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Yuanyuan Chen
Emory University, yychen@bus.emory.edu

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Information Technology Outsourcing Contracts: An Empirical Analysis on Contract Structure and Performance Implications

Yuanyuan Chen
Goizueta Business School
Emory University
yychen@bus.emory.edu

ABSTRACT

The study examines two dimensions of IT outsourcing contract structure: contract specificity and flexibility. We posit that the contract structures are influenced by (a) relational elements such as prior interactions, current nature of relationship between the contracting parties, and future interactions; and by (b) the attributes of transactions such as investment specificity and task and technology complexity of the outsourcing activities. We argue that balancing out the contract structure in terms of specificity and flexibility will influence the outsourcing performance and relationship management. Well-designed balance between contract specificity and flexibility is more likely to lead to the outsourcing success. Using publicly available data from 112 IT outsourcing contracts, we empirically test the proposed model. Our analysis provides evidence that relational elements significantly explain contract specificity and flexibility in this sample of contracts. The results suggest that relational factors are important to the management of inter-firm relationships in outsourcing exchange. Furthermore, we find that more investment specificity and task complexity are associated with higher levels of contract specificity and flexibility. Choices of contract structure influence the outsourcing outcomes. Our study, based on examination of contract terms in IT outsourcing contracts, provides guidelines for the design of service contracts, especially for IT outsourcing contracts and business-process outsourcing contracts. It supplements the current limited understanding about contract design and management.