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A Decision Making Framework for Information Technology Enabled Business Process Outsourcing

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Abstract

Information Technology enabled Business Process Outsourcing (BPO) is a growing phenomenon yet little research has been conducted to understand the factors that determine its appropriateness for organisations. A framework that considers the decision from the perspective of the transaction, the organisation and its context is outlined. The usefulness of that framework is then assessed using a case study of outsourced customer management services in Australia based upon 35 hours of interviews with three suppliers and three clients. The study suggests that the interaction between the factors shaping the BPO decision is more complex than envisaged and that for outsourcing to occur there needs to be a compelling motivation; in this instance increased competition as a result of deregulation.

Keywords: Business Process Outsourcing, Decision Making, Information Technology

1. Introduction

Business Process Outsourcing (BPO) occurs where a supplier takes over responsibility for one or more of an organisation's business processes. BPO is seen as particularly suited for well defined, self contained and measurable process based activities (Tas and Sunder, 2004). Such activities can be generic such as customer management, human resources and finance or industry specific such as loan application processing. Information Technology (IT) serves as a key enabler in many instances (Tornbohm and Andraut, 2005 ; Edwards, 2004). Indeed Tornbohm and Andraut (2005) have defined BPO as "the delegation of one, or more, information and communication technology intensive business processes to an external service provider".

While academic research specifically focused on BPO is emerging (see for example Feeny et al, 2003 and Ramachandran and Voleti, 2004) the field appears somewhat neglected compared to IT outsourcing. Yet Codling and Miller (2004) suggest that, for the UK at least, BPO will represent a market 75% as large as IT outsourcing by 2007. Technology Partners International (2004) suggest that increasingly BPO and IT outsourcing will be bundled with "the business process ruling the decision making" (p1). The importance of aligning an organisation's IT with its business operations has long been recognised (Delry and Doty, 1996; Sabherwal et al, 2001). BPO by subsuming IT considerations into a broader business decision – rather than being a focus in their own right *à la* IT outsourcing – reinforces that importance.

At a conceptual level, the underlying proposition informing the research programme that this paper forms a part of relates to IT reducing the transaction costs associated with using external suppliers enabling increased BPO. The choice of the actual activities to be outsourced is held to be shaped by the interplay of a number of forces while its ultimate success depends upon the selected supplier possessing the necessary capabilities to manage and deliver the outsourced service. Within this broad research milieu, the current paper is

focused upon improving understanding of the drivers and shapers of BPO with the objective of providing an aid to decision making.

A review of the literature by Dibbern et al (2004) suggests there is a relatively even split between research that has focused on questions of what to outsource, why to outsource and how to manage the relationship with the outsourcing service provider¹. When considering the timeline of the various publications though it might be argued that researchers appear to have moved on from the why and what questions to focus on how to make relationships successful. Increasingly, research papers are seeking to identify the critical factors for a successful relationship (Kern and Willcocks, 2000) or stress the importance of properly formulated contracts (Saunders et al, 1997). In a similar vein, Earl (1996) identified the risks of outsourcing that need to be managed and overcome while Lacity et al (2003) introduced the prospect of enterprise partnerships between customers and suppliers to share risks and rewards.

Furthermore, those papers – both historic and contemporary – that have considered the why and what of outsourcing have often considered the issues in quite generic terms. Objectives cited have traditionally revolved around flexibility, reduced costs and access to economies of scale or new capabilities (Quinn and Hilmer, 1994; Quinn, 1999; Linder, 2004). Lacity and Willcocks (1998) have discussed the merits of selective rather than total outsourcing. The work has also often been somewhat unidimensional applying a single theoretical lens to frame the outsourcing decision (for example Lacity and Hirschheim (1993) and transaction cost theory). There are of course exceptions such as the work of Cheon et al (1995) and Clark et al (1995) which considered a number of alternative theoretical perspectives and argued that they should not be seen as mutually exclusive.

Here it is suggested that the why and what questions need to be revisited – not least because of the evolution in orientation of outsourcing from Information Technology to Business Process. The objective of the current paper is to improve understanding of BPO by presenting a framework to help organizations better determine what activities BPO is appropriate for. While BPO can be adopted for a wide gamut of white collar functions (Codling and Miller, 2004) the framework will be oriented towards assisting decision making for that subset of services that are IT enabled.

The remainder of the paper comprises three sections. The first proposes a framework to guide decision making with regard to BPO. The second outlines an empirical study of outsourced customer management in Australia. Customer management has been recognised by Codling and Miller (2004) as the fastest growing BPO segment with an annual growth rate of 15.1%. The primary objective of the empirical study was to determine whether the framework suggested provided useful insights to assist the BPO decision making process in the customer management context. The final section of the paper outlines the implications and limitations of the current work and suggests opportunities for future research.

The paper contributes to the literature in two primary ways. Firstly it proposes a framework for BPO that draws together different strands of the extant literature. Secondly it further develops understanding of those factors and competencies.

¹ Dibbern et al (2004) identified 28 papers in the what category, 46 in the why and 36 in the how for the period 1988 to 2000.

2. A Theoretical Framework to Assist Business Process Outsourcing (BPO) Decision Making

Given the relative paucity of BPO specific research much of the theoretical underpinnings of the proposed framework will draw from, and synthesise, work conducted in the IT outsourcing realm, and seek to apply it to the context of BPO. The framework proposes IT enabled reductions in transaction costs as the primary motivator behind BPO with the specific choice for a particular organisation being shaped by a combination of firm specific and environmental factors as illustrated in Figure 1².

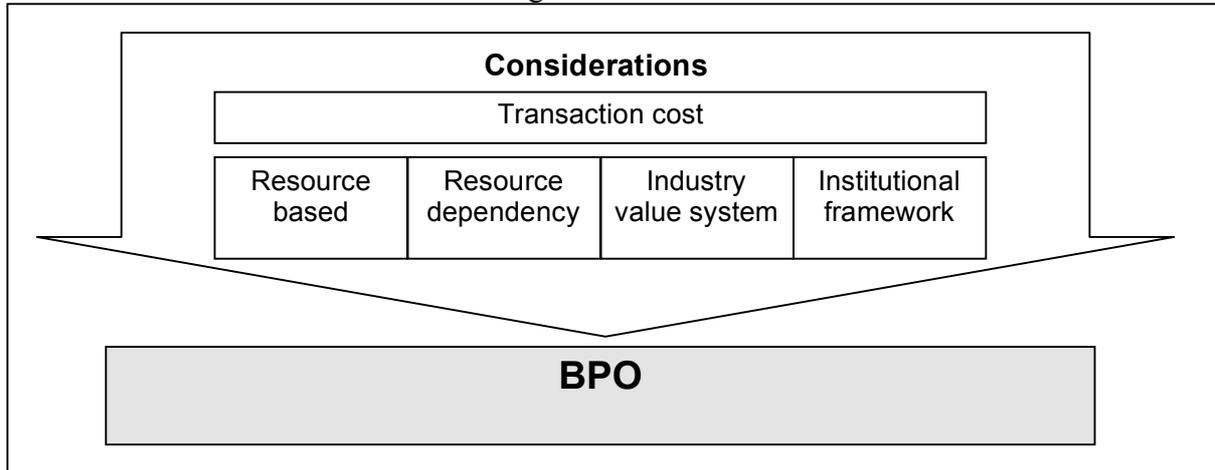


Figure 1. A decision making framework for BPO

2.1 BPO decision considerations

While research examining the motivation for, and objective of, IT outsourcing draws from many theoretical perspectives, three dominate: transaction cost economics, resource based theory and resource dependency theory (Klein, 2002; Cheon et al 1995).

2.1.1 Transaction cost economics

While from a production cost point of view the market (external supply) is always seen as the preferred mode for organising production, transaction cost theorists argue that whether activities are actually undertaken within a firm or obtained across a market, also depends upon the transaction costs associated with each option. Transaction costs are those costs incurred through putting in place, and operating, the necessary governance structure. Williamson (1986) argues that it is the interaction of human constraints and failings – bounded rationality and opportunism – with the specific qualities of a transaction – asset specificity, uncertainty and frequency of the transaction – that determine actual transaction costs.

2.1.2 Resource based theory

Resource based theory suggests that firms secure success by utilising their unique resources (Wernerfelt, 1984). Resources comprise intangible and tangible assets that are tied semi-permanently to the firm. Examples include brand names, machinery and effective processes. A firm can attain a sustained competitive advantage through its resources only when competitors are unable to acquire and deploy similar resources (Mata et al, 1995). In

² While the relationship between motivation & moderation and environmental shaping factors on strategy and between strategy and operational design are shown as unidirectional in reality those relationships are likely to be, to a degree at least, bidirectional. The strategy adopted, for example, is likely, over time, to influence both the prevailing institutional framework and industry value system.

addition, according to Coyne (1986), to provide an advantage the resources must contribute to “a consistent difference in important attributes between the producer’s product and those of his competitors” (p51). Success is maximised where organisations focus their attention on those areas where their distinctive capabilities lie (Hagel and Seely Brown, 2001) and rely on others for the provision of ancillary activities.

2.1.3 Resource dependency theory

Resource dependency theory recognises that organisations are dependent upon their environment and are faced with choices regarding how they manage that dependency. Kotter (1979) suggests dependency is usually the result of an external body’s control of a resource such as equipment, information or a specific service. Organisations need to adopt a strategy to stabilise, and secure, access to such resources. According to Teng et al (1995) the extent of the dependency is determined by a combination of the importance of the resource, the number of potential suppliers available and the cost of switching suppliers.

As Cheon et al (1995) and Clark et al (1995) suggest however it is not necessary to restrict oneself to a single perspective. The resource based and resource dependency theories do not inherently conflict with each other - nor with transaction cost theory (Duncan, 2002). Rather the three theories can be seen as complementary and summative³. Transaction cost theory identifies the general principle that BPO is advantageous subject to the transaction costs incurred. The addition of resource dimensions moves any decision beyond pure transactional analysis to take into account the underlying activity. Considerations relating to the strategic contribution of a resource to an organisation and the need to manage supplier relations are introduced. Specifically the two resource related theories suggest that an organisation needs to retain those activities which represent its unique core capability and ensure that it does not become overly dependent upon specific external parties for any other activity.

The synthesis of the three approaches provides a rationale for identifying candidate activities for BPO from the perspective of the focal firm – the outsourcer. Drawing from the work of Melville et al (2004) it is suggested that the operating environment in which that firm sits – specifically its institutional and industry context – also needs to be considered. The influence of such factors though appears to have been neglected by the outsourcing literature to date. Where they have been considered it appears typically only to determine that there is a sufficiently competitive supplier market (Ang and Straub, 2002).

2.1.4 Industry value system

Porter (1985) identified that the competitive success of an organisation is determined by a combination of the value chain of that organisation and the broader value system within which it is positioned. Porter argued that five forces determine the attractiveness of an industry to a firm: bargaining power of buyers; bargaining power of suppliers; threat of new entrants; threat of substitute products or services; and rivalry among existing firms. When considering how its activities are organised and whether to embark on BPO an organisation needs to consider the potential impact on its place within the value system – for example by reducing barriers to entry for new competitors. Griffiths and Remenyi (2003) provide the example of such a scenario in the financial services sector, suggesting it has become progressively easier for non-bank financial institutions to move into banking.

³ Melville et al (2004) suggest that adopting such a synthesising approach is beneficial. While the existence of multiple competing theoretical approaches can provide varied insights the resulting fragmentation and isolation can also limit the overall development of understanding in an area.

2.1.5 Institutional context

According to Perez (1983) organisational activity occurs within an institutional context. Together the political, economic and judicial institutions of a society function as a web of interconnected formal rules and informal constraints that establish a stable structure for individual and organisational interactions - the so called "rules of the game". By regulating relationships the institutional context is one of the key enablers of economic trade and specialisation and serves to promote particular modes of organising activities (North, 1990). Of particular interest here is the extent to which the prevailing institutional context allows, encourages or inhibits BPO.

3. Methodology

The case-study method is well established in information systems research especially where the aim is to enhance understanding in circumstances where research and theory are at a formative stage and a phenomenon is not well understood (Benbasat et al, 1987). The case work presented here is descriptive, seeking to improve understanding of the BPO decision (Bonoma, 1983; Yin, 1984).

A total of six cases were developed to examine BPO from both a supplier and client perspective. Three of the cases were supply side and three client side. Suppliers were selected on the basis of being the largest providers of outsourced call centre services in Australia. Together they represent over 50% of the market. Tas and Sunder (2004) suggest that BPO is particularly common in the financial services, utilities and telecommunications industries. Clients were selected to ensure coverage across these areas. Multiple cases, by providing the potential for either contradictory or similar results, increased the level of understanding of customer management outsourcing that could be achieved and the extent to which the findings would be generalisable.

Interviews were sought with multiple stakeholders in each organisation to provide a degree of confidence in the answers through triangulation. Supply side interviewees typically comprised business development managers and client managers. Client side interviews were conducted with managers with responsibility for call centre operations and managers responsible for outsourced operations. A total of 35 hours of interviews were conducted with individual interviews generally between one and two hours in duration.

Supplier 1	Founded in 1996 and operating at multiple sites in Australia and New Zealand with a total seat capacity in excess of 1500
Supplier 2	Founded in 1998 and currently operating nine call centres in Australia with a total number of seats in excess of 1500
Supplier 3	Local subsidiary of a multinational provider launched in 1996 with six sites in Australia providing a total number of seats in excess of 1500
Client 1	A major Australian financial services provider
Client 2	An established utility supplier that has recently expanded the range of services it provides
Client 3	A major telecommunications provider with operations in Australia and overseas

A semi-structured interview protocol was constructed to identify the factors motivating and shaping the BPO decision. Interview material was then reviewed to determine the extent to which those factors were addressed by the theoretical framework proposed thus enabling its

potential usefulness as a decision making guide to be assessed. Such an approach does not preclude the emergence of concepts not previously considered and is in line with the methodology presented by Eisenhardt (1989) as appropriate for theory building research

4. Analysis of BPO Decision Making by Providers of Outsourced Customer Management Services

4.1 Considerations

Interviewees suggested that outsourcing has been facilitated by IT which enables access to common systems and data regardless of location. In a number of cases virtual call centres – which combine separate call centres often provided by different providers accessed by a single telephone number – have been established. With regard to the motivation for outsourcing the primary reason suggested was to reduce cost.

“customers typically looking for savings of 20% to be worth the risk” Supplier 1

Suppliers suggested that the underlying impetus to outsource was increased competition as a result of deregulation. Existing players were moving to expand their operations into new activities and territories and defend their core business.

“[client] moved inter-State.. adopted a new model of a core team with the rest outsourced” Supplier 2

The reduction in cost achievable by outsourcing was seen primarily to result from lower labour costs. Lower costs reflected a combination of a largely non union workforce (with exceptions⁴) and the ability to establish preferential enterprise bargaining agreements (EBAs)⁵. Supplier 1, for example, cited its ability to establish a labour vehicle that gave it flexibility with regard to the contracting of staff as a significant source of competitive advantage. Supplier 2 believed the same was true with regard to its ability to negotiate an EBA with a major union.

“outsourcing allows clients to do something different break up their existing labour environment and drive different relationships” Supplier 2

At an industry level the penetration of outsourcing appears to reflect the sequence in which deregulation has occurred with interviewees suggesting that telecommunications leads the way followed by financial services and utilities. Outsourcing is increasingly also starting to be adopted by the public sector. A second learning curve appears to exist within individual organisations. Initially activities that do not directly impact upon customer service or are for non-core customer segments are outsourced. Acquisition (outbound telesales) often appears to be the first.

“outsourced services are those that are short, routine and high volume” Client 1

⁴ Supplier two transferred a heavily unionised workforce from one of its customers

⁵ Enterprise bargaining agreements (EBAs) establish work practices and conditions of employment that are specific to the employees and the business or businesses covered by the agreement.

“outbound services typically go first.. they are campaign based and requirements fluctuate making them hard [for clients] to manage” Supplier 3

Supplier 1 gave the example of a motor vehicle insurer that was only prepared to outsource customer service activities that were related to its recently established expansion into home insurance. All interviewees suggested that only those activities seen as non-core are outsourced. These vary considerably depending upon the focus of the individual organisation. The decision however appears to be more complex than a simple one time core/non-core assessment. As organisations become more comfortable with outsourcing they become prepared to outsource an increasing range of customer management related activities.

“we have moved away from seeing much of customer service as core as other areas have taken precedence with regard to money and management focus” Client 1

The prevailing organisational setting also appears to have an influence. A number of clients, for example, have outsourced an activity where it is associated with a new initiative. Yet they have not sought to outsource the same activity where it relates to an established operation. The principal reason cited was the difficulty of pushing through the organisational and cultural change required in the organisation. Client 3, for example, initially provided all customer management services in house. The collapse of a competitor led to much more rapid growth than was anticipated or manageable. As such an outsourced overflow facility was established. As growth has continued it has been absorbed by the overflow facility which now accounts for approximately 60% of all customer management services. There is no intention however to outsource the in-house portion.

Clients suggested that there is a limited pool of suppliers to choose from often resulting in competitors using the same supplier. Such arrangements are not preferred but are seen as inevitable and manageable.

“Australia is a small business environment with a limited pool of expertise.. [want] separation .. of people & buildings” Client 2

In part the “sharing of suppliers” is because multiple suppliers are often used to provide the same service. Different services are also outsourced separately. Such arrangements provide back-up and permit comparison in terms of service and price. Not having all or nothing contracts also provides leverage to clients. It becomes practical for a client to threaten to, or actually, move business between suppliers as a means of signalling that an improvement in service is required.

“.. it can be difficult for a supplier if they loose a chunk of business but generally suppliers look to the long term and have multiple streams of business with [client 1]” Client 1

Moving between suppliers though is acknowledged as difficult and costly and seen as becoming more so over time as the extent of the services outsourced by an organisation increases. Client 3 for example related the case where the initial implementation of a BPO initiative failed and they had to take the service back inhouse for three weeks. They doubted that they could do this now as they no longer have the necessary skills internally. Actual change is infrequent. Client 1 said that they do not go out for tender when contracts expire unless they have been unhappy with the service provided. In addition incremental business

will often be simply be added on to existing contracts. They were confident however that they had effective control over suppliers

“we re-negotiate contracts regularly and are also quite often approached by suppliers offering their services so we feel we have an understanding of whether the price is fair” Client 1

Contracts are typically long term with a cost reduction element. Supplier 1 cited one contract that was for 10 years with an option for a further 10 year extension while client 2 stated that some of its supplier relationships had run for up to eight years and were still ongoing. According to supplier 1 though clients can often fall into one of two traps. The first is where they do not accurately know what their baseline costs are.

“they had no idea what it cost them to service customers. They researched it and came up with a figure of \$X and asked for \$ X/2.. the actual figure was about \$X/8” Supplier 1

The second is where the client prices a contract so that it is marginal as to whether it is commercially viable for the supplier resulting in the supplier continually looking to cut costs or find ways to increase the price with negative consequences for the service delivered and the relationship between supplier and client.

With regard to the framework proposed the cases suggest that the situation is more complex than anticipated. An IT enabled ability to minimise costs appears prima facie to be in accord with transaction cost theory. However the cases also suggest that there needs to be some impetus for organisations to take advantage of the opportunity – provided by deregulation and increased competition here. As such institutional and industry factors are the actual drivers of the decision.

“It is not enough to be able to outsource, you also need to have to” Supplier 1

Specifically as regulation restricting the entry of new players into a sector, or governing prices, has been loosened competition has intensified. As the status quo is disrupted organisations have sought to maximise efficiency with BPO being one of the means of achieving this.

With regard to what is outsourced, resource based theory would predict non-core activities. And it does appear to be non-core activities that have been outsourced. However an organisation’s perceptions of what is core and non-core is fluid and over time they appear prepared to accept that an increasing proportion of activities do not need to be performed in house. Furthermore while resource based theory might be useful in identifying potential activities for outsourcing the cases suggest that the current organisational setting, or modus operandi, influences what it is actually outsourced.

From a dependency perspective the market would appear to be competitive with a number of alternative providers available. Clients have also often sought to manage their dependency by ensuring that they do not use a single supplier and breaking down their outsourcing requirements into a number of activities which are then contracted for separately. However it is recognised that changing suppliers is a difficult and costly process. Furthermore as the concept of what is a core customer management activity tightens and more and more is

outsourced dependency may increase as the ability to bring activities back in-house dissipates leaving only the option of moving from one supplier to another. It would also appear that the ability to manage suppliers varies as evidenced by the different views presented regarding contract pricing.

The research suggests that the adoption of outsourcing may be an industry level phenomenon and an organisation can expect many of its erstwhile competitors to be following the same path as it. As such BPO may lead to the efficiency of whole sectors being improved and at the same time the attractiveness of those sectors also being increased to competitors as barriers to entry – the range of activities that need to be conducted internally – are reduced. In such circumstances an organisation needs to ensure both that it does not get left behind but also that it is enhancing the core capabilities that differentiates it in the market.

As the framework suggested, the prevailing institutional framework has influenced the attractiveness of outsourcing. Its regulation of the cost of labour – whereby new lower rates of pay can be accessed by outsourcing – has furnished the key benefit to be obtained by outsourcing customer management services – at least initially. It is not so much the specialist skills or economies of scale of outsourcers that clients have sought rather their access to cheaper labour.

5. Implications, Limitations and Future Research

Building upon, synthesising and extending existing work in the IT and business process outsourcing domains, the paper proposed a theoretical framework to guide BPO decision making. While the case study offers support regarding the potential usefulness of that framework it also suggests that there is a more complex interaction between the factors identified than anticipated. At the outset, for example, it was thought that consideration of the industry context of an organisation would be from the perspective of ensuring that BPO did not improve its attractiveness to actual or prospective competitors. The research however suggests the possibility that changes in that context – specifically increased competition as a result of deregulation in this instance – can also serve as the impetus for BPO. As such factors that, at the outset, were positioned as *moderators* of BPO activity need also to be considered as potential *drivers*. That change in perspective implies that IT enabled reductions in transaction costs are a necessary but not necessarily a sufficient condition for BPO. Furthermore the cases also suggest the need to pay attention to and additional influence, the internal organisational context of an organisation that may also shape what activities it is operationally or politically feasible to outsource.

From a research perspective the paper, by highlighting the interactions between various influences on the BPO decision, demonstrates the value of combining multiple perspectives. From a practitioner perspective, the research allows organisations embarking on BPO to learn from the approaches adopted by others, for example with regard to managing dependency on suppliers. More fundamentally, by illustrating the spread of BPO over time to different aspects of customer management it raises the question of whether any part of customer management will ultimately remain a source of differentiation or competitive advantage.

One weakness of the research is that it is focused on one BPO activity – customer management – in one location – Australia. In addition it has considered only large suppliers and clients in the private sector. More extensive empirical work across a broader range of organisations, activities and locations is needed to determine whether the findings can be

generalised. It is likely, for example, that the factors influencing BPO will significantly differ between the private and public sectors.

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