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Threat-Balancing in Vendor Transition

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ABSTRACT

While many outsourcing contracts are expiring, and vendor transition is becoming an increasing concern, little research helps organizations manage vendor transition. This paper explores vendor transition across two case sites. In one case, the outgoing vendor cooperated with the client which resulted in the client distancing itself from interactions between vendors. In the second case, the outgoing vendor was openly hostile, with the result that the client allied with the incoming vendor to manage vendor transition. These findings mirror expectations from balance of threat theory, a political science theory about interactions between nations. Balance of threat theory predicts that outgoing vendor hostility and the capability of the client to mitigate hostility determine whether a client takes a hard or soft balancing strategy during vendor transition.

Keywords

Outsourcing, vendor transition, balance of threat, power

INTRODUCTION

Almost all of the substantial research on outsourcing explores the client's interaction with the initial vendor. However, IT outsourcing is now a mature industry, generating exchanges of over USD 200 billion in value (Whitten and Leidner, 2006). Given the field's maturity, one emerging trend is vendor transition, where client organizations switch from existing to new vendors. Studies suggest that between 35 and 47% of outsourced contracts are expected to be re-tendered (Willcocks and Lacity, 2006).

Vendor transition is a problem with many facets, including:

- *Transfer of physical and intellectual assets between transitioning vendors.* Being competitors, the transfer of resources between the outgoing (i.e., incumbent) and incoming (i.e., new) vendor presents a series of challenges not present in traditional outsourcing arrangements. Technologies, tools, business processes, intellectual properties and knowledge have to be transferred between vendors, not just between client and vendor. Pure monetary reward may encourage cooperation in traditional outsourcing; but in vendor transition, the outgoing vendor is reluctant to transfer assets to the incoming vendor. Such assets (eg. source code) often provide the outgoing vendor with competitive advantage in other contracts.
- *Transfer of personnel between transitioning vendors.* Knowledge of the client and the outsourced processes is often tacit, and resides with outgoing vendor personnel. A quick way to transfer such critical tacit knowledge is for the incoming vendor to hire staff from the outgoing vendor's team. However, the outgoing vendor is likely to block such transfers as it decreases the competitiveness of the outgoing vendor vis-à-vis the incoming one.
- *Outsourcing legacy.* Unlike in an initial outsourcing condition, there is a legacy between the outgoing vendor and client. First, there may be existing contractual obligations. Given that vendors are generally more savvy than first-time clients, the initial outsourcing contract tends heavily to favor the vendor (Saunders, et al., 1997). These contracts limit client behavior (Natovich, 2003). For example, source code developed to support client operations could be the intellectual property of the outgoing vendor.

Second, the outgoing vendor often has privileged access. For example, the outgoing vendor may have access to sensitive client data (Adler, 2003). Given that ill-will is often present in vendor transitions (Kern and Blois, 2002), and the risk of vendor opportunism is high (Bahli and Rivard, 2003), this vulnerability is a risk the client must address.

- *Time Horizon.* Once the outgoing vendor's contract expires, the outgoing vendor leaves, regardless of whether the incoming vendor is prepared to take on the responsibility. During the period of vendor transition, the client must ensure business continuity is maintained even though proficient outgoing vendor employees are being replaced by unfamiliar incoming vendor ones.
- *Knowledge Transfer and Client Personnel Management.* Clients who are knowledgeable about outsourced business processes and operations can serve as a bridge between the transitioning vendors. However, the client has usually lost the knowledge and skills necessary to perform the outsourced operation and may no longer have the absorptive capacity to relearn knowledge and skills (Clark Jr., et al., 1995, Hancox and Hackney, 2000). The client often does not maintain sufficient engagement with the outsourced operations to retain necessary skills.

Vendor transition is therefore complex and poses very real problems. However, to our knowledge, no work has suggested strategies that managers should employ during the process of transitioning from one vendor to another. The objective of this research is to *explore and identify effective strategies client managers could employ during the vendor transition process.*

METHODOLOGY

Given the paucity of research, we adopted an exploratory cross-case approach. Exploratory case analysis allows one to obtain an in-depth understanding of a phenomenon. We selected two vendor transition projects as revelatory cases (Yin, 2003).

To our knowledge, no research has investigated the actual transition of vendors in an IT context, hence an exploratory approach involving revelatory cases is ideal. Both vendor transitions completed successfully. However, in one case, the outgoing vendor and client parted on amicable terms. In the second, the outgoing vendor was hostile to the client.

Case 1 involved a non-hostile outgoing vendor. The case focuses on the transition between vendors during a large enterprise resource planning system project in a large Asian logistics organization, Logistico. The company employed two separate vendors to be responsible for individual phases of implementation. The outgoing vendor performed analysis and design for three subsidiaries and implementation for one subsidiary. Due to resource constraints on the part of the outgoing vendor, and the client's desire to avoid lock-in, the implementation contract for the two remaining subsidiaries was opened to tender. The incoming vendor successfully implemented the system for the two remaining subsidiaries.

Case 2 was a high threat vendor transition context involving a public organization's (Publico) online portal and customer call center. The vendors shared a more adversarial relationship as the organization expressed dissatisfaction with the outgoing vendor and felt it was not sufficiently innovative in managing the portal. The client chose not to extend its contract with the incumbent, and opted for an open tender. Although the client was less familiar with the systems and processes than in case 1, the incoming vendor successfully took over the portal.

We obtained comprehensive access to written project documentation and conducted interviews with key stakeholders representing the client, incoming and outgoing vendor for both cases. Interviews were always conducted by multiple interviewers and transcribed within 24 hours. In keeping with Pettigrew's (1990) suggestions, we focused on identifying temporal relationships between actions. We specifically examined the client's perception of the outgoing vendor, the client's corresponding strategy, and the impact of the strategy on the five issues associated with vendor transition (i.e., transfer of physical and intellectual assets, transfer of personnel, outsourcing legacy, the time horizon, and knowledge transfer and client personnel management).

DATA

Case 1

This case revolved around a massive information system implemented to replace three separate systems developed for three subsidiaries (A, B and C) in Logistico. A major consulting firm was contracted to design the information system and implement it for subsidiary A. Near the end of the implementation for subsidiary A, senior management opened tender on the implementation for B and C. They reasoned that a change in vendor could protect Logistico against vendor lock-in and the implementation should be relatively effortless as the design was already completed, and *any vendor 'worth his salt'* could implement it.

Perception of outgoing vendor. The outgoing vendor had signed a contract valued in the hundreds of millions of dollars and had about 50 capable individuals full-time on site. These people had been on site for at least a year. Some had been on hand since the inception of the project two years before. Given the size of the contract and extent of vendor involvement with the project, the vendor had some capacity to disrupt vendor transition. However, Logistico was not overly concerned for two reasons. First, client personnel had worked closely with the vendor to draft requirements.

Second, the outgoing vendor's expressed intent had been positive. For example, according to the contract, the outgoing vendor's warranty clause ended in August. Vendor personnel stayed on site to help until November, despite the fact the outgoing vendor had lost the contract in April.

We're happy they stayed around to close issues even after being paid. And we all knew. [Outgoing vendor] did their job. [Outgoing vendor] stayed around until November. The warranty ran out end August. (Logistico project manager)

Client Strategy. Given that the outgoing vendor was viewed as relatively benign, Logistico's strategy during vendor transition was to distance itself from vendor transition issues. In many instances, the client abrogated responsibility for decisions affecting both vendors. Instead of mandating a decision, the client desired vendors to resolve issues between themselves. Some cross-vendor disputes arose. For example, when the new vendor insisted that one of the processes designed by the outgoing vendor could not be implemented, the client brought third parties to arbitrate instead of directly intervening and resolving the issue itself.

The client sought to maintain a neutral stance between the vendors, even though one would naturally expect the client to be more concerned about the relationship with the incoming vendor. In fact, the relationship between the client and outgoing vendor was better than the relationship with the incoming vendor during the transition. The outgoing vendor had worked closely with the client during design and initial implementation, and so people on the ground had formed close bonds. The client and new vendor were still unfamiliar with each other.

In [first implementation] between [corporate IT] and [outgoing vendor], we had intense discussion but (it was) still (workable). It's quite cold between [corporate IT] and [incoming vendor]. (Logistico project manager)

Transfer of physical and intellectual assets. The outgoing vendor also was open to knowledge transfer, subject to the condition that the incoming vendor would not compromise on the outgoing vendor's rights and prerogatives. For example, the outgoing vendor's contract included a warranty clause. The outgoing vendor allowed the incoming vendor full access to the source code, so long as the incoming vendor did not tamper with it and therefore void the warranty.

Transfer of personnel. The client tried to respect the rights and prerogatives of the outgoing vendor, and made no attempt to "unfairly" obtain vendor personnel. For example, the incoming vendor wanted to hire some outgoing vendor staff as this provided immediate "grafting" of personalized knowledge. The outgoing vendor refused, because its staff had signed a non-competition clause. The client did not challenge the clause's legality.

Outsourcing Legacy. Perhaps because the client continued to deal with the outgoing vendor on friendly terms, the outgoing vendor made no attempt to invoke contract provisions beneficial to the outgoing vendor, or exploit its access to client data. Indeed, as mentioned earlier, the outgoing vendor provided extra support by helping to run and maintain the system during vendor transition. Logistico was grateful to the outgoing vendor, but was not too surprised. As one Logistico IT manager noted:

In the IT industry, the top level know one another. They really work on a co-opetition model. [They could be] competing on one project, but could be working together for another bid.

Time Horizon. While vendor transition occurred successfully, the client's hands-off approach threatened the success of vendor transition. Several cross-vendor disputes were never satisfactorily resolved during the handover. For example, during the handover, project documentation was not in good shape. Many documents were not updated to reflect the current status of the system.

In preparation for upstream work, we realized the documentation was not in good shape. It was not organized. They had no strict document control, like a library, to keep track of key events. It was far from there. (Incoming vendor project manager)

It should be emphasized that the poor documentation was not the sole fault of the outgoing vendor. Both the outgoing vendor and client were responsible for documentation, but documentation had been a low priority for both, as the focus had been on ensuring the system was successfully running for subsidiary A. However, the client never pushed the outgoing vendor strongly to update the documentation. As a result, the incoming vendor had to rely on source code to understand prior work.

Knowledge Transfer and Personnel Management. Knowledge transfer from outgoing vendor to client was not a significant issue as the client had involved itself heavily during all stages of the project during the outgoing vendor's implementation. The client was cognizant of the requirements, and was familiar with the design.

Post Vendor Transition. The incoming vendor completed implementation for subsidiaries B and C on time in April 2006 and 2007 respectively. The outgoing vendor left such a positive impression on the client that the client invited the outgoing vendor to bid on another project valued in the hundreds of millions of dollars. The outgoing vendor bid, and successfully won the contract.

Case 2

This case focused on vendor transition for an online portal maintenance contract. Vendor transition occurred because the client (Publico) was unhappy with the outgoing vendor's service. The outgoing vendor satisfied contract terms. However, the client wanted the vendor to be innovative and proactive with the website portal instead of only providing simple maintenance. The client acknowledged the contract did not drive such behavior:

We didn't have much control over the SLA [Service Level Agreement]...It was according to the minimum standards in the contract. [The analogy is like] If the light bulb is working and even though it's not very bright, you cannot ask [outgoing vendor] to change the light bulb because of that. It's not in the contract. (PubliCo project member)

Perception of outgoing vendor. Publico perceived the outgoing vendor as a problem. The outgoing vendor had signed a contract of about 100 million dollars and had about 50 experienced individuals full-time on site. These individuals had been on site for up to five years. Furthermore, Publico considered this a strategic application, but possessed no in-house portal and call center management capabilities. Not surprisingly, Publico felt vulnerable. Management of the outgoing vendor also exhibited antagonistic intent. During the outgoing vendor's tenure, its staff performed the bare minimum associated with the SLA. When the contract came up for renewal, the outgoing vendor emphasized that moving to a new vendor would damage the client.

They tried to frighten us with the risk of transition, which they mean it would be a disaster if we switch vendor. They were so confident. But they asked for the price of a Mercedes Benz but delivered a Camry. (User manager)

Furthermore, once the decision to switch vendors was announced, the outgoing vendor turned difficult and evasive. In many cases, the client would assert its rights to some service from the outgoing vendor. The outgoing vendor would present confounding factors, which forced the client to meet the outgoing vendor halfway. For example, the outgoing vendor did not attend the vendor transition project meetings, resulting in delay to the project handover schedule. PubliCo demanded an outgoing vendor presence in the project meetings, whereupon the outgoing vendor tried to identify schedule hurdles. PubliCo responded by adjusting meetings to the outgoing vendor's schedule.

Client Strategy. The client recognized the outgoing vendor was uncooperative, but that it would be difficult to switch. Thus, a year before contract expiry, the client began investigating ways of switching vendors. Once the client successfully switched vendors, the client allied very closely with the incoming vendor.

For other projects, it is like 'I-am-managing-the-vendor' type. Here, we worked closely as partners. We were very open with each other. If [PubliCo] couldn't do, we did, and vice versa. We didn't bring in

contracts during meetings. The relationship is that – if you fail, I fail as well. (incoming vendor project director)

Transfer of physical and intellectual assets. The outgoing vendor laid claim to portal components including the portal domain name. The vendor registered the domain name on behalf of the client. However, the client had never paid back the vendor for this. The vendor insisted on charging the client “a seven-figure sum” for the domain name.

The client refused to pay for the domain name, and instead purchased a new one. Unfortunately, customers did not know about the change, so Publico and the incoming vendor worked together to publicize that fact. A coordinated effort was made to send a physical letter to every customer. In addition, the change was advertised on radio, and a media blitz associated with football and karaoke (two activities strongly linked to the 18-30 year old, male demographic of most Publico customers) was conducted to increase awareness of the website change. The outgoing vendor converted the old portal to a “men’s lifestyle” website similar in respects to those of mens’ magazines.

Transfer of personnel. To transition successfully, the incoming vendor needed outgoing vendor call center personnel, since the client had little knowledge of the call center’s processes. The incoming vendor thus poached call center staff. The outgoing vendor complained about this poaching, but the client feigned ignorance.

[Outgoing vendor CEO] was complaining that [incoming vendor] was poaching their staff. [Incoming vendor] did go down to [outgoing vendor] for a road show. It was in an open manner and mainly for the call center staff ... All PubliCo wants is seamless transition (PubliCo IT manager).

Outsourcing Legacy. The client contract with the outgoing vendor left a lot of room for improvement. For one, the contract did not specify contractual obligations on the outgoing vendor in the event of a transition. Business continuity during the transition was thus in danger of disruption.

[Outgoing vendor] doesn’t see itself having a significant flow of business from [PubliCo] from [when they lost the contract], so they don’t need to leave a good impression. They were pulling out resources even from [existing portal]. (PubliCo IT manager)

Requests for maintenance during the transition process were generally denied. The lack of outgoing vendor support meant business continuity during the transition period could never be guaranteed. In fact, because the outgoing vendor laid claim to the source code, the incoming vendor had to redo the portal, essentially from scratch. Incoming vendor employees worked “18 hour days,” “even coming back on Sundays” to perform this task.

Also, both the client and outgoing vendor laid claim to the customer data. The final resolution held that the client owned the customer data since the client had supplied that. However, the outgoing vendor had ownership of the login IDs and passwords, as customers to the portal had provided those while creating portal accounts.

This caused two problems. First, all customers had to recreate their logins on the new portal when it launched. Second, the outgoing vendor used customer data to send newsletters about the revamped old website. Recall that the revamped website’s content differed from that in the original portal.

[Customers] also came back about the [outgoing vendor] newsletters, so we have to tell them to unsubscribe from [old website], and [outgoing vendor] has to make it easy for them to do so. (Publico IT manager)

Knowledge Transfer and Personnel Management. As the client no longer possessed sufficient knowledge of the business processes, they requested for the source code from the outgoing vendor. The incoming vendor needed the source code to determine requirements. The outgoing vendor laid claim to all source code and refused access. The client demanded access to the source code, whereupon the outgoing vendor responded that the incoming vendor would be allowed to read the code, but not bring any back to the client site.

Post Vendor Transition. Publico’s portal is active today- the first two authors are customers. However, problems with vendor transition left many individuals in Publico bitter about the outgoing vendor. The client refused to consider the outgoing vendor for future contracts. Subsequently, the outgoing vendor lost other contracts with other dissatisfied customers and shut down.

DISCUSSION

Our exploratory study suggests the appropriate strategy a client organization should take during vendor transition depends on the attitude of the outgoing vendor when the transition takes place. An outgoing vendor can adopt two strategies. First, it can pursue a strategy of enlightened self-interest by cooperating with the incoming vendor. The client responds by taking a neutral stance in the vendor transition process to preserve the good relationship with the outgoing vendor. Alternately, the outgoing vendor can pursue a hostile strategy of being uncooperative. The client responds by allying with the incoming vendor to ensure vendor transition proceeds smoothly.

The behaviors of the outgoing vendor and clients in our study parallel the way nations establish alliances to ward against threats as modeled in balance of threat theory (Walt, 1994; Walt, 1996). Balance of threat theory is a realist theory, subscribing to the belief that nations try to survive in an anarchic environment (Waltz, 1979).

Like nations, vendors and clients operate in an anarchic environment. Vendors or clients could appeal to the law to remedy a wrong, just as nations could appeal to the United Nations. However, the process of appeal is so long, that by the time the case is heard, the transition process has ended. Thus, decisions by vendors or the client to respect laws or agreements are made based on strategic necessity, and not because of respect for the law. A vendor could break an agreement or deliberately drop its service levels. Similarly, a client could perform “unsavory” acts such as poaching vendor staff.

In Case 1, both the vendors and client held themselves up to “the law,” because doing so met their strategic interests. The client could have attempted to poach outgoing vendor staff even though the outgoing vendor had non-competition clauses. Generally, non-competition clauses are difficult to enforce in law.

In Case 2, the outgoing vendor did not enact its contractual obligations. Service levels fell to unacceptable levels during the transition, and the vendor enacted barriers to inhibit knowledge transfer. Similarly, the client supported the poaching of vendor staff.

Balance of threat theory postulates that a nation’s long term stability and survivability comes from its ability to achieve a balance of power against threats. Alliances are enacted to counter nations perceived as a threat. Threat perception is measured by three factors (Walt, 1996):

- *Aggressive Intent*: These are the actions of the other nation. A nation that has through words or behavior demonstrated hostility is viewed as having aggressive intent.
- *Aggregate Power*: This is the total capability of the other nation. It includes the population of the nation, its industrial level, arms expenditure, and other capabilities to fight a war or compromise another nation.
- *Offensive-Defensive Balance*: This is the ability of a nation to defend against attacks by a particular nation. Attacks need not require direct military confrontation, but could include propaganda, embargoes, or the severance of a key oil pipeline (Rose and Van Dusen, 2002). The offensive-defensive balance takes into account such factors as geographical features, distance between the nations, and the relative composition of a nation’s military portfolio (Walt, 1994; Walt, 1996).

Within the context of vendor transition, we translate aggressive intent as the actions of the outgoing vendor. In case 1, the vendor exhibited no aggressive intent. In fact, the vendor remained onsite to support client operations without pay. In case 2, the outgoing vendor exhibited aggressive intent.

Next, aggregate power in vendor transition refers to the overall capabilities of the outgoing vendor. In both cases, the outgoing vendor had about 50 individuals on site. In Case 1, the contract was in the hundreds of millions of dollars, while in Case 2, the amount approached a hundred million dollars. Both vendors thus had high aggregate power.

Finally, the offensive-defensive balance considers the effect on the client if the vendor turns hostile. In Case 1, the effect was moderate. Client employees had worked with the vendor to create the design, and the source code was available on the client machines. In case 2, the effect was large. Client employees did not know anything about portal operations and the vendor held licenses to critical third party tools (e.g., the underlying RDBMS). Furthermore, the vendor held critical intellectual property necessary to the portal such as the domain name and ownership of the source code.

A nation enacts one of three strategies in response to its total assessment of the three factors identified by Waltz. First, if it perceives low threat, the nation will soft balance all other nations against each other. Soft balancing refers to non-confrontational and indirect strategies such as reliance on international institutions like the United Nations to counter threats. In soft balancing, a nation attempts to reduce the ability of another nation to harm it, without directly attacking the source of the other nation's power. As one illustration, the United States maintains the status quo in the Middle East by providing foreign aid to multiple Middle Eastern nations and groups (Kinsella, 1994).

Case 1 is an illustration of soft balancing in vendor transition. We observed three aspects to the strategy: (1) The client elected not to directly intervene in disputes between the two vendors. Indeed, when pressed to mediate, the client instead recruited a third vendor to arbitrate. (2) The client consciously maintained good relationships with the outgoing vendor. For example, the client did not press for updated documentation, demonstrating a spirit of give and take that recognized that the outgoing vendor had gone the extra mile in other areas such as staying on beyond the warranty period. (3) The client provided incentives for the outgoing vendor to behave well, by inviting them to bid on another major contract.

If a nation perceives another nation as a high threat, and perceives that there are actions it can take to block the threat, the nation will hard balance against the threatening nation. Hard balancing involves two practices: (1) building internal capabilities and (2) forming alliances with other nations. The goal of hard balancing is to destroy or reduce the source of the threatening nation's power.

Case 2 provides an example of hard balancing. The client developed internal capabilities by pulling in users, increasing its staffing, and getting senior management attention. The alliance with the incoming vendor was also close. The client helped the incoming vendor overcome obstacles by the outgoing vendor. For example, the client escorted the incoming vendor to the outgoing vendor's site to view source code.

The final strategy, called bandwagoning, occurs when a nation perceives another nation as a high threat, but perceives that there is nothing it can do to mitigate the threat. The nation allies with the high threat nation, ceding to it concessions out of proportion with the benefit from the alliance (Walt, 1994). The classic example of bandwagoning in vendor transition is where the client renews the vendor contract despite dissatisfaction with vendor performance. In case 2, a small amount of bandwagoning occurred, since the client renewed the outgoing vendor's contract on a short-term basis to allow vendor transition to proceed.

CONCLUSION

This research is an attempt to uncover client strategies to orchestrate a successful vendor transition, which is an increasingly common phenomenon as global outsourcing matures. We contrast two cases of successful vendor transition in an attempt to understand and develop theory to help manage the phenomenon. Our study reveals that a contingency-based strategy founded on balance of threat theory is one possible way of successfully transitioning vendors. If a vendor transition is feasible, then in the event that the outgoing vendor is a threat, the client should actively court an alliance with the incoming vendor. However, in the event where the outgoing vendor is not a threat, the client should disengage from the vendor transition process so as to maintain a positive relationship with the outgoing vendor in the future.

While we believe the study has provided a constructive approach to client management of vendor transitions, further research is needed of vendor transitions in other organizations. Additional data will enable assessment of the extent to which client perception of the overall level of threat influences their choice of hard or soft balancing strategies. Further research is also needed to articulate the range of specific tactics that make up each strategy.

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