take of responsibilities, the supplier should have mechanisms to renegotiate terms and conditions of the contract.
- Relying solely on the relationship – without a contract to support the endeavour, may increase the likelihood of the IT outsourcing agreement failing.

A5.9 Case Study 9

Not Used.

A5.10 Case Study 10

The IT function being outsourced was proving highly problematic to the client. Well known to internal consumers, for many years, was the IT function's inability to meet the demands of the organisation. This was perceived to be due to process in-efficiencies, under skilled and apathetic staff, inferior tools and out-dated systems. The staff on the other hand, complained about being over-worked, under paid, having to endure ever-increasing demands, un realistic deadlines, increasingly being unable to take days off and have proper weekends, and subjected to verbal abuse from internal customers. This in-turn had increased their level of frustration with the job, and all but a few had left. The new staff struggled without proper training.

The IT services rendered were tightly integrated with business processes. Thus all the tools/processes being used were highly specialised and tailored to the organisation. The processes being used by the IT function were not based on any industry standards or best practices – they just evolved over the past 20 years, as the organisation itself had evolved and grown from a small enterprise to a large ASX listed firm. The processes (if at all there were processes), had been created and modified largely under the guidance of the oldest serving member. The oldest serving member of the IT function (not the operational manager) seemed to be highly insecure about her position and thus held onto control of many specific tasks and did not readily share knowledge with the new staff. There was a high turn-over in staff as well as constant change in the leadership of the IT function.

The impact to the organisation as a whole was significant. The IT sub-unit provided services that were critical to the success of many other business units and the Managing Director of the company suspected it was indirectly impacting the overall success of the organisation. However, no specific study had been conducted to confirm this belief. Also, because the IT unit was well known within the company to be in-efficient, many other issues were incorrectly associated with the IT unit.

There was also a lack of consistent leadership for the IT unit. Appointments to the manager of the IT unit went through a constant revolving door with appointments being made several times a year, Each new incumbent blamed the predecessor for all the problems, and undertook, even guaranteed, to improve and completely turn around the operational success of the IT unit. However, as the true extent of the problems became apparent to the individual, or as each individual tried their different strategies to address the underlying issues, sometimes making the situation worse, the organisation lost patience with the individual's effort and the manager was either replaced or left on their own accord.

The CIO had been appointed recently, and had fired the previous operational manager. An ultimatum had been issued by the new CIO to the new operational manager to "fix the problem" in less than 3 months or face the consequences. The CIO had in turn been promised lucrative incentives to get the problematic IT unit into shape.

The CIO of the client and the CEO of the vendor had been former business colleagues. They had done business together several times in the past. They had agreed over a social drink that it would be a good idea to outsource the problematic function to the vendor. The client's CIO informed the operational manager to ditch any plans to "fix" the problematic business unit and just outsource it. The decision was made on personal expectations, power and politics, not based on costs or capability to deliver. The mandate to the operational manager was not to explore the validity of the decision, or any weaknesses of flaws in the approach – but just to "make it happen".

However, on closer scrutiny / deeper questioning, the operational manager agreed that the CIO may have had reasonable expectations that the vendor was capable of delivering the services adequately. This perception may have been due to the level of "trust" and credibility in the marketplace, as well as previous personal experiences that the CIO had with his former colleague, rather than with the vendor organisation.

The negotiation was conducted in an ad-hoc manner. No industry standards or knowledge was sought. No external parties were consulted. The newly appointed Operational Manager from the client side initiated discussions with the Account manager from the vendor corporation. Initially the discussions focussed on communicating the decision to outsource – and how this might be achieved, and how long the process will take. The operational manager had no previous experience in outsourcing in general, let alone IT outsourcing. The mandate was to outsource and start transitioning operations within 3 months. The decision was to be kept confidential – none of the client's IT unit staff were to be told, and the staff was expected to be made redundant once the transition had been completed. One of the key challenges in the negotiation process was the lack of knowledge. The vendor had agreed in principle to take over the operations of the IT unit without fully understanding the intricate details of what these operations entail. They had some specialists in the domain area. However, the processes (where processes existed) seemed to be tightly integrated with each different internal customer-business-unit that was being serviced. So, in other words, the IT unit operated differently, depending on whom they were servicing. No set processes. The decision on which process was appropriate was made by the individual concerned and sometimes with consultation with the oldest serving member.

The dates of transitioning operations were mandated by the customer – regardless of whether it was feasible to establish a contract and start transitioning operations within 3 months – without the IT sub-unit's staff being alerted to the prospect of losing their jobs.

The negotiation process was largely in-effective between the vendor's Account Manager and the client's Operational Manager. They could only discuss the main principles of the arrangement. As specific information was needed to set price, service delivery expectations and other aspects of the agreement, the operational manager had to involve some of the IT unit's staff. However, the selected few were sworn to secrecy and did not include the oldest serving member. The vendor's account manager involved the specialist from their organisation to liaise with the selected IT unit's staff to try and learn the specific operational information needed to establish the outsourcing arrangement and start transitioning the efforts. There was significantly more time and effort involved in this activity than originally anticipated. The vendor had to dedicate a specialist resource to this activity for initially several days per week. However, it became apparent that the vendor will need to dedicate several specialist resources towards this project for possibly the entire 3 month period, as the customer was so in-experienced in the outsourcing endeavour.

The customer in turn severely under estimated the effort of "outsourcing". Expectations were that once the decision was made to outsource, that the workload would start reducing for the internal staff. However, in the short term, while the vendor was brought up to speed on operational issues, the workload increased significantly.

There were also human resources issues that were not at all handled properly. The oldest serving member got increasingly more insecure about her position, as she felt left-out of meetings and generally felt that people were doing something behind her back. She incorrectly assumed that she was being targeted for a dismissal. So she became increasingly "closed" about specific details of what she was doing, and the decisions or changes that she was making. All this contributed to a considerable amount of confusion. The processes (on the certain occasions where processes existed) were not documented. They were verbally passed on from member to member of the IT sub-unit. Each operation unit staff member also did things in his/her special way. So, no consistent manner in which the operational activities were being done. Several workshops (over a 6-8 week period) were held by the vendor (with the IT unit's staff members being completely unaware of the underlying reasons why), to glean this information. It was then that the decision was made to bring a few members of the IT unit into confidence. But the situation was extremely complex with the oldest serving member, and others in the IT unit not knowing that the decision had been made to outsource had already been taken. The vendor then negotiated with the client that the whole IT unit be informed, and that knowledge transfer be undertaken in an open and organised manner. However, when the news was given to the rest of the IT unit, the human factors/reaction to this news was severely underestimated. It took a further several weeks to convince the IT unit staff that it was in their best interest to cooperate with the decision – and that the decision will not and cannot be revoked. The entire 3 months passed without a contract being established, a significant amount of time, effort and resources being expended by both parties on the IT outsourcing endeavour, without any tangible achievements. The whole period was like a "learning period".

It was then decided that the best course of action was to forcibly transition operations as is – without a formal contract being in place. A MOU was drafted instead. The vendor dictated a set fee per month for delivering services with the option to adjust this fee once the operational details and expected service delivery requirements were fully known. The monthly fee demanded for the services were significantly more than the current operating costs for the IT unit *(nearly triple that of the current costs). No personnel were to be exchanged. No assets changed hands. One person from the vendor's operational staff was to be permanently located at the client's premises until the operations were fully transitioned, and then the client could appoint staff of their choosing to manage the vendor or govern the agreement. This ongoing requirement was also not anticipated by the customer. The customer had assumed that any ongoing activity on the client side would consume insignificant resources. There had been no plans on who will undertake these governance activities – and no budget had been allocated for any resources.

The vendor ended up taking over the operational activities gradually over a 4-6 week period. There was significant resistance from the existing IT unit staff, so the client organisation suffered badly during this period. Any issues were happily blamed by the IT unit's staff on the outsourcing provider. The client organisation's internal customers then had a pre-conceived negative opinion of the outsourcing provider.

The vendor organisation had to dedicate far more resources and effort towards this outsourcing project than initially anticipated. They had to appoint a new staff member to be solely focussed on overseeing this particular outsourcing transition project. The staff member was then to continue to manage the client/outsourcing relationship once the contract was established.

The contract details, including price and terms and conditions, were dictated largely by the vendor, having taken over operations and after fully understanding the complexity of the services involved, they successfully convinced the customer that the exorbitant fees and charges proposed were appropriate. The customer had handed over the operations under a memorandum of understanding, had no prior experience of outsourcing and had no benchmark of what a reasonable price should be. The terms and conditions were heavily contested – however, the customer was at a severe disadvantage, having handed over operations. One of the terms that the customer mandated was that the operational activities, which were highly customised to fit in with the client organisation, remain unchanged. This served as some assurance to the rest of the client organisation that even though the decision had been made to outsource, that this decision would not negatively impact them. There was so much pessimism around the decision to outsource, and negative perceptions of the vendor internally within the client organisation, that the promise of keeping things the same seemed to appease the customer.

The participants in the research study were reminded by the PhD researcher, that "keeping things the same" seemed contrary to the initial mandate – i.e., they were not happy with the current state – that is why a decision to outsource the business function was made in the first place. It seems during the initial period of negotiation and subsequent attempts at transitioning the effort, the situation had deteriorated so much that the original state of affairs seemed to be far more appealing.

However, several months into the contract, the vendor decided to adopt industry best practices instead of continuing with the client's practices, because it was becoming cost-prohibitive to operate in that way. The vendor set a ridiculous price if the customer continued to mandate that the old procedures need to be adopted. So, the client organisation had to undergo extensive amount of changes (business process re-engineering and changes to applications, reports, etc.). They also need to train staff on the new procedures. This did not go down very well. There was a lot of resistance to change – particularly when each internal customer-unit was promised that there would be no changes as a result of the IT outsourcing.

At the time of the review of this case study, it was approximately 3 years after the transition. Things seem to have settled down. The initial term was set for 3 years, but was extended to 5. The customer considered the outsourced services of reasonably good standard. The customer lamented that the price was still exorbitant, however, sustainable. The vendor was possibly making a healthy profit considering the processes are streamlined and based on industry best practices. However, they had to invest in new systems and software applications to cope with the customer demands. The investment on new technology was not discussed during initial negotiations. But, the customer had agreed to absorb some of the. The vendors could possibly gain further efficiencies by employing the same software tools, processes and resources to provide services for several other customers, and thus reduce their operating costs.

Having the customer on their client list, and the most up-to-date tools/software as well and industry best practices also enhanced their chances of winning further lucrative deals with other organisations.

The client possibly benefited in the long run - although the cost and the complexity of outsourcing had been severely underestimated. The streamlined processes meant better services. The initial glitches with the rollout of the new processes, such as needing to retrain the customer community and re-engineering business processes, had all been sorted out. The initial negativity with the vendor has died down.

Because there was no formal service delivery objectives set out in the initial contract – there was a lot of ongoing negotiations and re-negotiations of terms and conditions well into 2nd year of the contract. There were still no real measures agreed on "success". "Success" seemed to be a concept that was constantly changing in definition. The initial goals seem to be irrelevant now. Both parties were looking forward to setting some firm measures when the contract was re-established at the end of the term (5 years). They also wanted to ensure some method of constantly reviewing SLAs and closely monitoring them to make them remain relevant throughout the next term of the contract. The customer understood now that governance of an IT outsourcing arrangement will be a significant, ongoing requirement.

Whether it was a good decision to outsource the IT function is debatable. It would have made more sense to address the problems in the IT unit – rather than "outsource the problematic function to get rid of the problems". If the client had implemented industry best practices and sorted out the human resources issues, the outcomes may have been equally successful and much less costly.

➔ Learnings:

- Some specific challenges in this particular outsourcing negotiation:
- The process of negotiating and establishing the contract, the parties seemed to be learning as they went. There was no real negotiation process or specific style adopted. The decision to outsource had already been made, and the vendor pre-selected when the parties came together. So, the whole process was heavily influenced by power and politics, and personal expectations, rather than the capability to deliver.
- The negotiation was not structured

- The negotiation was not based on price. In the end, the price the customer had to pay for these services far exceeded their internal operating costs. There were also many hidden costs that both the supplier and client failed to anticipate initially.
- Of particular note was the amount of effort, time and resources that it took to establish the outsourcing arrangement and transition the operations.
- Knowledge transfer was particularly difficult and wrought with several challenges.
- Human factors / Personnel issues brought a whole new element to the on-ramping/ transition process.
- The negotiation and the contract established was not a successful one– by the definition provided by the Researcher, or by the interviewees' personal expectations.
- It is not wise to rely solely on the strength of the relationship when embarking on an IT outsourcing agreement.
- The contract formulated needs to specify expectations clearly, with SLAs, pricing structures and other governance mechanisms.
- The contract also needs to specify how disputes will be resolved and how the relationship will be managed.
- There needs to be an agreement on how scope changes will be handled and have pricing structures that accommodate changing needs of the customer.
- The contract needs to deal with financial and other terms and how risks will be handled.
- The damaging influences of the outsourcing endeavour, including how staff and transition of services are handled needs to be carefully considered during negotiation.
- A lot could have been done better. Both parties noted that framework such as the one proposed by this PhD thesis would have helped significantly.

A5.11 Case Study 11

The negotiation being examined was not to establish a new IT outsourcing arrangement, but the negotiation to extend an existing outsourcing agreement, with the incumbent supplier, for a new term.

The contractual agreement for IT services being rendered by the supplier was nearing the end of term. The client and supplier had each entered into the outsourcing agreement approximately 3 years prior. The initial costs anticipated by the client, had been well exceeded. However, there were no significant concerns from the client organisation to extending the contract for another 3 years, provided the costs could be brought down. There were some changes anticipated in the client organisation / business environment in the coming year. This could alter the contract terms and conditions significantly. The client was heavily dependent on the supplier for the IT services rendered. The IT services were critical to the client's organisation's overall success. The client had increased awareness that these functions underpinned some of the upcoming strategic initiatives. If the client was to maintain market competitiveness, it needed to assure that the delivery of these outsourced IT services were consistent and of adequate quality. There needed to be more rigour with which the supplier was monitored and with which the outsourcing relationship was governed. There were other suppliers who could deliver the same services, but the incumbent supplier was deemed to be one of the best. However, it was perceived by the customer that the supplier, having many other customers, and being a large multi-national organisation, did not consider the customer as very important, or that this outsourcing arrangement was an important relationship for the supplier.

For the vendor, the relationship with the client was a lucrative one. The client was a multi-national large sized firm, and seen as a leader in the market place. Other potential customers were impressed when the vendor mentioned the customer's name as a reference-able client. Maintaining a good relationship was far more important than the outsourcing deal. And a good relationship was possible even without the outsourcing deal because the client organisation frequently purchased ad-hoc products and services from the vendor organisation. Because of the past, long-standing association, even if they failed to do any new business together, the supplier could call upon the client to act as a referee to new potential clients. It is for this reason the relationship was of great importance to the supplier – more than the outsourcing deal itself.

The outsourcing arrangement facilitated many opportunities for the vendor to add-value to the client organisation. Those additional opportunities, and thus, increased revenue for the supplier, would not be possible without the outsourcing arrangement being in place. The existing outsourcing arrangement gave an “inside edge” to the supplier over other suppliers. They got to know about opportunities first, and had better knowledge of the opportunities/environment so they could easily out-bid other suppliers for the same piece of work.

Also during the transition of the initial outsourcing arrangement, the supplier had uncovered that the client’s high call volume to the IT support centre was partly due to a new technology being rolled out to the client’s business without training being offered to the users on how to use the new tool effectively. The supplier was able to significantly reduce the call volume, and thus, the ongoing effort and resources required, by proposing the client purchase some training (at an additional cost). The profits for the supplier, through this outsourced arrangement, was therefore much higher than initially anticipated. However, this unexpected increase in costs did not sit well with the client, which was one of the reasons for trying to bring the costs down during the renewal negotiation.

The outsourcing arrangement was with one single vendor, (the incumbent), and the re-negotiation was only conducted, at least initially, with the incumbent supplier.

The client organisation was well prepared for the negotiation – with solid understanding of what it would consider a reasonable price, and what variables/alternatives it could pose to entice the supplier to bring the price down - but the negotiation was heavily focussed on price. The customer was willing and able to sign a longer-term contract to ensure the price came down to their expectation. The client was reasonably confident that these alternatives were adequate and having conducted a market survey of what other suppliers were charging for similar services, was confident that the asking price was reasonable. Hence the client considered the new contract all but sealed and delivered.

The vendor organisation had a good understanding of the client organisation's general needs and operations, having been in the existing outsourcing relationship for nearly 3 years. Furthermore, the supplier was also aware that the outsourced services being rendered were critical to the success of the client's organisation. The client had been very successful during the past term of the contract, and the vendor had no doubt that some of that success could be, at least indirectly, attributed to the quality of outsourced services being rendered by the vendor. The vendor was seeking a bigger slice of the pie, so to speak. The profit margins were already very healthy, but the expectation was that it could be even better in the new term.

In terms of the outsourcing arrangement, the vendor was reasonably sure that there were no concerns, although the relationship was not being actively governed. "They hadn't heard any complaints!" Thus, the vendor approached the negotiation as if the renewal of the outsourcing arrangement for another 3 years was a "done deal".

The negotiation process was discussed and agreed by parties at the initial meeting, along with timelines and agreement on who the decision makers were from each organisation, and who to involve in the negotiation process. The approach was for each organisation, the client and the supplier, to make presentations to each other's executive teams, on the strategic direction of their respective organisations. In their presentations, the organisation included, impending or current challenges they faced, any specific changes that are upcoming during the next 3 years, and any relevant information about the marketplace or external business environment, that could indirectly impact the outsourcing arrangement.

The supplier was also asked to prepare a quote for the next 3 years, and the client prepared their estimates for how much they were prepared to spend. The client hired a specialist resource, with previous expertise in IT outsourcing, to assist with the outsourcing negotiation. The vendor dedicated one resource to work closely with this person, to understand, at a deeper level, all aspects of the outsourcing arrangement being negotiated.

Unfortunately, the negotiation did not eventuate in a deal being signed. The vendor could not meet the customer's expectation on price. The negotiation was heavily based on price despite both parties knowing that the supplier had capability to deliver. There were discussions centred on creating opportunities for mutual gain. However, in the end, the decision was solely dictated by the price of services for the next 3 years. The client was not prepared to accept a compromise on the price. The parties agreed not to proceed with another term.

The client had conducted brief survey of other suppliers in the marketplace, but did not actively engage in any discussions/negotiations. The client decided that it was best (cheaper) to bring the effort in-house, and instead shifted strategies to discuss with the incumbent supplier on how best to transition the services to a newly (yet to be appointed) internal team, with minimal disruptions to the client organisation.

Was the negotiation process successful? Arguably, yes. The client certainly believes so. However, the supplier was disappointed that it was so heavily focussed on price. The supplier did try to engage the client in discussions based on exploring alternatives or seeking opportunities for mutual gain. However, the options put forward did not interest the client. The client was less inclined to explore or present any opportunities of their own or to shift their focus away from the price. In this context, the negotiation was perhaps not a principled one.

The negotiation itself did not result in the signing of a deal. However, the relationship between the parties did not deteriorate. The focus was shifted to engaging the supplier to ensure a smooth transition. Additional services/resources were bought under the existing outsourced arrangement, to ensure that knowledge and skills from the supplier were effectively transferred to the client, and that the operational activities were handled jointly during the transition time. Some of the supplier's staff, located at the premises of the client for the past 3 years, felt personally affronted by the decision – they viewed it as a bad reflection on their efforts for the past 3 years. This caused some unexpected negativity and friction between the client and the supplier. There was also a lot of initial reluctance from the supplier's staff to aid the client's newly appointed team in getting up to speed. However, the client advertised for a number of positions (to take over the functions previously serviced by the supplier). These were highly paid positions, with significantly more benefits than what the supplier's staff were currently getting. When this happened, the incumbent outsourcing supplier's staff's attitude changed. Those located at the customer's premises were keen to demonstrate that they could easily fill these positions, and come across as internal client staff. Those back in the supplier's premises were keen to get known by the client, so went over and above the call of duty to get noticed. So, suddenly, the quality of services seemed to improve. The customer admitted to the PhD researcher that, had the client known how good the level of services could have been – i.e., if the level of services were as good as the final few weeks, during the transition, then the client may have been open to paying the fees demanded by the supplier during the negotiation.

During the transitioning, it became apparent that either party had not actively governed the outsourcing agreement. Hence the supplier was not aware of some of the perceptions held by the client – including problems, issues, challenges. At the time when the client organisation initially outsourced their IT function, it was experiencing significant issues with their network and this resulted in poor applications performance. A number of initiatives were already underway to implement new infrastructure, however, the initial measures of success included a number of metrics to ensure a certain level of network / application performance was delivered. Once the new infrastructure was in place, the main concerns shifted away from network performance to another source of business frustration. However, since the contract was never reviewed, the original measures of success were still being reported on, and "skimmed over" in the monthly reports, the more pressing needs of the client, their new and "implied" measures of success, was not being reported on, or discussed.

Most of the assessment of the supplier's performance, by the client organisation's wider internal community, were based on perceptions of success or failure and not based on actual measurement of service delivery data. The supplier was un-aware that these perceptions existed, and that the issues could have been remedied with proper communication and collaboratively working with the client. If the supplier was unaware of problems, or largely assumed that the outsourcing arrangement was progressing well, how then, can they be expected to address any issues? The supplier also did not make any attempts to actively manage the relationship, or seek to understand how things were really progressing at the client site. The approach was "no news is good news". Unfortunately, this approach may have ultimately costed them a lucrative deal.

The client organisation had in the meantime undertaken a long-term strategy to acquire another company and merge the two IT departments into one. The operational manager did not know this strategic decision during negotiations. It may have significantly changed key decisions made during negotiation – and it may have changed the outcome of the negotiation.

➔ Learnings:

- Although the process of negotiating was reasonably structured and was conducted in a rational manner – not based on power, politics or personal expectations, and where parties sought to understand each other's interests and needs, it was heavily based on price. Thus parties did not fully explore opportunities for mutual gain.

- The relationship had not been governed effectively, there were underlying issues that were not addressed during negotiation.
- The client may have limited their options by focusing only on price and not considering any of the opportunities presented by the vendor.
- The decision to in-source may or may not have been the correct decision. It was certainly based on the perception that the customer's current quality of services was as good as it gets. Had the client known the true capability of the supplier – and if the supplier had understood any underlying issues or perceptions and addressed these – then the outcome may have been different.
- Human factors / Personnel issues did play a role in the negotiation / transition process. The effect of these issues was severely underestimated.
- The negotiation and the contract established was not a successful one– by the definition provided by the Researcher.
- Both parties commented that the process could have definitely been improved by adopting a framework such as the one proposed by this PhD thesis.

A5.12 Case Study 12

Not Used.

A5.13 Case Study 13

Not Used.

A5.14 Case Study 14

Not Used.

APPENDIX 6: EVALUATION FORM

The outcome of the PhD Research Study conducted by ***Subha Chandar*** is a decision support tool, in the form of a ***Framework for Negotiating IT Outsourcing Agreements***.

You are invited to assess the efficacy and completeness of this tool or framework.

The measure of success against each criterion described below, can be obtained by applying the use of the framework, in the practice of negotiating an IT outsourcing agreement. If a direct application is not possible, you can also use one or more, past industry-based, real-life (not simulated) instances, where you were directly involved in the negotiation of IT outsourcing agreements. You can make an assessment regarding how the use of this decision tool may have aided in the Negotiation of such an agreement.

For each criterion, please *circle a number* indicating the level of success of the framework.

1. **Indicate the level of improvement to the process of negotiation, as a result of using this framework.**

   1 - None 2 - Negligible 3 - Some 4 - Considerable

2. **Indicate the usefulness of the framework in highlighting factors that need to be considered prior to conducting an IT outsourcing negotiation.**

   1 - None 2 - Negligible 3 - Some 4 - Considerable

3. **Indicate the usefulness of the framework in providing guidelines on a suitable negotiation style and techniques to use when negotiating IT outsourcing agreements.**

   1 - None 2 - Negligible 3 - Some 4 - Considerable

4. **Indicate the usefulness of the framework in preparing for negotiating IT outsourcing agreements. (Eg. providing topics or factors to be considered for discussion during the negotiation; providing structure to the process of negotiation).**

1 - None 2 - Negligible 3 - Some 4 - Considerable

5. **Indicate the usefulness of the framework in establishing a contract with success criteria and mechanisms to measure these criteria objectively.**

1 - None 2 - Negligible 3 - Some 4 - Considerable

6. **Indicate the usefulness of the framework in creating flexibility in the contractual arrangement i.e., The resultant contract allows for the planned re-negotiation of certain terms and conditions; it allows for early termination under certain circumstances.**

1 - None 2 - Negligible 3 - Some 4 - Considerable

7. **Indicate how the resultant contract may cope with changes to the organisations' priorities, strategic direction and structure.**

1 - Does not allow any such changes,

2 - Allows negligible changes,

3 - Allows some useful changes,

4 - Has mechanisms to cope with changes to organisational priorities and strategic direction.

APPENDIX 7: PUBLICATIONS AND CONFERENCES

The PhD researcher has published the following papers:

1. Chandar, S. and Zeleznikow, J. (2006) "The need to negotiate and govern Technology Outsourcing Agreements", Proceedings of the 7th International WeB (Working for E-Business) 2006 Conference, November 29 and 30th - December 1st, 2006, Victoria University, Melbourne, Australia, pages 176-185. ISBN 178-1-86272-670-3

2. Chandar, S. and Zeleznikow, J. 2007. "A Structured Approach To Negotiating Information Technology Outsourcing Agreements", Proceedings of the Fifth International Conference on Law and Technology (IASTEAD) September 24-26 2007, Berkeley CA, USA: 18-23.

3. Chandar, S. and Zeleznikow, J. 2009. "Risks To Consider When Negotiating IT Outsourcing Agreements", Proceedings of GDN2009, the 10th annual meeting INFORMS section on Group Decision and Negotiation, Toronto, Ontario, June 14-17. ISBN 978-0-9812745-0-8

4. Chandar, S. and Zeleznikow, J. 2010. "Negotiating Information Technology Outsourcing Agreements", Proceedings of GDN2010, the 11th Group Decision and Negotiation Conference, G. J. De Vreede (ed.), Delft, Netherlands, June 21-23, University of Nebraska at Omaha: 140-151, ISBN 9789056382360

The PhD research study has been presented at the following academic conferences:

- "A Framework for Negotiating Information Technology Outsourcing Agreements"

20th Australasian Conference on Information Systems,

Monash University: Caulfield Campus, Melbourne, Victoria, Australia. Date: 2–4 December 2009,

- "Techniques for Negotiating IT Outsourcing Agreements",

  Third International Workshop on Online Dispute Resolution In conjunction with the 18th Annual Conference on Legal Knowledge and Information System (Jurix) *Vrije Universiteit Brussels (Belgium),* December 10, 2005

- "Considerations when Negotiating IT Outsourcing Agreements", NADRAC 3rd National ADR Research Forum, Melbourne, Victoria, Australia, July 2007.

- “Risks to consider when negotiating IT outsourcing agreements”, *3rd International Biennale On Negotiation: Negotiation Strategies and Risks: Research and Applications*, November 14 & 15, 2007 at NEGOCIA, Paris, France, 2009 (Distributed as a paper).