

Switching IT Outsourcing Providers – a Conceptual Framework and Initial Assessment of Critical Success Factors

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Abstract—Although IT outsourcing is a growing industry and a common topic in the literature, there is limited research which critically analyses and assesses the switching of IT outsourcing providers – in particular the factors contributing to success are under-researched. This article explores this growing area of management and consultancy activity by analyzing the existing literature in the field. This allows the identification of critical success factors that are pertinent to the switching of providers and the development of a conceptual framework for further research.

Keywords - service providers; outsourcing; IT outsourcing; ITO; switching providers; critical success factors.

I. INTRODUCTION

When companies outsource their IT for the first time, it can be assumed that the majority of IT experts will transfer from the client company to the IT outsourcing (ITO) provider. Together with the IT experts, the client specific knowledge is transitioned to the provider. This reduces the negative performance impact. In contrast, when providers are switched, it cannot be anticipated that the majority of IT experts (together with the client specific knowledge) will transition from the incumbent provider to the new provider.

It can be assumed that the leaving provider has only marginal interest in actively supporting the incoming provider, for example with knowledge transition. This results in major challenges for the tripartite relationship (client, incumbent provider, new provider).

A main building block in switching ITO providers is the transition. Transition is a complex, risky, and challenging building block of strategic importance which begins after the contract is signed and ends with service delivery. Two thirds of all issues can be tracked to the transition [1] [2].

Despite growing interest in topics such as sourcing the IT back in-house or switching providers [3] [4] [5], no studies have holistically focused on how successful ITO transitions are performed for clients switching service providers.

The factors contributing to a successful transition from the incumbent provider to the new provider are not fully understood. Yet understanding the factors contributing to a successful transition is vitally important. For the client, these factors determine on the one hand the success or the failure of the whole outsourcing endeavour; and on the other

hand, ultimately the survival of the overall business as it is linked to the successful switch of the ITO providers. This article sets out to review available literature relating to this topic and draw conclusions regarding critical success factors for achieving the switching of service providers. In the following section, a wide range of literature relating to ITO is systematically reviewed. This leads to a discussion of critical success factors in section three, focusing on both the pre-delivery phase and the critical transition process. Section four then makes some concluding remarks relating to the analysis of existing literature, and highlights a conceptual framework for future work in this field.

II. INITIAL LITERATURE REVIEW

“Outsourcing can be defined as turning over all or part of an organizational activity to an outside vendor” [6]. In contrast to other types of outsourcing, ITO affects the complete organisation – IT “is pervasive throughout the organization” [7]. Reference [4] suggests that in an ITO deal, the IT is either partly or fully turned over to “...one or more external service providers”.

A. ITO History and Market Development

Even though large scale modern ITO began in 1989 with the Kodak outsourcing deal [4], some researchers argue that ITO “is still at the early stages of the profession itself” [8]. Kodak was not the first ITO deal in history although other deals had only received scarce attention. “It was not until Kathy Hudson, the Kodak CIO, announced to the world that Kodak had entered into a ‘strategic alliance’ with its IS partners, led by IBM but also including DEC and Businessland, did the world sit up and take notice” [7].

Many scholars and practitioners forecast further growth of the ITO market [8] [9] [10]. Reference [11] emphasises that: “on conservative estimates, looking across a range of reports and studies, global ITO revenues probably exceeded \$270 billion in 2010; it is very clear that, with its 20-year history, outsourcing of IT and business services is moving into becoming an almost routine part of management, representing in many major corporations and government agencies the greater percentage of their IT expenditure”. All reports (Gartner, Everest, NASSCOM, and IDC) reviewed have indicated a global growth of ITO in the range of 5-8% per year [11].

B. Reasons for ITO

Research findings indicate that the main reasons for ITO are driven by the goal of cost reduction, the focus on core capabilities and a desire to access resources of the provider such as superior capabilities, expertise and technology [6] [11]. The primary reason for outsourcing in 90 % of the reviewed literature indicated the motivation of cost reduction [11]; but not all researchers agree that the goal of cost reduction and performance improvement will automatically be achieved - no matter how the outsourcing endeavour is managed. Reference [6] argues that “this overly optimistic view of outsourcing derives from the fact that most articles about outsourcing are written during the so called ‘honeymoon’ period i.e., just before or after the contract is signed”. Outsourcing strategies therefore need to be deliberate to increase the companies’ overall performance.

From the perspective of the ITO provider, *long-term revenue* is the primary reason to enter outsourcing arrangements. Reference [7] points out that “long-term outsourcing arrangements help stabilize vendor business volume and revenue, making planning more predictable, and increase shareholder’s comfort levels”.

The typical length of ITO contracts is generally 5-10 years and “thus, both client and vendor have come to expect that during the life of the contract, some form of renegotiations will be likely” [7]. The rapid growth and the complex nature of ITO have not been without impact. Recently a number of outsourcing deals have experienced both serious problems and the premature discontinuation of contracts [3] [4] [5] [7] [10]. This leads companies to reconsider sourcing options and strategies. The discontinuation of contracts results in several strategic options. Regarding ITO contracts, “as much as 50%” of these are ended for other options such as switching the provider, or IT back-sourcing [4]. Other researchers have found that most clients stay with the incumbent provider [8] [10]. Reference [10] estimates that 25% of contracts will be awarded to new providers and merely 10 % will be back-sourced. Reference [3] notes the reasons for changing ITO providers as follows:

- “Dynamic changes in the customer landscape (e.g. the client organization may have outgrown the supplier)
- A shift in management’s risk tolerance
- Changes in the supply market (e.g., emergence of new or specialized players)
- Supplier rationalization (e.g., consolidation to enhance bargaining power)”.

C. Factors Influencing Sourcing Options

What factors influence sourcing option decisions when contracts are re-evaluated? Switching costs play a vital role in sourcing decisions – they are a good indicator for understanding and predicting clients’ outsourcing decisions after re-evaluating sourcing options [12]. Reference [4] argues that “the greater the information transfer/setup costs, the more likely that outsourcing continuation will be the strategic choice, vendor switching will be the intermediate choice, and back-sourcing will be avoided”. The researchers

warn that “high switching costs might entrap the customer organization into a ‘no change situation’, forcing it to continue outsourcing IT work to the same vendor”. Although customer entrapment has been noted - not much has been written in the academic literature about how to avoid or adequately address it.

In contrast to high switching costs, if companies anticipate low switching costs and the option to choose from many vendors, there is “no real advantage in recontracting with the same vendor” [6]. Despite the significance of switching costs, the measurement of these costs remains unclear [12].

A study analyzing the influencing factors of sourcing options found that firms which decided to switch providers or to backsource typically experienced high service quality and low relationship quality. They acknowledged that “relationship quality plays an important role in the decision to switch vendors. Of our three groups, those that switched vendors had the lowest perception of trust, commitment, culture, and communication in relation to their vendors...hence, the building of trust between an outsourcer and a firm is far more a socio-emotional condition than it is a matter of providing excellent product and/or service” [5].

The importance of relationship for staying with the current provider has been highlighted in a previous study [6], where the researchers found a high interest in staying with the same provider if relationship specific investments have been made. The risk of losing knowledge and the potential service operation distortions prevents companies from switching ITO providers. Reference [13] argues that the “switching of IT vendors is seen to impose too much short-term operational risk to justify the financial savings and quality improvements that could accrue from a relationship with a new vendor”.

D. ITO Success

ITO success has not been extensively researched and there are contrasting conclusions on the contributing success factors. It is not clear if this is due to the lack of a generally accepted construct of a success definition or because “ITO success is so idiosyncratic that one must assess it against each organization’s own, different criteria” [14]. Reference [7], in a widely cited (more than 500 times according to Google scholar) literature survey and analysis, notes that “outsourcing success is usually viewed as the attainment of economic, technological or business-related benefits. Satisfaction with the benefits attained is often used as an indicator of outsourcing success”.

Companies outsource their IT for different reasons, as previously noted. For example one company outsources to gain access to superior IT capabilities, another to focus on core competences, and another to reduce costs. This means that outsourcing success is dependent on the overall context. Thus, it is plausible that “any attempt to assess ITO success in terms of more detailed criteria, such as cost savings or focusing on core business, requires identification of the different criteria relevant to each organization for each different contract at the time of the study” [14].

Therefore it appears to be important to define factors contributing to outsourcing success before the contract is signed [15]. Reference [14] argues that success should be assessed by:

1. Defining most important outcomes before they actually materialise during the lifecycle of the contract
2. Measuring the extent to which the outcomes have been achieved.

Can outsourcing be considered as a standardised activity of everyday management with readily defined solutions? Reference [11] disputes this and concludes that “our review of 20 years of research establishes the common denominator that, for management and operational staff, outsourcing is far from easy”. Reference [16] found that even skilled organizations don’t work in a proactive mode and are hurt by slow organizational learning. Therefore, in order to reduce learning curves, it is important to understand how success can be defined and what the contributing factors are. Reference [15] suggests a more abstract description of success factor such as:

- “Use ‘best outsourcing practices’ as major references for corporate outsourcing decision.
- Clearly understand the goals, objective, scope, budget, and the duration of IS outsourcing project....
- Select a reputable vendor and then communicate well on the corporate outsourcing plan.
- Realize the legal issues related to contract negotiations and signing.
- Communicate well with employees and stakeholders about the outsourcing plan; this may reduce the severity of resistance.”

Even though these factors are useful to get an overview about common success factors, they are of limited applicability for the specific issue of switching ITO providers. A review of 191 ITO articles relevant to practice from the early 1990s until 2009 found that “the three major categories of determinants of ITO success are *ITO decisions, contractual governance, and relational governance*” [17]. These determinants are depicted as direct relationships to ITO success in Fig. 1.

Although organizational capabilities are also important as a success contributing factor, they are neither depicted in Fig. 1 nor are they described in the section about the determinants of success. Reference [17] recognises that “the most widely cited papers on this topic identify a mix of complementary capabilities that lead to ITO success”. Reference [18] develops this further into a list of nine pertinent organizational capabilities shown in Table I.

Reference [17] summarises research findings thus: “overall, we know *ITO decisions* that entailed selective use of outsourcing, the involvement of senior managers, and rigorous evaluation processes, were associated with higher levels of ITO success. *Contractual governance* also

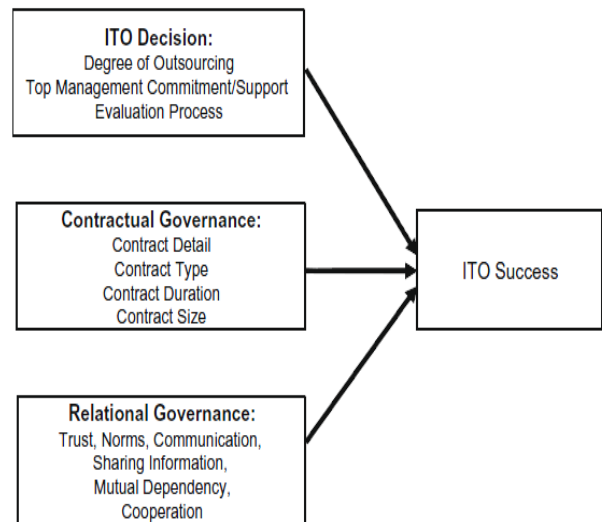


Figure 1. Three main categories of determinants of ITO success [17]

positively affected ITO success. In general, more contract detail, shorter-term contracts, and higher-dollar valued contracts were positively related to outsourcing success.... *Relational governance* positively affected ITO outcomes. Trust, norms, open communication, open sharing of information, mutual dependency and cooperation were always associated with higher levels of ITO success”. The researchers found that top management commitment/support is the most critical success factor and that trust plays a vital role in the success of ITOs. Reference [7] adds that “Sabherwal also suggests that a ‘psychological contract’ exists in outsourcing relationships. This contract, which consists of unwritten and often unspoken expectations, is supported by the level of trust between the parties, and plays a role in resolving unanticipated problems or changes in the accomplishment of outsourced activities”.

Based on these findings, it seems clear that trust and the management of relationships between the client and the outsourcing provider are important factors contributing to success. However, given that significant amounts of capital are often invested in outsourcing deals, clients should probably not solely rely on relational governance factors such as trust and relationship. Reference [6] endorses this view in asserting that it is not advisable to completely rely on partnership factors and neglect contract negotiation – “a

TABLE I. ORGANISATIONAL CAPABILITIES RELEVANT TO ITO SUCCESS [18]

	Capability		Capability
1	IS/IT leadership	6	Informed buying
2	Business systems thinking	7	Contract facilitation
3	Relationship building	8	Contract monitoring
4	Architecture planning	9	Vendor development
5	Making technology work		

good contract is essential to outsourcing success because the contract helps establish a balance of power between the client and the vendor”.

Understanding the budget is of critical importance [15]. Reference [6] proposed the hiring of external experts as they know the hazards of outsourcing and how they can be managed. They argue that the additional costs may be justified in relation to the potential impact of the hidden costs. Other researchers found that “managing costs is less important than managing portfolio configuration, complexity and risk” [16]. This implies the importance of actively managing the outsourcing provider.

Success itself can be considered an important factor contributing to success. “ITO success fuelled higher levels of trust (relational governance, built stronger client and supplier capabilities, and determined the kinds of ITO decisions and ITO contracts clients made moving...Conversely, ITO failure fuelled greater need for controls, monitoring mechanisms, tougher contracts, and determined the kinds of ITO decisions clients made” [17].

E. ITO Methodologies

Reference [16] defines a detailed process model using nine building blocks with 54 activities. This model describes the complete ITO process lifecycle and appears to be the most comprehensive in the academic literature. Many ITO process models distinguish between activities before signing the contract (pre-delivery) and after signing the contract (delivery & re-evaluate) [3] [13] [16] [19]. The ITO process model for this research is depicted in Fig. 2. The six major building blocks are: investigation, provider selection, contract negotiation, transition, manage/service delivery, and options evaluation. The first three building blocks can be considered as pre-delivery phase, the next two can be considered as delivery-phase, and the last activity can be considered as the re-evaluation phase.

Transition is a complex, risky, and challenging building block of strategic importance which begins after the contract is signed and ends with service delivery. Transition “sets the tone for the entire relationship and involves handover of outsourced services from either the client’s internal IT department or the incumbent service provider” [1]. Transition can be summarized as “a pre-requisite to implementing an outsourcing contract successfully” [1]. Reference [20] defines the transition stage as “implementing the new way of operating” and states that it is the goal of transition to ensure that the new way of working is realized. Transition includes the following activities: “conducting knowledge transfer, determining and implementing new governance structures, and applying the processes of the service provider” [1]. This demonstrates that many actions need to take place during transition before “an outsourcing project can be actually implemented” [15]. Reference [16] has identified the main transitional activities as shown in Fig. 3. The cost the transitional building block can take a significant portion of the overall costs, with some researchers suggesting that the cost of transition ranges from 2 to 15% of

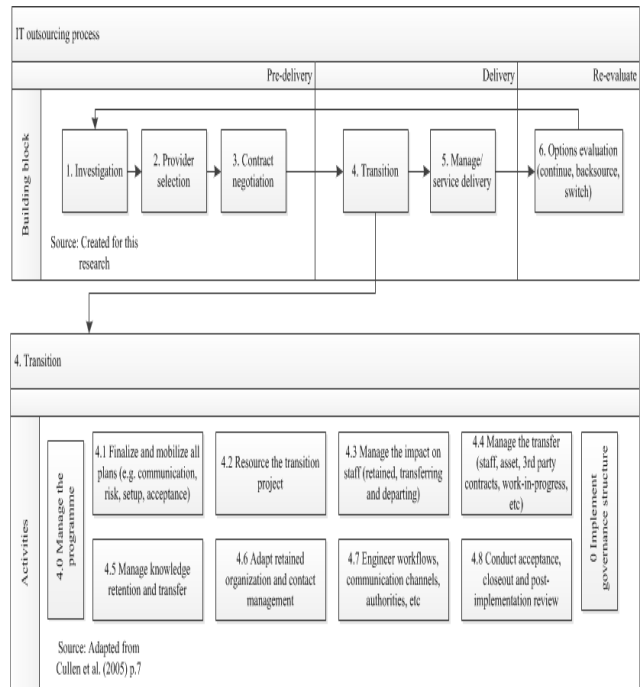


Figure 2. ITO process with the focus on transition

the total cost of the first year of the outsourcing deal [1]. It is assumed that “over two-thirds of the problems in these unsuccessful engagements arise due to failed or poor transition” [1]. Due to the lack of statistical information regarding what percentage of switching ITO providers fail due to poor transition, it is assumed in this review that the percentage is at least as high as this.

III. CRITICAL ISSUES IN SWITCHING PROVIDERS

When companies outsource their IT the first time it can be assumed that the majority of IT experts will transfer from the client company to ITO provider. Together with the IT experts, the client specific knowledge is transitioned to the provider. This reduces the negative performance impact. In contrast, when providers are switched it cannot be anticipated that the majority of IT experts (together with the client specific knowledge) will transition from the incumbent provider to the new provider. Reference [13] concludes that “a long-term outsourcing relationship with a prior vendor means that much daily operational knowledge stays with the prior vendor. The client’s knowledge loss exacerbates the problem of knowledge transfer as the client no longer possesses the information that the new vendor critically needs to service the client”. The new provider requires close cooperation with the incumbent provider, who can pursue two different exit strategies. They can either actively cooperate with the new provider or “pursue a hostile strategy of being uncooperative” [21].

It can be assumed that the leaving provider has only marginal interest in actively supporting the incoming provider, for example with knowledge transition. This is

particularly the case if the outgoing provider is not contractually obliged to support the incoming provider. Reference [21] named source code as an example of this, but the findings apply to all client specific knowledge.

Reference [6] found that “many managers are reluctant to anticipate the end of an outsourcing contract. Therefore, they often fail to plan an exit strategy”. With the risk of loss of knowledge comes the risk of degraded service quality. Reference [13] found that switching often lead to “temporary service disruptions of operations, lowered service levels and frustrations and dissatisfaction among the client employees”. In addition this can lead to broken transition milestones, extended project duration and additional costs. Clients should take into consideration that once the contract of the incumbent provider has expired, the provider will leave regardless of whether the new provider is already prepared to deliver the service [21]. This can negatively impact service levels and even risk business continuity if the new provider is not completely ready. Alternatively, the client needs to be prepared to additionally pay the old provider for extending the contract until the new provider can adequately deliver the IT services.

When providers are switched transitional activities can be extensively resource draining for client, who needs to manage (monitor and correct) the operations of both the incumbent and new provider and additionally the transition between the two. Even relatively simple transitions where the IT can be transferred directly from the client to the outsourcing provider can be a costly phase and “in some cases, they (the transition activities) halved or even cancelled out the company’s potential savings from outsourcing” [22]. It can be assumed that the transitional activities for switching providers are even more costly. As a general rule it can be stated that the more idiosyncratic the IT service to be outsourced, the more complex and costly the transition.

If the perception is that ITO can be handled as a commodity, there is a risk that companies which have chosen to switch outsourcing providers underestimate the effort, complexities and risks involved. Reference [3] has disputed the common perception that “once part of a business process has been outsourced, it can, if necessary, easily be ‘un-plugged’ from one supplier and ‘re-plugged’ into another”.

A. Pre-delivery Phase – Factors Contributing to Switching Success

The client should ensure that the new potential ITO provider conducts an extensive *due diligence* review. “Before the service providers make a final offer during contractual negotiations, a thorough due diligence activity is required to closely understand the actual outsourced work and its related dependencies.” [1]. Due diligence is even more important when providers are switched to ensure that the interdependencies between client and leaving provider are fully understood. Due diligence lays the baseline for the overall project management of the outsourced activity, encompassing scope, time and quality definition. Reference [3] has noted the importance of identifying essential specific

knowledge before the actual transition phase to avoid disruptions during transition.

However, it is questionable whether some clients have sufficient resources to successfully accomplish such preparations. Identifying knowledge gaps before the transition is likely to be only partly successful. Reference [13] noted that “at the time of the contract negotiations, both parties (client & new provider) were still largely unaware of the gaps in the knowledge that would trouble the change-over from the prior provider to the new provider”. Much of the operational knowledge is only visible to the people involved in everyday operations. This means that the client and the new provider can possible face unexpected knowledge gaps during transition.

B. Building Block Transition - Factors Contributing to Switching Success

Good project management and realistic time schedules are critical. “Unrealistic transition timetables are a frequent source of trouble. Both buyers and providers should look with a sceptical eye at the viability of their transition timeframes” [2]. It is also important to incorporate project buffers or contingencies into the project plan. “Any organization that explores a new sourcing option in terms of suppliers, new services, or new engagement models...must plan on false starts. Executives often manage learning by pilot testing new sourcing options” [17]. Although this is a good method of learning and getting the experience for some sourcing options in principle, it is not easy to pilot test switching ITO providers in practice.

To effectively manage the transition the client needs to set up an overall transition governance structure. Reference [1] asserts that “both client and service providers need to develop and implement an appropriate governance model for efficiently conducting day-to-day activities and for monitoring it at a higher level”. The governance structure should define project roles and responsibilities such as the project joint steering committee. All parties (client, new provider and old provider) should be part of the joint steering committee. Part of the responsibilities of the joint steering committee is it to manage conflicts and to implement a joint transition program to plan, monitor, execute, and report on all transition switch deliverables and milestones.

Managing the complex tripartite relationship is resource intensive. Reference [3] emphasises the importance of sufficient resources from the client to manage the transition and materializing risks. The authors call for the active involvement of the client management to ensure that the old provider supports the new provider as needed and therefore minimize service disruptions.

Reference [13] found that: “switching required close collaboration and mutual adjustment among all parties”. Although the motivation of the old ITO provider to support the new provider might be low, it is a critical success factor for the overall transition success. “An uncooperative old supplier or an insensitive new supplier increases the risk of transition problems. Organisations must therefore carefully manage the delicate tripartite relationship tensions” [3]. Reference [13] also found that the old supplier is often

needed to develop joint knowledge together with the new supplier to ensure that all parties meet their responsibilities - "critical to the success is the transfer of the knowledge of the client's environment and processes. Poor knowledge transfer may result in disruptions of operations, lowered service levels, and frustrations and dissatisfaction among the client's and the new vendor's employees".

Reference [6] emphasises the importance of "commitment of employees transferred" to the provider and that the outsourcing success is related to it. "First, key employees must be retained and motivated. For most activities, outsourcing does not mean transferring all the employees to the vendor. When an activity has been performed in-house for a long period of time, firm-specific knowledge about how to run the activity smoothly has accumulated. Employees who possess this firm-specific knowledge must be identified".

What does this mean for switching providers? Clients need to identify employees from the incumbent provider who possess important firm specific knowledge and try either to reintegrate them into the client company or make sure that they move over to the new client or ensure adequate knowledge transfer. However, it is likely that the leaving provider will block the transfer of personal to stay competitive [21]. Transferring key employees early to the new provider could negatively impact the production capability of the incumbent provider.

IV. CONCLUDING REMARKS

Even though the modern form of ITO practice effectively started in the late 1980s, it still cannot be considered a standardized routine management practice. Companies outsource their IT for different reasons though the primary objective is cost reduction. Several studies indicate a further growth of the ITO market of 5-8% per year [11]. The typical length of ITO contracts is 5-10 years [7] - a time span over which it is neither possible to foresee the clients' IT requests nor to estimate the impact of the overall economic environment. Various factors have led a number of clients to cancel their contracts prematurely.

The options for clients are to continue with the incumbent provider, switch the provider, or IT backsource (i.e., in-source again). It is estimated that between 25% [10] and 50% [4] of clients do not continue the relationship with the same provider. Miscellaneous factors influence these three sourcing options, most importantly the anticipated switching costs, the relationship between client and provider, and the fear of losing knowledge.

ITO success has not been extensively researched and there are contrasting conclusions regarding the contributing success factors [14]. Research has found that success needs to be considered in the context of the specific outsourcing arrangement. Several academics agree that the desirable outcomes need to be defined before the ITO starts, and that outcomes should be systematically assessed after it has been finalized and is underway.

General ITO factors contributing to success can be grouped into the major categories of ITO decisions, contractual governance, relational governance, and

organizational capabilities [17]. In the category of ITO decisions, top management commitment and support is the most important factor [17]. In the relational governance category, trust and relationship management play a vital role [17]. However, given that significant amounts of capital are often invested in ITO deals, clients should not completely rely on relational governance factors such as trust and relationship. Important capabilities are required for success such as cost control and provider management. In addition, success itself can be considered as an important factor contributing to success.

The outsourcing process may be conceptualized as six major building blocks - investigation, provider selection, contract negotiation, transition, manage/service delivery, and options evaluation. The first three building blocks can be considered as the pre-delivery phase, the next two can be considered as the delivery phase, and the last activity can be considered as the re-evaluation phase. The transition building block is a complex, risky, and challenging process of strategic importance which begins after the contract is signed and ends with service delivery. It is assumed that "over two-thirds of the problems in these unsuccessful engagements arise due to failed or poor transition" [1].

When providers are switched, it cannot be assumed that the accumulated IT expertise (both in terms of personnel and client specific knowledge) will transition from the incumbent provider to the new provider. This results in several major issues, which are significantly impacted by the strategy of the incumbent provider. Their reaction can be grouped into two categories - a cooperative strategy or hostile strategy. Clients are well advised to prepare for both scenarios. Switching providers can be extensively resource draining for clients, as clients need to manage (monitor and correct) the operation of the incumbent provider, the operations of the new provider and additionally the transition from the old to the new one. This means clients should budget and plan for extra resources and associated contingencies.

During the pre-delivery phase it is essential for a successful transition to identify specific knowledge that needs to be transferred. A strategy should be developed to establish how this knowledge will be transferred and key knowledge experts need to be identified. Clients may reckon that major knowledge gaps will only be recognised during the actual transition.

In the critical transition building block, several factors contributing to success have been identified. Conducting a stringent project management methodology with focus on realistic time schedules and incorporated buffers is an important ingredient for success. Implementing an effective governance structure plays a vital role for a successful transition when providers are switched. Ensuring early knowledge transfer and the transfer of key knowledge

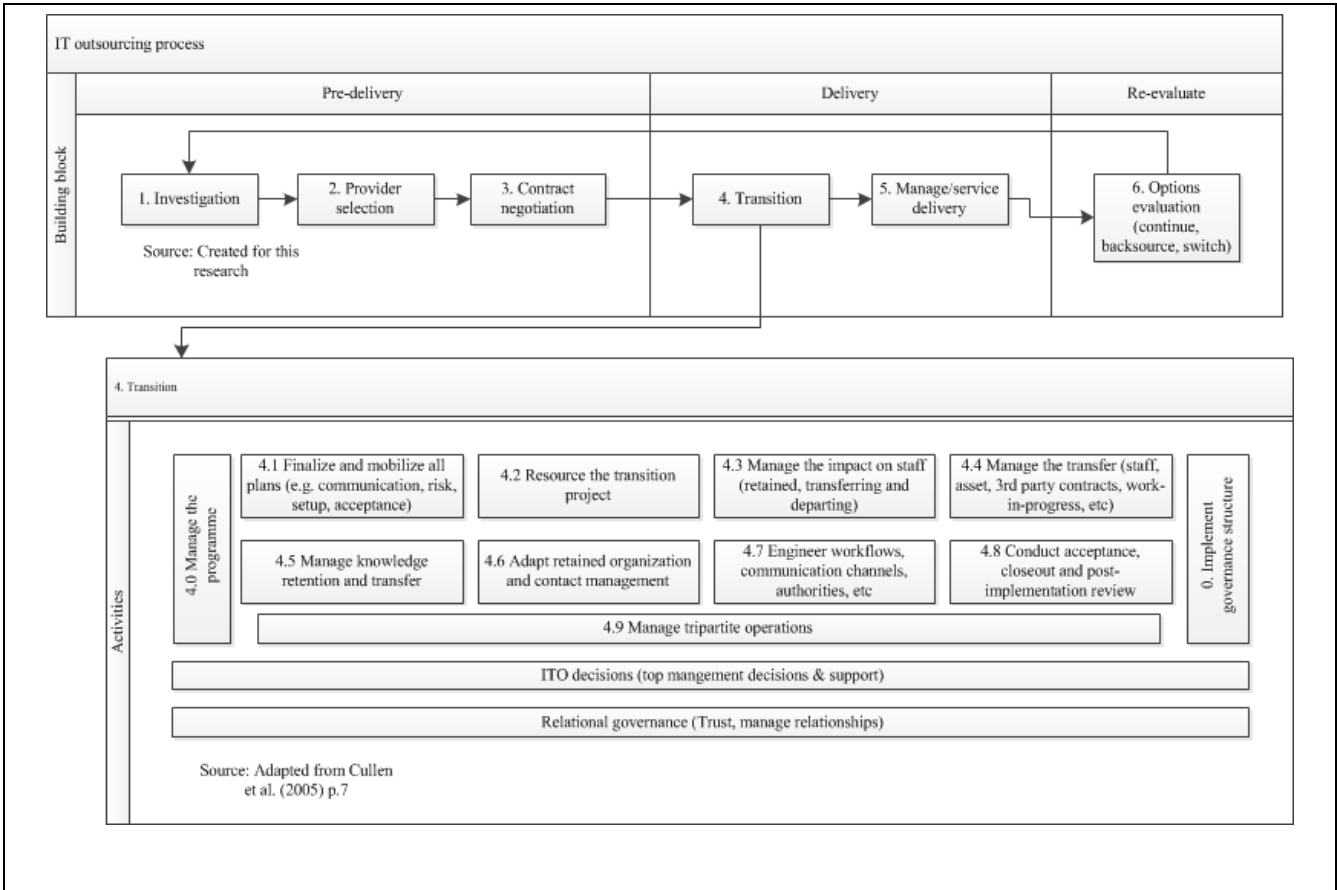


Figure 3. Conceptual framework - Switching providers with the focus on transition

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experts from the incumbent provider are two of the most important factors for success. Finally, managing the complex tripartite relationship is resource intensive but an important factor for success. The conceptual framework depicted in Fig. 3 has been developed to guide further research.

In conclusion, the switching of ITO providers is a complex, risky and resource intensive endeavour with the transition stage being the major building block in a wider process. However, not much is known about methods, processes and strategies for switching ITO providers as most research has focused on the initial outsourcing [15] [20] [23]. It is intended that this literature review and analysis will provide a useful starting point for subsequent research into these areas, and this is being pursued by the authors through primary research involving a wide range of practitioners from ITO clients and ITO providers. The scope of this research will be a) large ITO deals with total contract value of more than €150 million and b) at least 2 IT-services (e.g. network services and server production services) which have been outsourced and need to be switched. The scope of this research will not be limited to any specific industry.

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