Drivers of Vendor Satisfaction with Clients in IT Outsourcing Relationships[1]

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***Abstract*--This research begins to help us understand the factors that help build the trust between the vendor and client and this is one of the keys to maintaining a long-term relationship between the parties. Both contractual and relationship factors affect the ability of vendors and clients to work together over time. A recent study had demonstrated that relational factors such as trust and information exchange dominated in their ability to explain client satisfaction when compared to contractual factors. In this study we further explore the role of trust and other relational factors such as social control and mutual dependence on vendor satisfaction with the clients. India has established itself has the premier location for offshore outsourcing because of its availability of a skilled talent pool with strong communication skills and English language capabilities**

Using data collected from 214 vendor firms in the Indian subcontinent, we found that mutual dependence and competence based trust were significant predictors of vendor satisfaction with the client. Social control or the ability to resolve conflicts did not impact satisfaction. We discuss the import of these findings for managing vendor client relationships in the short and long term.

I. DRIVERS OF VENDOR SATISFACTION WITH CLIENTS IN IT OUTSOURCING RELATIONSHIPS

Solli-Saether and Gottschalk [51] define outsourcing as ‘a discontinuation of internal production (whether it be production of goods or services) and an initiation of procurement of services from outside suppliers” (p. 19). IT activities and services that are being offshored have been growing dramatically, since the 1990s and is expected to exceed $285 billion in 2020 up from $18 billion in 2002, a CAGR of 15% [22]. China and India, two of the most populous countries with a large and expanding base of information technology human capital have emerged as the largest centers of offshored IT work (Friedman, 2005)[18]. Since the emergence of the internet, there has been a rapid disaggregation in the implementation of activities within the value chain in many industries; and various activities including R&D, customer relationship management and implementation of business processes are being undertaken in disparate offshore and onshore locations. As information technology (IT) outsourcing has become more pervasive, the need to manage these IT outsourcing relationships on a long-term basis has become more important both from a client and vendor point of view [32].

Offshore outsourcing is where firms contract for services with external firms located in remote destinations other than where the client firm is located [43]. Client firms outsource information systems related activities to offshore vendors to achieve higher profitability by taking advantage of flexible labor and infrastructural costs [42]. Other reasons for outsourcing include that the internal departments have difficulties managing the complexity of IT and retaining the IT expertise in-house. Although there are significant benefits of lower costs and increased flexibility, outsourcing is also associated with increased costs of monitoring and managing activities since organizational boundaries are altered significantly [4], [14].

Many studies have examined outsourcing relationships from the client’s perspective and have focused on the why, what, which, and how client firms outsource [30], [21], [13]. The “why” refers to the reasons a company might consider using outsourcing and this initial intelligence phase explains the determinants or drivers of outsourcing. The “what” refers to the activities the company should outsource (this is also linked to the “why” to outsource decision). The “which” refers to making the choice of vendor; including coming up with the guidelines and selection criteria. Finally, the “how” refers to the implementation of decisions related to outsourcing. Dibbern et al. [13] also include the outcomes of the outsourcing decision in this last phase. In this study we are focusing on the last phase where the emphasis is on the outcomes. Outcomes can also be viewed as satisfaction, expectations and their realization and overall performance [13]. We focus on overall satisfaction between the vendor and client. This is likely to impact relationship longevity or whether the client and the vendor want to continue working with one another based on realized outcomes and objectives.

Many of the studies have explored these elements from the client’s perspective [13]. Jugdev and Müller [23] focused on efficiency-oriented measures from the client’s perspective and Ang and Straub [3] have focused on the financial impact to the client. However, as was the case in Palvia, King, Xia, and Palvia [41] and Ojha [39] this study shifts from a client-focused perspective to a vendor focus. As these relationships are dyadic, it essential to understand both sides and this is an important step in gaining knowledge and understanding these relationships. There may also be a need to pay attention to intra-organizational dynamics within a client or vendor to understand the success of these relationships [40].

While the outsourcing can be done with vendors both onshore and offshore, we focus on “*offshore outsourcing*” with vendors based in India. India has established itself has the premier location for offshore outsourcing because of its

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availability of a skilled talent pool with strong communication skills and English language capabilities [6], [20]. McKinsey Consulting argues that for every dollar that US client organizations spend on outsourcing to vendor organizations in India, American corporations benefit by $1.14 and India by 0.33 cents [36]. A recent study, “A T Kearney's 2016 Global Services Location Index (GSLI)” rated India as the most favored country for offshore outsourcing among the 55 countries analyzed. The study suggested that the attractiveness of offshoring to India has been sustained by the relocating operations to tier 2 and 3 cities to reduce costs to offset challenges from China and other Asian countries. Further, to offset the dependence on US outsourcing, the firms have attempted to establish offshore outsourcing relations with firms located in other countries [38]. The firms located in tier 1 cities, that were the original destinations for offshore outsourcing to India, have moved up the value chain to work on their own products in an eco-system in which start-ups and entrepreneurial firms are thriving. NASSCOM estimates suggests that the IT services business in India was worth US$ 143 billion in 2016, and is expected to reach US $ 225 billion by 2020 and US$ 350 billion by 2035 [37].Offshoring outsourcing has proved to be beneficial to both client and vendor firms.

There are two aspects that we explore further. The first relates to the theoretical anchoring of past research and the second relates to the lens through which we view the client-vendor relationship. In the past, the two key theories-transaction cost theory [53] and agency theory [17] were used in examining outsourced projects. They had a pronounced “client bias” and their focus was on the uncertainty and the opportunistic behavior that vendors may engage in to the detriment of the client. The research from the agency viewpoint has focused on formal controls, and incentives from the client to manage the offshore vendors [44] underplaying the relational aspects. In reality, vendors and clients over time develop working procedures that facilitate communication, interaction, and continued co-development of mutual activities. Both contractual and relationship factors affect their ability to work together and the subsequent relationship. A recent study has demonstrated that the relational factors such as trust, information exchange and conflict resolution mechanisms dominated in their ability to explain client satisfaction when compared to contractual factors [39, [45].

The second issue focuses on research from the client versus the vendor’s point of view. Historically research been “client centered” and has focused on client related factors such as the cost advantages that accrue to the client as a result of outsourcing [28]; optimal outsourcing rate based on the client’s ability to obtain optimal production knowledge from the vendor [8]; client search strategy to find appropriate vendors in offshore location [26] and the specific conditions under which knowledge transfers to offshore locations would reduce a client’s domestic in-house production costs leading to lower costs both in the short term and the long term [7]. Theory and research from the vendor’s perspective is more recently coming to the fore [41], [21]. Just as clients are an important aspect of the relationship, so are the vendors that work with the clients to deliver the required services over time [39]. Success in relationships is a multidimensional construct and its perception can be significantly different depending on the “eye of the holder” or whose perspective that it is seen from [21]. Some of the recent findings with vendor-centered research that was case based were that vendor adaptability to client, flexibility of the contract and adaptability of client were considered key aspects that drove success with the client relationship from the vendor’s perspective. Here, we examine some additional relational factors measured though a survey setting from the vendor’s perspective.

“An important finding from the social exchange perspective is that vendor-client relationships are either terminated or continue based on the perceived satisfaction of these relationships” [19]. Satisfaction of both parties is important to sustained long- term relationships. Although the satisfaction of client with the vendor seems an obvious factor in the longevity of the relationship, vendor satisfaction with the client can also be equally important to the continuity of the relationship. Examining the vendor side of the dyad can be instrumental in developing a successful partnership between the client and vendor [47].

The rest of the paper is organized as follows. First we discuss background literature and build the hypotheses, then the methods, and results followed by the discussion, limitations and conclusion.

II. THEORY AND HYPOTHESES

Deng, Mao and Wang [12] state “a relational view to offshore IS outsourcing can enrich our understanding of the source of relational performance, which in turn helps clients reap more benefits from the vendor in the long term” (p. 10). The relationship factors that have been examined include mutual trust, knowledge sharing, mutual dependency, information exchange, intercultural competence, conflict resolution, and mutual obligations [33], [21], [47]. Lee et al. [33] have determined that mutual trust, knowledge sharing and mutual dependency affected outsourcing success. Haried and Ramamurthy [21] argue that key relational success dimensions include trust, commitment, and conflict resolution. Based on these previous studies we decided to focus on three relationship factors that are important to vendor satisfaction. In this study we focus on the relational perspective by examining three factors: competence-based trust of the client (which includes information exchange), social control (conflict resolution mechanisms) and mutual dependence between the client and the vendor.

These relational factors allow for a co-dependence between the client and vendor. There are a number of advantages, including cost-reduction, flexibility and adaptability for the client, mutual trust, adaptive learning and co-operation for the vendor that result from long-term relationships [29], [15]. While client satisfaction with the vendor, allows the vendor to grow and cement the relationship, it is also important for the vendor to be satisfied with the client. Over time, when activities are outsourced, it becomes harder for the client to backshore activities back to the client site, which can become complicated because of long-run degradation of the firm's knowledge base [7]. Over time, both parties become vested in the relationship and are looking for ways to sustain it.

Trust is essential for the success of partnerships and strategic alliances [2], [11]. "Trust has been defined as "a psychological state comprising the intention to accept vulnerability based upon positive expectations of the intentions or behavior of another" [48; 395]. The focus of this definition is on intention. However trust can also be defined as competence-based trust. It is this construct of trust, the cognition-based, competence trust, where trust is defined as a trustor's belief about trustee's competency or ability to carry out obligations, that this study focuses on [10]. When there is competence-based trust there is the assumption that the partner is capable of meeting expectations. This is generally viewed from the client's perspective. But this can also be viewed from vendor's perspective. This view of trust incorporates the vendor's perspective that the client knows what they are looking for. This allows the vendor to cultivate trust in the relationship. When the client knows what they are looking for, this makes meeting the requirements easier and the vendor understands more readily what is expected and this in turn increases their satisfaction with the client. Mutual trust between the client and vendor is very important for knowledge sharing and ITO success [33]. Competence-based trust facilitates continued collaboration [35] and as such, competence-based trust is an important relational attribute for ensuring outsourcing relationship success. This leads to the following hypothesis:

Hypothesis 1: The higher the client's knowledge of their business needs, the higher the vendor's trust of the client's competence, and greater the vendor satisfaction with the client.

Social exchange theory is a social psychological and sociological perspective that explains social change and stability as a process of negotiated exchanges between parties. In any relationship there are conflicts that need to be managed. Conflict in the vendor-client relationship is reflected in the overall level of disagreement between parties over goals, roles, procedures and execution of the contract [25]. The relationship needs to be managed both in the short and long term. One element of social exchange theory is social norm control. Control is "a regulatory process by which the elements of a system are made more predictable through the establishment of standards in the pursuit of some desired objective or state" [34; 117]. Social control however is not included in the alliance contract but represents unwritten or tacit work rules that evolve into acceptable or unacceptable norms of behavior [16]. Social control in alliances emerges from a socialization process between the partners over time, which results with shared beliefs and values and influences the partner's behavior in a way that commitment to the alliance is enhanced [11]. One result is that there are systems in place to resolve conflicts (relationship vs contractual). Robey et al. [47] determined that the existence of conflict resolution processes were positively associated with outsourcing success. Working through the operational problems and resolving the problems strengthens the outsourcing relationship between the vendor and client [5]. This leads to the following hypothesis:

Hypothesis 2: The more developed the social control norms between the client and vendor, the greater the vendor's satisfaction with the client.

Satisfaction is important to both companies' (vendor and customer) long-term relationship. In relationships including outsourcing agreements, interdependence is the degree to which members of the group are mutually dependent on the others. Lee and Kim [31] found that the higher the degree of mutual dependency, the more likely it is to result in a higher quality of the relationship. Mutual dependency determines the extent to which a firm will have influence over and in turn be influenced by its partner. Mutual dependence creates mutual obligations that may be based perceived expectations of the other party. Mutual dependence creates stronger expectations of reciprocity of behavior [24], [1]. In addition, mutual trust between the client and vendor is very important for knowledge sharing and ITO success [33]. Mutual dependence allows the vendor to leverage their position with the client and this in turn can make the client more adaptable if necessary [21]. This leads to the following hypothesis:

Hypothesis 3: The greater the mutual dependence between the client and vendor, the greater the vendor's satisfaction with the client.

III. METHODS

A survey was developed and pre-tested with vendors in India and client firms in the US that used international IT vendors. Based on their comments and suggestions, modifications were made in the survey questionnaire. The survey was originally sent to all of the 1578 NASSCOM (The National Association of Software and Services Companies) members in India in June 2014 using Survey Monkey software. Four reminder emails were sent to the non-respondents. As of mid-August 2014, we had received 214 responses a response rate of 13.6%. Of the surveys that were returned only 114 surveys were complete and usable.

IV. THE SAMPLE

This study is focused on vendors in the IT/BPO section in India which had aggregate revenues of $88.1 billion in the year 2011 and employed almost 2.5 million employees. The vendors in the IT/BPO sector can be divided into four categories – large integrated players, mid-sized players, emerging players, and small start-ups. The characteristics of the players in each of the four categories are vastly different [37].

The *large integrated players* have revenues over $1 billion. There are 9 players in this category accounting for 45-48% of the total revenues. They are MNCs and Indian firms and they are all fully integrated and have over 40,000 employees each. These players can offer IT-bundled solutions and are locating services near-shore to reach out to more customers. We had no firms from this category that responded to our survey.

The *midsize players* have revenues between $100 million and $1 billion and account for 30-35% of the total revenues of this sector. There are about 75-80 players in this category. These firms have between 5000 and 40,000 employees. They include off-shore delivery centers for the major firms and large third party vendors that have develop specialized delivery capabilities for specific verticals. There were 17 firms from this category that responded to our survey.

The *emerging players* have revenues between $10 million and $100 million and account for 9-12% of the revenues. There are a total of 300-350 players in this category and many of these firms have developed niche capabilities around a single vertical and have a dedicated client base in the small and medium business segment. There were 81 firms in this category that responded to our survey.

The last category is the *small start- up*. They have revenues of less than $10 million and there are over 3500 players in this category and they account for 10-12% of the total revenues. There were 116 firms in this category that responded.

V. MEASURES

A. Dependent Variable

Vendor satisfaction with the Client: The variable vendor satisfaction with the client was constructed using a 7-item scale which measured the satisfaction with the communication, business terms and overall business growth. This scale was adapted from [46]. Their scale use the earlier work of Claro [9] and the scale had an α score = 0.81. Our seven items on our scale included satisfaction with (i) the frequency of communication with the client; (ii) type of communication with the client; (iii) the way the client solves problem together with the vendor; (iv) general business terms; (v) growth in sales volume with this client over the last three years; (vi) growth in sales volume over the term of the relationship; and (vii) the overall relationship with this client. The ideas for this scale and the scale had a α score of 0.88**.**

B. Independent Variables

The scales for the three independent variables competence based trust, social control, and mutual dependence were adapted from Sengun and Wasti [50] which looked at alliance relationships between wholesalers and pharmacists.

Competence based Trust. This scale had a reliability score of α =0.67 and was constructed using a three item scale - (i) the client is an excellent source of accurate information; (ii) the client is very reliable; and (iii) the employees of the client know their business. The reliability of this scale was very similar to that found by Sengun and Wasti [50] in their study.

Social Control. This scale was constructed by combining five items and had a reliability score of α =0.62. The five items were as follows (i) this client has a good reputation in the industry; (ii) legal disputes with the client are unlikely; (iii)disagreements with this client are solved by working together; (iv) we both cooperate to solve disagreements; and (v) this client understands the needs of our business and the way we work.

Mutual Dependence: This was measured by a two- item scale and had a reliability α score of 0.71. The two items that made up this variable were (i) we are very important to this client’s future profitability; and (ii) this client is very dependent on us for its business success. The original scale used by Sengun and Wasti [50] came from Svenson [52] had three items but in the reliability of the three item scale was 0.58. We dropped one item and the scale reliability improved to its current score.

C. Control Variables

We used three control variables in this study. The first was the number of vertical segments or business categories that the vendor participated in. This was indicative of diversity of the businesses that the vendor was involved in. For example, some of the vertical segments that vendor was involved in included aerospace, automobiles, apparel, banking, biotechnology, communications, consulting electronics, financial services etc. We also controlled for size of the firm measured by the total number of employees and age of the firm measured by total number of years since the founding of the firm.

VI. RESULTS

Table 1 presents the means, standard deviations, and the correlations of the study variables. As is evident from the Table, the older firms are larger and are involved in a larger number of businesses. The three independent variables seem somewhat correlated.

In Table 2, we present the results of the hierarchical regression model. In the baseline model, the control variables were entered in the equation and vendor satisfaction with the client was the dependent variable. It seems that larger firms that were involved with more verticals seemed more satisfied with their clients. The F-score with the control variables was 5.65, α= 0.001, and explained R^2 was 0.11. When the independent variables were entered into the equation in Model 2, the R^2 went up from 0.11 to 0.45. The independent

TABLE 1
MEANS, STANDARD DEVIATIONS, AND CORRELATION MATRIX OF STUDY VARIABLES

Variables	Mean	Sd	1	2	3	4	5	6	7
1. Vendor satisfaction with client	4.09	0.56	1.00						
2. No. of Businesses	1.95	1.19	0.27**	1.00					
3. Size of Business	2.90	1.75	0.25**	0.02	1.00				
4. Age	12.20	7.59	0.16*	-0.08	0.45***	1.00			
5. Competence Based Trust	4.15	0.57	0.62***	0.20*	0.41***	0.17*	1.00		
6. Social Control	4.22	0.45	0.53***	0.27**	0.28***	0.16*	0.69***	1.00	
7. Mutual Dependence	4.02	0.65	0.46***	0.11	0.29***	0.08	0.34***	0.50***	1.00

* $p<0.05$ ** $p<0.01$ *** $p<0.001$

TABLE 2
HIERARCHICAL REGRESSION RESULTS WITH VENDOR SATISFACTION OF CLIENT AS DEPENDENT VARIABLE (N= 114)

Variables	Model 1 - Baseline with control variables	Model 2 - Independent Variables
1. No. of Businesses	0.27**	0.15*
2. Firm Size	0.21*	-0.09
3. Firm Age	0.09	0.10
4. Competence Based Trust		0.52***
5. Social Control		-0.01
6. Mutual Dependence		0.28***
F-Scores	5.65***	15.96***
R^2	0.11	0.45
Δ R^2		0.34

* $p<0.05$ ** $p<0.01$ *** $p<0.001$

variable competence based trust was significant at (ß =0.52, α= 0.001) fully supporting hypothesis 1. The more competent and knowledgeable the client was of their needs, the more satisfied the vendor was with the client. Hypothesis 2 that argued, the more developed the social control norms between the client and vendor, the more satisfied the vendor was with the client was not supported by the data (ß =-0.01). From the data it appears that the social control norms was not associated with vendor satisfaction with the client. Hypothesis 3 that proposed, the greater the mutual dependence between the vendor and the client, the greater would be the vendor satisfaction with the client was supported fully (ß = 0.07, α= 0.001). The F-score for the full model was significant at 0.001 (15.96, α= 0.001).

VII. DISCUSSION

The goal of this research was to begin to understand the factors that impact the vendor's satisfaction with the client in IT offshoring. Most previous research has viewed the dyadic relationship from the client perspective and has focused on client satisfaction with the vendor as a means to make decisions on vendor selection, retention and evaluation. Increasingly, as clients are becoming more dependent on their vendors because of the complexity associated with back-shoring activities back to the client, the vendor's perspective of satisfaction with the client needs to be further examined [7]. The concentration of IT related outsourcing activities among vendors in the Indian sub-continent has increased their skill repertoire and their leverage over time, and the findings of this research further elaborate how the vendors assess their satisfaction with their client and gradually leverage their position. It is important for clients to understand that as the industry in IT industry in India matures, the aspirations of the original outsourcing firms are changing. They are attempting to reduce reliance on large clients, located primarily in the US, to clients located in other geographies and also moving into the domain of software products. In this context, clients that want to retain relationships with reliable service providers may have to understand the needs of the vendors to sustain the relationships.

As suggested by previous researchers, we recognize that the relational aspects in the client-vendor relationship could be a driver in building effective cooperation and coordination between the two the parties. In this study we focused on three specific aspects - the knowledge and competence of the client also labeled as competence based trust, the effectiveness of conflict resolution and working together also labeled social control norms and finally mutual obligation or reciprocity labeled mutual dependence.

The competence and knowledge possessed by the client engendered trust in the vendor and was strongly associated with vendor satisfaction with the client. When the client was competent and knowledgeable, the vendor had clearly defined expectations and the client was also able to specify the outcomes required from the vendor. In such cases, there was less ambiguity in the job specifications. More competent clients have more information and are able to exchange the necessary information with the vendors. The data seems to indicate that larger vendors engaged in more verticals generally perceived their client as being more competent. It could be the larger vendors were also more experienced and had better developed systems and procedures and therefore found it easier to understand the client needs. To some extent, perhaps the client and the vendor exchanged information to define the work specifications in the early stages of the relationship. This shows that greater the information exchange, the greater the trust and this in turn impacted the vendor's satisfaction with the client.

Contrary to our expectation, there was no positive relationship between social control norms and vendor satisfaction with the client. It could be that when the client was competent, there were fewer conflicts that needed to be managed and this was not a significant predictor of vendor satisfaction.

Finally mutual dependence was strongly associated with vendor satisfaction. Previous studies [49] have suggested that outsourcing relationships are better when they are partnership based and emphasize reciprocity and flexibility of the relationship. When the vendor is more dependent on the client, it tends to be one-sided, and tends to be managed and controlled by the client through complex, lengthy contracts [27]. However, when there is mutual dependence, it creates mutual trust and reliability among the parties and these factors play a bigger role in shaping the relationship *Hypothesis 1: The higher the client's knowledge of their business needs, the higher the vendor's trust of the client's competence, and greater the vendor satisfaction with the client.*

Overall this research provided the first steps in understanding the factors that helped build the trust between the vendor and client and this is one of the keys to maintaining a long-term relationship between the parties. As mentioned earlier long term relationships are beneficial both to the vendor and the client. For the vendor, it clearly provides market and profit opportunities and a means of growth and innovation. But for the client, it provides an element of continuity since changing vendors can be a complex and cumbersome process.

VIII. LIMITATIONS AND FUTURE RESEARCH

This was a preliminary study done to understand factors that impact vendor satisfaction with the client. There are several limitations to this study. First, although studies from the vendor perspective are not as common, a dyadic analysis using both the client and the vendor perspective would have provided a richer understanding of the relationship. Second since the data was collected on a cross-sectional basis, it is hard to make predictive assessments. Third, given that it was an internet based survey, we had a very limited response rate. Future research can explore whether trust and social control varied systematically based on where the clients were based - developed versus developing countries. Future studies can also explore the role of relational factors and vendor satisfaction on the longevity and overall effectiveness of the relationship.

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