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Governance Mechanisms as Substitutes and Complements: Explaining Differential Relationships between Contractual and Relational Governance

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Governance Mechanisms as Substitutes and Complements: Explaining Differential Relationships between Contractual and Relational Governance

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Abstract
In recent years scholars have discussed the relationship of contractual and relational governance in information systems outsourcing. For a long time the substitutional view of governance mechanisms originating from transaction cost theory was dominant. As an example, complex contracts were seen as an opposing alternative to unwritten agreements based on trust. Empirical results, however, challenged this view and rather supported the competing perspective, implicating that relational and contractual governance are complements. However, results of novel investigations favor another argument: Relational and contractual governance mechanisms can simultaneously be complements and substitutes. However, if governance mechanisms can be both substitutes and complements, the question arises whether the relationship between governance mechanisms is the outcome of distinct processes of interaction between contractual and relational governance. Therefore our research question is: Which underlying processes explain the relationship (substitutes or complements) between relational and contractual governance? To answer this research question we conducted an exploratory, multiple-case study of five IT outsourcing projects at a leading global bank. Our results show, that there are three archetypical processes that illustrate how the interaction between relational and contractual governance results in their complementarity. Our major contribution is a shift in perspective. While former studies focused on explaining, whether contractual and relational governance are complements or substitutes, we answer the question how and why they become complements or substitutes. We argue that the processes we discovered have the explanatory power to unify contradictory empirical results by tracing them back to differences in the underlying processes. Based on our findings, we give implications for further research.

Keywords: Contractual Governance, Relational Governance, Substitutes, Complements, Outsourcing, Offshoring

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ABSTRACT

In recent years scholars have discussed the relationship of contractual and relational governance in information systems outsourcing. For a long time the substitutional view of governance mechanisms originating from transaction cost theory was dominant. As an example, complex contracts were seen as an opposing alternative to unwritten agreements based on trust. Empirical results, however, challenged this view and rather supported the competing perspective, implicating that relational and contractual governance are complements. However, results of novel investigations (Tiwana, forthcoming, Woolthuis et al., 2005) favor another argument: Relational and contractual governance mechanisms can simultaneously be complements and substitutes.

However, if governance mechanisms can be both substitutes and complements, the question arises whether the relationship between governance mechanisms is the outcome of distinct processes of interaction between contractual and relational governance. Therefore our research question is: Which underlying processes explain the relationship (substitutes or complements) between relational and contractual governance? To answer this research question we conducted an exploratory, multiple-case study of five IT outsourcing projects at a leading global bank.

Our results show, that there are three archetypical processes that illustrate how the interaction between relational and contractual governance results in their complementarity. In addition, we find one process explaining a substitutional relationship between contractual and relational governance.

The first archetype 'contractual governance as enabler for relational governance' explains how contractual clauses stipulate social interaction fertilizing relational governance. The second archetype 'relational governance as enabler for contractual completeness' explains how strong social ties give access to knowledge which would otherwise be hard to access and is utilized to refine contractual clauses. The third archetype 'contractual governance as safety net' shows how contractual governance facilitates application of relational governance by reducing perceived relational risk. While the aforementioned processes explain complementarity, 'relational governance as enabler for contractual flexibility' shows how strong social ties reduce the need for detailed contractual clauses and hence explain substitution.

Our major contribution is a shift in perspective. While former studies focused on explaining, whether contractual and relational governance are complements or substitutes, we answer the question how and why they become complements or substitutes. We argue that the processes we discovered have the explanatory power to unify contradictory empirical results by tracing them back to differences in the underlying processes. Based on our findings, we give implications for further research.

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