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Innovation Through IT and Business Process Outsourcing – Literature Review

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INNOVATION THROUGH IT AND BUSINESS PROCESS OUTSOURCING – LITERATURE REVIEW

Research paper

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Abstract

Innovation is increasingly expected in today's ongoing outsourcing relationships. While prior studies made considerable strides to examine innovation through outsourcing, the research landscape remains highly fragmented. In this review, we bring together and analyse prior research examining this emerging phenomenon in the contexts of IT outsourcing (ITO) and business process outsourcing (BPO). We focus on articles published between 1997 and 2018 in the top outlets across information systems (IS), management, and related disciplines. Our contribution is threefold: First, we present an overview of the key literature on this topic. Second, we identify and document three different scopes of achievable innovation through outsourcing, associated firm-specific intentions and capabilities, and relationship governance structures conducive to such value creating activities. Third, we put forward propositions for future research on innovation through outsourcing.

Keywords: Innovation, outsourcing, literature review, BPO, ITO, service agreements

1 Introduction

ITO and BPO currently experiences a shift from being considered as a mere cost-cutting tool for transaction-intensive business processes, to increasingly being used as a new source for innovation (Langer and Mani, 2018; Oshri et al., 2015). A growing wealth of empirical evidence shows cases where the partners involved in an ongoing dyadic outsourcing relationship successfully realised innovations on the client firm's behalf (Krishnamurthy et al., 2009; Weeks and Feeny, 2008). A pioneering study by Weeks and Feeny (2008) for instance presented a broad spectrum of innovations delivered on top of outsourced IT services. These included incremental operational improvements such as new e-mail platforms, and strategic innovations, including an IT infrastructure customised for a new market that the client recently moved into.

Prior research largely suggests that turning traditional outsourcing engagements into engines of innovation may be worthwhile. At the same time, clients and providers may easily become victims of their greater ambitions. Research widely recognises innovation through outsourcing as an elaborate undertaking requiring a sophisticated understanding of how to manage the relationship (Aubert et al., 2015). Indeed, challenges coming with the aim of extracting innovations from ongoing ITO and BPO relationships are manifold. Among them, the "significant heterogeneity in the nature and strategic context" (Barua and Mani, 2014, p. 101) of individual outsourcing relationships leads to a rich diversity of achievable innovations. Specific innovation outputs and outcomes may thus vary greatly from relationship to relationship and may not be completely replicable across multiple outsourcing contexts (Mani and Barua, 2015). Furthermore, not knowing which innovations may be beneficial for the client firm in the future makes it difficult to enshrine appropriate obligations in the contract that would require the service provider to co-deliver innovations in combination with explicit performance

targets (Wallenburg, 2009). Research thus points to the necessity of approaching the relationship as a strategic partnership rather than as a straightforward transaction (Levina and Ross, 2003; Mani and Barua, 2015).

However, the question of the best formal controls and relational governance mechanisms for such partnerships is still open (Lacity and Willcocks, 2013; Oshri et al., 2015). The inherent uncertainty embedded in the nature of innovation increases the risk of disagreements and misaligned intentions. These may develop into serious conflicts and inhibit the partners from realising the full innovative potential of the relationship (Lacity and Willcocks, 2017; Shi, 2007). Lastly, prior research underlines the need for well-developed communication, coordination, and collaboration capabilities to identify and implement innovative IT-enabled business initiatives for the client firm (Mani and Barua, 2015)

In this review, we focus on innovations that are achieved through ongoing ITO and BPO relationships. We define innovation as solutions customised to the client firm's specific needs, resulting from a range of process enhancements made during the ongoing outsourcing engagement that exceed contracted service-level agreements (Mani et al., 2010; Oshri et al., 2018). These solutions may emerge either through the service provider's existing pool of resources and capabilities, including specialised technologies, management techniques, and industry expertise, or through collaborative, boundary-spanning activities and combination of the partners' individual resources (Su and Levina, 2011). The following research questions guide our review:

- How do organisational capabilities moderate value-creating activities in outsourcing relationships?
- How are outsourcing relationships governed when innovation is an expected, but not necessarily contractually specified outcome?

Our contributions are threefold. First, we review conceptual and empirical studies dedicated to the emerging innovation through outsourcing phenomenon across multiple disciplines to arrive at a concise set of the most relevant research articles to date. Secondly, we analyse existing literature in a structured fashion using a four-dimensional analytical innovation through outsourcing framework, and thereby identify key themes that have been subject to ongoing debates. Lastly, we provide a set of research propositions geared towards filling a major research gap we identified through our article analysis. Specifically, we introduce vital avenues for future research by underlining the importance of differentiating within innovation and their implications for outsourcing-specific issues.

2   Foundations and scope

Innovation in the ITO and BPO context is multifaceted and complex, leading to a variety of definitions. The concept is often outlined broadly, if at all, for instance as "the introduction of strategies, business processes, or technologies that are new to the relationship and are intended and expected to lead to new business outcomes" (Weeks and Feeny, 2008, p. 130), or "supplier-led, proactive undertakings – with or without the outsourcer's collaboration, but in any case on their behalf – that in the outsourcer's perception result in new or improved ways of delivering transactions" (Sumo et al., 2016, p. 13). To make the concept more tangible and clarify the scope of our review, we consider four core elements: (1) *output*, (2) *timing*, (3) *novelty*, and (4) *outcome*. We then bring these aspects together to define the scope for our topic.

In line with Busse (2010), we distinguish between immediate, technical innovation *outputs* and their economic benefits (outcomes). Prior outsourcing literature presents a broad view of achievable tangible and intangible innovation outputs, such as aforementioned strategies, business processes, and technologies. This would not allow us to adequately narrow down relevant outputs to a specific form or type of innovation. Nonetheless, a fundamental characteristic of any reportedly achieved innovation output through ITO and BPO was its enablement by IT, such as new predictive analytics tools (Lacity and Willcocks, 2013), digital platforms (Holweg and Pil, 2012), wireless technologies to transform business processes (Krishnamurthy et al., 2009) or management dashboards (Kotlarsky et al., 2016).

With *timing*, we refer to the distinction made in prior literature between innovations that were generated at the initial stage of the relationship when a new service was implemented, and therefore could be contractually specified, and innovations that were implemented within the ongoing relationship to further enhance the existing service over the course of time (Wallenburg, 2009). Our focus is on the latter, not necessarily contractually specified (Holweg and Pil, 2012) or perhaps loosely specified (Aubert et al., 2015) form of innovation.

Novelty of an output to the client-provider relationship is understood to be essential. The output would not have to be entirely new to the world (Laursen and Salter, 2006; Weeks and Feeny, 2008), nor entirely new to either firm. Instead, the output may emerge in some customised form from the service provider's already existing resources and capabilities, directed toward multiple client firms (Su and Levina, 2011). The output may also be highly relationship-specific, only emerging from the combination of the service provider's and the client's resources and capabilities (Su and Levina, 2011; Wallenburg, 2009). Purely internal innovations taking place within boundaries of either party, but not affecting the outsourcing relationship directly (Wallenburg, 2009) are out of the scope of this review.

Prior research suggests great diversity in expected *outcomes* (economic benefits) from ITO and BPO (Mani and Barua, 2015), often ranging from cost efficiencies to quality improvements (Lacity and Willcocks, 2013; Oshri et al., 2018). Regarding outcomes from innovation initiatives through outsourcing, Lacity and Willcocks (2013) emphasised on their sustainable, business-wide impact, stating that they "deliver substantial long-term improvements to the client's operating efficiency, business-process effectiveness and strategic performance" (p.63). Short-term economic benefits are thus not quintessential to innovation in our study's context, but rather outcomes with lasting effects that may be reached with less common but comprehensive one-time transformations, such as IT infrastructure overhauls (Miozzo and Grimshaw, 2005; Weeks and Feeny, 2008), or with multiple incremental improvements that, when accumulated, create a similarly significant impact on the client firm's performance (Lacity and Willcocks, 2013).

Although prior research lacks a cohesive definition of innovation through outsourcing, it provides us with some orientation and boundaries of the concept. When reassembling the four individual components of the concept, we can place the focus of our study on IT-enabled innovation outputs that are new to the ongoing ITO and BPO relationship and are expected to have a sustainable impact on the client firm's overall business performance.

We identify the following seemingly similar sourcing relationship types worth mentioning which may be associated with innovations but fall out of this study's scope. Firstly, collaborative innovation initiatives that are pursued through contract manufacturing, rather than outsourced information-intensive activities are excluded. Secondly, and in line with Lacity et al. (2016), another form of BPO which is excluded from our phenomenon of interest is research and development (R&D) or innovation outsourcing. This form of outsourcing has innovation as the sole contracted performance outcome agreed on at the initiation of the relationship, and contrasts with the multiple performance objectives typical in modern ITO and BPO engagements (Sumo et al., 2016). Indeed, R&D outsourcing has evolved into a vibrant research field of its own (Hsuan and Mahnke, 2011; Quinn, 2000). Lastly, we excluded innovation through crowdsourcing studies, as they normally focus on a large public group rather than on a project-based relationship with carefully selected commercial service providers.

3   Methods

This review shares a lot of characteristics with what Paré et al. (2015) call theoretical review: 1) A broad scope of questions, 2) a comprehensive search strategy, 3) the consideration of both conceptual and empirical studies, 4) an explicit study selection process, and 5) a structured approach to effectively organise prior research through the use of a framework. Furthermore we followed the best practices for literature search and synthesis provided by Webster and Watson (2002), Tranfield et al. (2003), and Rowe (2014). In this section we describe our literature search and analysis methods.

3.1   Literature search

Before commencing a proper literature search, we wanted to gain a broad understanding of the innovation and outsourcing field. Our aim was to identify appropriate keywords, relevant outlets, and the major disciplines studying innovation through ITO and BPO. To this end we conducted a broad search through high-ranking academic journals. We included journals ranked 3, 4, and 4* in the Chartered Association of Business Schools (CABS) Academic Journal Guide 2015. As a result, we screened through 239 article titles and abstracts, fully reading 50 papers. Forward and backward search (Webster and Watson, 2002) yielded further 20 articles. At this stage we have not yet applied strict search criteria, as we aimed to familiarise ourselves with the existing research progress. This preliminary review allowed us to specify research keywords and narrow down subject groups from the CABS list to focus on.

After completing our preliminary review, we proceeded with a three-phase search process (study identification, study selection, data extraction), in which we aimed to narrow down the collected articles to the most relevant sample. Our search strategy is illustrated in Table 1. We used the CABS Academic Journal Guide 2015, this time excluding journals from subject groups "Entrepreneurship and small business management", "Human resource management and employment studies", and "Organization studies". Our preliminary review did not yield any studies of interest that were published in these outlets. As a result, we ended up with 32 journals ranked 3, 4, and 4*.

We limited our search to articles published 1997-2018 inclusive. The starting year of our defined timespan coincides with the publication year of Venkatraman's (1997) paper about recognising IT as a driver of competitive advantage by managing IT resources as a value centre. Studies with similar notions have appeared around this time, such as DiRomualdo and Gurbaxani's (1998) prominent paper about a firm's strategic intent for ITO, marking the period of time when the client firm's strategic objectives were increasingly linked to outsourcing engagements. As for BPO, we found support for our chosen timespan in Lacity et al.'s (2011) comprehensive review of the BPO research landscape, in which the late 90s were similarly used as starting point for identifying relevant articles.

During the preliminary review we realised that definitions and precise terminology used in the literature is diverse. As a result, we decided to trade-off search specificity for a better literature coverage (Bartels, 2013). Thus, we used the broad search term "innovation AND outsourcing" to capture as many articles as possible. We then filtered articles that clearly fell out of scope manually by screening titles, abstracts and keywords. The set of articles was thereby reduced to 436 works.

We then located our search terms in the full text of each remaining paper. By checking their frequency and context we were thus not only able to skim through the content, but also conveniently remove literature that would mention innovation and outsourcing only once or twice but not examine their interdependencies in detail. We further applied additional qualitative selection criteria when screening the results. First, we only included papers examining innovation through ITO and BPO arrangements. As stated in the review scope, studies focusing on product-centric outsourcing relationships, R&D outsourcing, and innovation through crowdsourcing, as well as innovation with offshored captive centres, or outsourcing itself presented as a business model innovation were excluded. Second, we looked at empirical and conceptual ITO and BPO studies with original contributions to the field in which innovation was a key theme (Leidner and Kayworth, 2006; Wiener et al., 2016) and excluded editorials, research commentaries, and research notes, as well as book reviews and teaching cases. Our article repository was thereby narrowed down to 60 studies.

In the last phase, we read through each remaining article in its entirety. We found that by going back and forth, as suggested by Webster and Watson (2002), no new articles that fall into our review scope could be identified as relevant and added, with the reason being that studies in the article repository would frequently draw on innovation literature which lacked a direct relationship to outsourcing, or vice versa. Apart from that, they would often cite studies already stored in our article repository and supplement these with literature specialising in the specific area that was to be examined in an innovation through outsourcing context, such as literature about advisors (Oshri et al., 2018), organisational ambidexterity (Aubert et al., 2015), or multisourcing (Su et al., 2015). After reading the

articles, we eliminated four articles that mentioned the innovation through outsourcing concept only as a potential outcome without going into greater detail, referring to other studies already in our article repository instead. We ultimately arrived at a final literature sample of 56 articles.

Search phase	Description	Number of articles
Initial database search (Study identification)	Applied following search filters: • Thirty-two CABS 3, 4, 4* ranked journals • Published: 1997-2019 • Keywords: "innovation AND outsourcing"	4,037
Manual review of titles and abstracts and keywords (Study selection)	Discarded all articles that were clearly out of scope based on title, abstract and keywords	436
	Discarded articles based on keyword context and additional qualitative selection criteria	60
Review of full text (Data extraction)	Reading remaining articles fully and conducting forward and backward search	56

Table 1.   Stages of literature search.

3.2   Analytical framework

Following Paré et al.'s (2015) suggestion to use a structured approach for bringing together the literature streams, we examined our final sample of articles to find an overarching framework with broad enough dimensions to accommodate the diverse study findings. Despite uncovering a variety of concepts, the sheer breadth of research foci examined with different levels of granularity made it inviable to adapt any one framework for our purposes without quoting it out of context. Consequently, we found it necessary to develop a new analytical framework to meaningfully integrate the full spectrum of studied innovation through outsourcing dimensions and attain a more nuanced understanding of the phenomenon. It must be acknowledged that our framework's themes are nonetheless strongly influenced by existing works, above all Aubert et al.'s (2015) framework which was originally designed to facilitate our understanding of the paradox inherent in the simultaneous pursuit of innovations and cost savings through outsourcing projects.

We propose a four-pronged framework that structures the fragmented research landscape along the following higher order themes: The first theme, *scope*, involves illuminating what kinds of outputs are recognised as innovations, and consolidating the variety of typologies previous studies introduced to categorise these. The second theme, *capabilities*, encompasses specific capabilities that studies identified to be crucial for successfully pursuing innovations through outsourcing. The third theme, *intent*, relates to the conditions that may positively or negatively influence the decision when to actively pursue innovations. The fourth theme, *governance*, deals with outsourcing strategies and governance mechanisms that foster or inhibit the pursuit of innovation initiatives through outsourcing.

4   Findings

Thirty-two out of the 56 studies we reviewed investigate innovation through outsourcing in an ITO context, 15 in a BPO context, and nine in both contexts. Most outlets which featured relevant articles fall under the CABS Academic Journal Guide 2015 category "Information Management", with 25 studies. 21 out of these studies are published in AIS Senior Scholar basket of Eight[1] journals. The remaining studies are spread across well-ranked journals related to other business administration

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[1] The AIS Senior Scholars' Basket of Eight includes the *European Journal of Information Systems*, *Information Systems Journal*, *Information Systems Research*, *Journal of Information Technology*, *Journal of Management Information Systems*, *Journal of Strategic Information Systems*, *Journal of the Association for Information Systems*, and *MIS Quarterly* (in alphabetical order).

subject areas. A summary of our literature sample is provided in Table 2. Forty-one studies examined innovation through outsourcing from the client perspective, 13 from the service provider point of view, and two from a bilateral perspective. Twenty-eight studies used quantitative methods to analyse empirical data, 16 studies used qualitative methods, three studies used mixed methods and nine studies are conceptual papers drawing solely on anecdotal evidence.

CABS Academic Journal Guide 2015 Subject categories	Rank	Number of articles
Subject category: General Management, Ethics and Social Responsibility		
California Management Review	3	4
Harvard Business Review	3	1
MIT Sloan Management Review	3	5
Subject category: Information Management		
Information Systems Research (*AIS Basket of Eight*)	4*	2
MIS Quarterly (*AIS Basket of Eight*)	4*	4
Journal of Management Information Systems (*AIS Basket of Eight*)	4	4
Journal of the Association of Information Systems (*AIS Basket of Eight*)	4	1
Journal of Information Technology (*AIS Basket of Eight*)	3	4
Journal of Strategic Information Systems (*AIS Basket of Eight*)	3	6
Decision Support Systems	3	2
Information and Management	3	1
Information Systems Frontiers	3	1
Subject category: Innovation		
Research Policy	4	1
Subject category: International Business and Area Studies		
Journal of World Business	4	1
Journal of International Management	3	3
Subject category: Marketing		
Industrial Marketing Management	3	2
Subject category: Operations and Technology Management		
IEEE Transactions on Engineering Management	3	3
Journal of Supply Chain Management	3	3
Subject category: Operations Research and Management Science		
Decision Sciences	3	3
Subject category: Strategy		
Strategic Management Journal	4*	5
Total number of included articles		**56**

Table 2.   Literature sample summary

4.1   Understanding the *scope* of innovation

In general, most of the reviewed studies observed innovation through outsourcing without differentiating between different types of innovation, concentrating primarily on relationship-specific issues that emerge with the pursuit of innovation. However, ten studies provide a more nuanced view of the innovation *scope*. Within these ten studies, a variety of typologies are used to examine innovations in the ITO and BPO context in isolation or combined (see Table 3). These typologies are roughly structured along simplistic groups adapted from Swanson (1994), who differs between innovations that are restricted to the functional IT core, innovations that involve the application of IT products and services to the client firm's administrative core, and innovations with a potentially strategic impact, as IT products and services are integrated with the client firm's core business.

Innovations with an impact confined to the IT function and IT infrastructure. Innovations in this group comprise IT function-centric solutions that enable better ways to exploit IT but are unlikely to affect the client firm's other business functions and overall generated business value individually (Weeks and Feeny, 2008). Initiatives targeting this scope of innovation only appeared in ITO-focused studies. They may materialise in form of new technologies in software development, such as the use of object-oriented technology and Internet computing (Qu et al., 2010) or hardware such as printing and imaging devices (Weeks and Feeny, 2008). To classify these innovations, Qu et al. (2010) rely on

Swanson's (1994) innovation framework (Type I-III innovations), whereas Weeks and Feeny (2008) introduce the category "IT operational" innovation as part of their self-created, three-level innovation taxonomy. The taxonomy further includes business process innovations, which we grouped as innovations mainly impacting the client firm's administrative core, and strategic innovations, which we grouped as innovations that significantly contribute to the client firm's overall performance. The achievement of innovations with an impact confined to the functional IT core is associated with low complexity and little effort but may be of paramount importance for paving the way for subsequent, higher level innovations (Weeks and Feeny, 2008).

Scope of innovation	Label for observed innovation	Outsourcing context	Reference
Functional IT core	IT operational innovation	ITO	Weeks and Feeny (2008)
	Type I innovation	ITO	Qu et al. (2015)
Administrative core	Business process innovation	ITO	Weeks and Feeny (2008)
	Dynamic innovation	Combined	Lacity and Willcocks (2013)
	Customer-related innovation	BPO	Wallenburg (2009)
	Modular innovation	ITO	Aubert et al. (2015)
	Type II innovation	ITO	Qu et al. (2015)
Core business	Collaborative innovation	ITO	Willcocks et al. (2011)
	Disruptive innovation	ITO	Krishnamurthy et al. (2009)
	Strategic innovation	ITO	Weeks and Feeny (2008)
		Combined	Oshri et al. (2015, 2018)
	Systemic innovation	ITO	Miozzo and Grimshaw (2005); Aubert et al. (2015)
	Type III innovation (not supported)	ITO	Qu et al. (2015)

Table 3.   Scope – Targeted levels of innovation

IT-enabled innovations targeted at the client firm's administrative tasks. Innovations in this group include IT-enabled solutions that go beyond the boundaries of the IT function by significantly altering administrative tasks of the client's non-IT, business functions. The successful completion of launched initiatives targeting this group of innovation is supported in both the ITO and BPO context. Within the ITO context, explicit examples include the deployment of IT applications related to accounting and human resource management (Qu et al., 2010), or more specifically, new technologies such as radio-frequency identification (RFID) devices or enterprise resource planning (ERP) software (Weeks and Feeny, 2008). In the BPO context, Wallenburg's (2009) study on the innovativeness from a logistics service provider point of view presents the introduction of a track-and-trace system offered to all clients. Drawing on a data sample that combines ITO and BPO engagements, Lacity and Willcocks (2013) more broadly point to new tools and technologies, new or improved processes and automation to enhance a client firm's business functions. In addition to the typologies for categorising innovations discussed above, further classifications are borrowed from established innovation literature, such as Langlois and Robertson's (1992) autonomous and systemic innovations in a modular system, adapted by Aubert et al. (2015), and original typologies, such as Wallenburg's (2009) customer-related innovation, and Lacity and Willcocks's (2013) dynamic innovation.

Strategic IT-enabled innovations targeted at the client firm's core business. Initiatives targeting this group of innovation appeared in both ITO and BPO relationships and differ considerably from the previous ones in the degree of customisation, as they are tailored exclusively to the client firm's specific core business needs. The reviewed studies present IT infrastructure transformations (Krishnamurthy et al., 2009; Weeks and Feeny, 2008), supply chain management (SCM) systems (Oshri et al., 2015; Qu et al., 2010), RosettaNet-based inter-organizational systems (Qu et al., 2010), the development of a social media marketing platform (Oshri et al., 2015) or dashboard tools (Oshri et al., 2018) as explicit examples that may directly contribute to the client's overall business performance. In this group of studies, scholars again draw either on established innovation literature, like Krishnamurthy et al.'s (2009) disruptive innovation category based on Bower and Christensen's (1995) identically termed innovation type, and original definitions, such as Willcocks et al.'s (2011) collaborative innovation type.

4.2   *Capabilities* necessary for successfully pursuing innovation

The successful development of innovations is widely associated with well-developed communication, coordination, and collaboration capabilities (Mani and Barua, 2015; Weeks and Feeny, 2008) that help deepen the level of shared understanding about the nature of services to be developed and provided (Goo et al., 2007). Studies categorised in the *capabilities* dimensions are directly associated with our first research question and are mainly concerned with the key firm-specific profile of capabilities required for reaching this level of understanding. The list of client and service provider capabilities found in the literature are presented in Table 4.

Client firm capability	Reference	Service provider capability	Reference
Relationship-specific learning	(Mani and Barua, 2015; Veltri et al., 2008; Weeks and Feeny, 2008; Weigelt, 2009; Willcocks et al., 2011)	**Relationship-specific learning**	(Chatterjee, 2017; Oshri et al., 2015; Weeks and Feeny, 2008; Wiener and Saunders, 2014)
Procedural learning	(Shi, 2007; Weigelt and Sarkar, 2012; Mani and Barua, 2015)	**Procedural learning**	(Chatterjee, 2017; Gopalakrishnan and Zhang, 2017; Lahiri et al., 2012; Levina and Ross, 2003; Shi, 2007; Weigelt, 2013; Weigelt and Sarkar, 2012; Wiener and Saunders, 2014)
Retained functions	(Veltri et al., 2008; Weeks and Feeny, 2008; Weigelt, 2009, 2013; Willcocks et al., 2011)		
Executive-level leadership	(Mani et al., 2010; Weeks and Feeny, 2008; Willcocks et al., 2011)		

Table 4.   Client firm-specific and service provider-specific capabilities

Client firm and service provider – Relationship-specific learning. Reviewed studies repeatedly emphasise on the client's learning capability to enhance process execution and management of an ongoing outsourcing relationship (Willcocks et al., 2011). Herein, researchers frequently draw on Cohen and Levinthal's (1990) absorptive capacity concept to underline the role of prior experience in learning to scan, acquire, assimilate, and exploit valuable knowledge (Lacity et al., 2016). Mani and Barua's (2015) study focusing on the client firm showed that the complex task environment of innovation initiatives significantly increases relationship-specific learning as experience accumulates. This enables the development of improved relationship-specific communication and collaboration practices with the service provider to better understand the latter's structures, processes, and technologies. This logic can similarly be transposed to the service provider perspective, who can thereby gain a clearer understanding of idiosyncratic, complex task requirements, the client firm's business domain and IT landscape, and subsequently deliver more customised solutions (Oshri et al., 2015; Shi, 2007; Wiener and Saunders, 2014). Collectively, relationship-specific learning effects empower the parties with the ability to establish common ground and trust in different language and cultural contexts, and a shared understanding of the outsourced task (Mani and Barua, 2015; Shi, 2007).

Client firm and service provider – Procedural learning. Procedural learning results from prior experience in managing multiple outsourcing engagements and enhances coordination skills related to the design of aligned contracts and complementary relationship management processes and technologies (Mani and Barua, 2015). Mani and Barua's (2015) study focusing on the client firm demonstrated that, similarly to relationship-specific learning, procedural learning is significantly enhanced when actively managing outsourcing relationships with complex task environments. From the service provider perspective, procedural learning is paramount to streamline and standardise processes and thereby improve its own organisational performance through scale and scope economies (Levina and Ross, 2003; Weigelt and Sarkar, 2012). This however must be understood with caution, as in highly customised, knowledge-intensive types of services, economies of scale are often far more limited than in generic, transactional types of services (Su and Levina, 2011). Nonetheless, combined

with a wide client-industry scope, service providers can learn from different partnership dynamics with diverse clients which consequently enables the accumulation of radical ideas from disparate sources (Weeks and Feeny, 2008), and the gradual development of industry best practices that can be redeployed across different outsourcing projects (Lahiri et al., 2012). Despite not being unique in their application to any specific client, these practices still remain valuable for client firms (Weigelt, 2013).

Client firm – Retained function. By continuously contracting out value-adding services, the client firm may not realise its widening organisational competency gap (Shi, 2007). While relationship-specific learning enhances communication and collaboration necessary for the generation of unique solutions tailored to the client firm's individual business needs, practices learnt thereby alone are insufficient to facilitate their ultimate adoption. Users at the client firm may face difficulties in working with these newly developed solutions as they may lack adequate knowledge for using the solutions or resist switching if an already existing solution remains a viable alternative (Weigelt, 2009). Hence, research highlights that in-house competencies through retained functions are absolutely indispensable for building the relationship-specific capability of effectively absorbing the service provider's IT capability know-how and facilitating the actual use of innovations generated through outsourcing (Veltri et al., 2008; Weeks and Feeny, 2008; Weigelt, 2009; Willcocks et al., 2011). However, too strong internal operational capabilities may result in costly duplication of efforts (Weigelt, 2013). Client firms thus face the difficulty of judging how far the competency gap should be bridged with internal capabilities to enable the use of different targeted levels of innovation.

Client firm – Executive-level leadership. Prior research shows that in-house IT leadership in both ITO and BPO contexts plays an essential role in linking the internal business strategy with the market through a smooth execution of the sourcing strategy (Willcocks et al., 2011). Integrating executive-level IT leadership at the corporate level, at the client firm, is thus crucial for directing relationship-specific innovation efforts through outsourcing towards business transformation rather than IT improvements (Mani et al., 2010; Willcocks et al., 2011). Willcocks et al. (2011) further argue that the more radical and business focused the targeted level of innovation is, the more crucial it is for the client firm to lead the project. Including IT leaders at the corporate level also acts as a supplementary capability by providing a review mechanism for innovation proposals (Weeks and Feeny, 2008).

4.3   *Intent* – Justifying the use of outsourcing for obtaining innovation

Innovation through outsourcing is usually necessary when problems and solutions are complex and unclear, and precise metrics guiding the project are dethroned by general business goals (Willcocks et al., 2011). Studies focusing on the *intent* dimension are concerned with further conditions that legitimise or invalidate the motivation of using outsourcing for pursuing innovation initiatives. Key themes that have been subject to considerable research are the evolving role of IT, the relative effectiveness of outsourcing when innovation is targeted as a potential outcome, and the service provider's perceived benefits when innovating for a client.

Client-side – Role of IT. Despite the range of success stories showcasing a variety of successfully achieved innovations through ITO and BPO, prior research emphasises on the strategic importance of IT, recognising that it should not be viewed as a peripheral tool that helps firms focus on other core competences, but rather considered as a core competency in and of itself (Qu et al., 2010). By outsourcing IT and IT-related activities however, client firms minimise their functions and shrink their internal competencies which hinders the effective internal deployment and exploitation of information within and across organisational business units (Peppard et al., 2000). Subsequently, this complicates the timely planning and execution of IT strategies and innovations targeted at supporting overall business services. Client firms may thus be able to achieve competitive parity by benefitting from the service provider's industry-wide best practice solutions, but may thereby inhibit their ability to set themselves apart from the competition (Kim et al., 2011). As a consequence, study implications increasingly exhort client firms to develop corresponding information competencies inside the firm's own boundaries in order to better seize IT-enabled strategic opportunities (Ejodame and Oshri, 2018; Qu et al., 2010).

Client-side – Relative effectiveness of outsourcing. Closely related to the evolving role of IT, the literature is inconsistent as to whether setting innovation as a targeted outcome of outsourcing is justified, especially in relation to intra-firm sourcing arrangements. Through a social capital lens, Zimmermann et al. (2018) show that, while the extent of knowledge sharing is increased by the client firm's intent to find new sources of innovation, the increase is significantly greater in captive centres than in outsourcing engagements. Furthermore, while an earlier study (Weigelt and Sarkar, 2012) finds a positive, curvilinear effect of outsourcing on efficiency, indicating that outsourcing yields efficiency gains up to a certain threshold, the same study finds a negative linear effect of outsourcing on more complex tasks, leading to the conclusion that such activities should best be done through in-house experimentation. Miozzo and Grimshaw (2005) and Aubert et al. (2015) similarly question the sustainability of innovation through outsourcing, particularly regarding one-time innovations with a strategic, business-wide impact, due to significantly greater coordination requirements for boundary-spanning knowledge flows and between IT and business strategies. Qu et al. (2010) provide quantitative evidence for this notion, showing that ITO is not significantly associated with developing such innovations. Instead, they find partial support for developing these through IT insourcing.

Provider-side – Own firm performance. Studies show that service providers may voluntarily go beyond agreed on service levels when they perceive the opportunity to put themselves in a better position for expanding their spectrum of up-selling possibilities and thereby coming closer to their own goals for commercial gains (Aubert et al., 2015; Oshri et al., 2015). This not only significantly improves their revenues during the duration of the outsourcing contract but also strengthens their negotiation power for later contract renewals (Su and Levina, 2011). As the ITO and BPO market matures, service providers may also feel the pressure to innovate in order to set themselves apart from similar competitors offering conventional outsourcing arrangements (Lacity and Willcocks, 2013). However, research also clearly warns of several risks that may emerge with these conditions. Since service providers are independent market participants, their own business objectives may naturally conflict with those of their non-affiliated partner and those for the outsourcing project, prompting them to forgo their initial collaborative attitude as they succumb to the temptation of opportunistic behaviour. They may also act in their own self-interest as a protective response to potential opportunism enacted by the client firm, who may threaten to end the partnership prematurely if it does not receive wished-for strategic value at contractually agreed on knockdown prices (Veltri et al., 2008). Consequently, service providers may not be willing to disclose the strides they have made in developing the innovation using their own investments, steering innovation efforts towards outcomes that are more beneficial for them than for the client, or delivering the innovation but for a greatly escalated price (Aubert et al., 2015; Shi, 2007).

4.4 *Governance* mechanisms and suggested models

Existing research largely concurs that partnership-based outsourcing arrangements, often referred to as strategic partnerships (Mani et al., 2010), are the most conducive to innovation (Goo and Huang, 2008; Lacity and Willcocks, 2013; Oshri et al., 2015). Herein, the client and provider share a dedication to create value and engage in high levels of joint action (Mani et al., 2010), and informal information exchange (Mani et al., 2010; Oshri et al., 2015), and commit to a long-term relationship (Goo et al., 2007). They are further characterised by high levels of coordination and trust, increased flexibility in accommodating changes, and perceive the external party to be a business partner rather than a generic buyer/provider of services (Lahiri et al., 2012). Prior research showed that different sets of contractual and relational governance mechanisms are used to achieve these attributes, and further introduced new outsourcing strategies that are designed to create a particularly conducive environment for innovation. The *governance* dimension thus directly links back to our second research question and includes findings related to relationship governance.

Contractual governance mechanisms. Contractual governance mechanisms are used to align incentives and individual interests by providing an administrative architecture within which an

outsourcing partnership proceeds (Goo and Huang, 2008). They typically involve low uncertainty, measurability, and detailed contracts (Aubert et al., 2015).

As both the client firm and provider contribute capital and people to the partnership, the partners are exposed to a similar level of risk. And as a consequence, the partners are less likely to act opportunistically, and are motivated to work toward common business goals as the potential return on investment will depend on the success of the collaboration (Oshri et al., 2015; Sumo et al., 2016). Integrating gain-sharing clauses for each separate innovation project is found to be a highly effective approach, as partners can agree in advance how the financial compensation will be allocated for each initiative (Lacity and Willcocks, 2013).

Based on inconsistent results, opposing views surround the level of specificity of the outsourcing contract. On the one hand, a trust-but-verify approach is suggested, by drawing up a highly detailed contract in conjunction with well-defined service-level agreements (Miozzo and Grimshaw, 2005; Weeks and Feeny, 2008). Herein, the client firm can use service-level objectives to explicitly formulate its expectations of the service provider for innovation and integrate an innovation plan as an additional contractual element in which the process for innovation, including implementation and prioritisation is formally described (Goo and Huang, 2008). The selective use of contract terms relevant to the targeted innovation outcome will more likely result in success (Goo et al., 2008; Langer and Mani, 2018). Such terms not only help to better monitor the costs and benefits of associated innovation activities, but also assist in locating new innovation targets (Weeks and Feeny, 2008). Furthermore, it is found that well-structured service-level agreements reinforce relational attributes such as trust and relationship commitment, and are therefore indispensable for cultivating high-quality outsourcing partnerships (Goo and Huang, 2008). On the other hand, Sumo *et al.* (2016) revealed that provider-led innovation are more likely to occur as a result of increased provider autonomy, which is enabled by an atypical but intentional decision to rely on low contract specificity. Since required ideas, knowledge, and expertise cannot be easily specified in advance (Aubert et al., 2015), the thereby enabled flexibility allows the service provider to more easily venture out of the contractual framework to take on explorative initiatives characterised by high uncertainty and complexity (Holweg and Pil, 2012). Research also showed that lower levels of formalisation facilitate the timely sharing of process information and clarification of task outputs, thereby accelerating a shared understanding of changes in the information environment of the outsourced process (Mani et al., 2012).

Prior literature further presents outsourcing strategies aimed at effectively increasing value creation efforts. Both the "forced coopetition" concept (Wiener and Saunders, 2014) and the "long-tail strategy" (Su et al., 2015) introduced outsourcing arrangements in which long-term partnerships are established with a few selected strategic service providers. The concepts mainly differ in supply base breadth. Whereas the former concept proposes building a strong collaborative relationship with these providers and incentivising a healthy balance of cooperation and competition, the latter concept promulgates that a larger pool of smaller, more flexible service providers should be nurtured in addition to selected key service providers. These providers at the tail end may act as diverse sources of innovation and are motivated to compete for and secure a place next to the few strategic providers.

Relational governance mechanisms. Relational governance mechanisms address how the informal information exchange between the client firm and the service provider promotes both a shared understanding of the task environment and mutual adjustments to align actions and ensure the success of the outsourcing relationship (Goo and Huang, 2008). Prior research frequently highlights high levels of mutual trust and commitment (Aubert et al., 2015; Goo et al., 2009; Søderberg et al., 2013; Zimmermann et al., 2018), as well as effective conflict resolution (Lacity and Willcocks, 2017; Mani et al., 2010) as imperative for achieving innovations through outsourcing. While trust is mainly built through action over time (Weeks and Feeny, 2008) research showed a significant negative relationship between trust and contract specificity. Specifically, greater levels of formalisation may signal a lack of trust and shift the service provider's focus and resources from information exchange aimed at problem solving to defending actions and choices (Cao et al., 2013). This finding does not remain uncontested however, as other studies provide evidence that both trust and commitment complement greater levels of formalisation (Goo and Huang, 2008; Goo et al., 2009). Altogether, while debates surrounding the

relationship between formal and relational governance mechanisms seem to evolve into a perennially dichotomised battle, recent empirical evidence proves that their complementarity is more likely when innovation is sought in a partnership-based outsourcing arrangement (Mani et al., 2010; Oshri et al., 2015). As for conflict resolution, prior literature found that an effective approach to conflict resolution is adopting a collaborative style in which partners seek a solution that balances the needs of both (Lacity and Willcocks, 2017) and is argued to be improved by greater commitment and lower formalisation (Barua and Mani, 2014).

5   Research propositions

In the following, we make six research propositions to explain the dynamic interaction of previously identified key themes and thereby aim to forge a foundation for future innovation through outsourcing research to build on. With this in mind, we point to the current research landscape being largely populated by studies which examined innovation in light of required capabilities, more or less conducive intents, or governance mechanisms. The emphasis of our propositions is on a more differentiated view of innovation in these contexts.

With our first two propositions, we discuss the interactions between the targeted scope of innovation and the capabilities needed at the client and provider firm. We argue that incremental improvements with an impact confined to the client firm's IT or administrative areas can be more easily derived from overall outsourcing experience. Their low degrees of customisation may only require slight changes of existing industry best practices. Executive leadership support and retained functions at the client firm further positively influence the achievement and adoption of these innovations. In contrast, with our second proposition, we highlight the significance of relationship-specific capabilities for more customised innovations that may have a strategic impact on the client firm's business performance.

Proposition 1: Targeting innovations with an impact limited to the client firm's IT or administrative area likely requires capabilities with a low degree of relationship-specificity.

Proposition 2: Targeting innovations with a strategic impact on the client firm's overall business performance likely requires capabilities with a high degree of relationship-specificity.

In our third and fourth propositions, we link the *scope* dimension with the *intent* dimension. Herein, we take into account study results which showed that relative to alternative sourcing arrangements, and when IT plays an integral role at the client firm for creating new business value, outsourcing is not the most conducive for innovation, and for higher levels of innovation in particular (Miozzo and Grimshaw, 2005; Qu et al., 2010). Our third proposition thus supports anticipations of increasing backsourcing and captive sourcing scenarios, as client firms attempt to quicker respond to IT-enabled opportunities through internally developed IT competencies (Qu et al., 2010). However, on the other side of this debate, studies revealed that leading service providers gradually evolve into solution-generating powerhouses as competition intensifies. Considering discussed service provider-specific conditions, we argue in our fourth proposition that successfully achieving innovations with a strategic impact on the client firm's overall business performance highly depends on the service provider's posture towards innovation and differentiation.

Proposition 3: Innovations with a strategic impact on the client firm's overall business performance are less likely to be achieved in the context where fulfilling business objectives relies on IT.

Proposition 4: Achieving the desired level of impact from an innovation through outsourcing is facilitated by a positive posture towards innovation and differentiation from the service provider.

In our fifth and sixth propositions we argue that if the parties still seek innovation through outsourcing, then a partnership-based outsourcing arrangement, as opposed to arm's length contracting, is absolutely essential. In such strategic partnerships, we propose that formal and relational governance mechanisms act as complements for lower level innovations, thereby reflecting Weeks and Feeny's (2008) trust but verify approach. As increasingly higher levels of innovation are prioritised, we propose that these mechanisms gradually transform into substitutes. We thereby vindicate the views of Holweg and Pil (2012) and Sumo et al. (2016), and argue that the high levels of

uncertainty of such impactful innovations require full autonomy and unrestricted flexibility. Despite the extreme complexities and danger of opportunism, it is likely that they can still be achieved due to the greatly shared interest in a successful outcome.

Proposition 5: In a partnership-based outsourcing arrangement, prioritising innovations with an impact limited to the client firm's IT or administrative area is facilitated by high contract term specificity and greater levels of relational governance.

Proposition 6: In a partnership-based outsourcing arrangement, prioritising innovations with a strategic impact on the client firm's overall business performance is facilitated by low contract term specificity and greater levels of relational governance.

6 Conclusion

In this review, we aim to build a stable foundation for future research on innovation through outsourcing. We first defined a scope for our review based on prior descriptions of the phenomenon. We then structured our literature analysis with a four-pronged innovation through outsourcing framework including the following dimensions: scope, capabilities, intent and governance. Additionally, we offered six research propositions that emphasise on the importance of a more differentiated view of innovations; a major research gap that prior IS sourcing studies largely neglected due to their bias towards investigating outsourcing-specific matters. We suggest that a more fine-grained examination of innovation in our topic of interest's context would benefit the thriving research stream. As with all research, this study has limitations. Our review scope, though broadly defined, isolates our literature sample to our perceived angle of the innovation through outsourcing phenomenon. We also acknowledge the abundance of relevant studies in journals that were excluded in this paper due to our defined inclusion criteria. Future research focusing on innovation through outsourcing may find insights from existing literature published in these outlets to be of great value.

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