Managing Risks in Business Critical Outsourcing –
A Perspective from the Outsourcer and the Supplier

Mike Malmgren

2010

Department of Management and Engineering
Linköpings universitet, SE-581 83 Linköping, Sweden
“Managing risks in business critical outsourcing - A perspective from the Outsourcer and the Supplier”

Linköping Studies in Science and Technology, Dissertations, No. 1309

ISSN: 0345-7524

Printed by: LiU-Tryck, Linköping

Distributed by:
Linköping University
Department of Management and Engineering
SE-581 83 Linköping, Sweden
Tel: +46 13 281000
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- A perspective from the Outsourcer and the Supplier -

Abstract

Companies are increasingly outsourcing business critical activities to suppliers of outsourcing services. As the complexity and business criticality of the outsourced activities increases, the risk of poor performance increases. This thesis studies large scale outsourcing in the telecom industry where a recent trend is to transfer the development, operation and maintenance of the telecom infrastructure to telecom equipment suppliers. The significance of this type of outsourcing is that the outsourced activity is the revenue generating part of the telecom operators business.

Part 1 discusses the purpose and research questions followed by the theoretical underpinning in the research. The research strategy is to study the outsourcing relationship in three distinct stages of its development and the theoretical underpinning applies transaction costs analysis in the Scoping & Search stage and Das & Teng’s (2001) framework of trust and control for managing risks in the Negotiation and Transition stages. This design is in response to calls for a more detailed understanding of how organizations manage risks, it therefore takes the perspective of both the outsourcer and the supplier in the research.

Part 2 is a multiple case study of telecom operators in Holland, Sweden and Australia where the supplier in all three cases is Ericsson Global Services organization. The study is further supplemented by mini-cases of large scale IS/IT infrastructure outsourcing.

Part 3 has three main parts. Firstly, a cross case analysis of the cases in Part 2; secondly, a discussion of the findings linked to the research questions resulting in a set of propositions. The third and final part covers additional insights and learnings from studying business critical outsourcing and suggestions for further research.

The main contributions in the research can be summarised as:

- Physical asset specificity follows transaction costs logic, however human asset specificity is largely ignored by both outsourcer and supplier

- Business critical outsourcing by its nature faces a limited market for capable suppliers. This results in single-source negotiations followed by a cooperative stance and open book negotiations.

- Das & Teng’s (2001) framework for management of risks has been found to have specific directions, some bi-directional and others uni-directional. Furthermore, different dimensions in the framework operate at different managerial levels. Goodwill trust-building operate at the corporate executive level, competence trust-building, output and behavioural control at the level of the negotiation team, and the research indicates that the social control dimension is not applied in business critical outsourcing negotiations.

- A further finding is that goodwill trust-building precedes all other dimensions of trust and control, and is a pre-requisite for establishing a cooperative stance in the negotiations.
Acknowledgments

Like many before me I am now writing the last page on something that has occupied my life for many years. The fact that I am writing this page is only in part of my doing. I owe a deep sense of gratitude to many others. The most important others are my family; my wife Ginny and our children Madeleine, Oscar and Nina. No words can express my gratefulness and love for giving me the space and time to pursue my personal interest.

The other important people that I owe an enormous gratitude to are my supervisors Prof. Mats Abrahamsson and Docent Dan Andersson. I have never met two more supportive and professional individuals. They have given me all the attention and time at the drop of a hat, always constructive, always supportive, never making the decisions for me but always helpful in resolving a problem. They are an amazing team with Dan’s fantastic attention to detail and Mats strategic view of what the whole is all about. Thank you.

I would like to thank the people at the Department of Management and Engineering and in particular the Logistics Management department at Linköping University in Sweden. From the first day when I transferred my PhD from Cranfield Business School I was made welcome and immediately accepted as part of the team. Several of you have read my half baked attempts and given your honest views and feedback, so thank you Fredrik Nordin, Jakob Rehme, Maria Huge Brodin, Erik Sandberg, and Christian Kowalkowski.

Another group of people whose support has made this research possible is staff at Ericsson Global Services, in particular Patrik Jakobson and Jörgen Holmström, but also all the people I have met and talked to in the participating companies in the research.

Fiona Dent and Narendra Laljani at Ashridge Business School has supported my research financially but also personally by allowing me time and space to pursue my research whilst still meeting my obligation as a member of faculty. The last piece has been to knock my words together into coherent sentences, checking my grammar and spelling whilst asking me, what does this actually means so thank you Tracy Bowdrey-Long, Rebecca Coatswith, Kicki Dalberg, and Martin Lockett.

I would like to return the attention to my family who have followed the ups and downs of a very long journey. I dedicate this thesis to my children with the hope that they will never stop learning and pursue their goals in life with this in mind.

And finally to Ginny, my wife and life companion who for over 20 years have moved around the world with me, supported me in my work and allowed me the privilege to pursue the PhD. My time is now yours.

London
February 2010
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Part 1  Introduction to the research

Part 1 of the research is set out in three chapters. The objective in Chapter 1 is to introduce the purpose of the research and the context within which the research has been carried out. Identification of the purpose is led by the literature review and the understanding and knowledge of outsourcing developed during the initial pilot study prior to the main research in this thesis. The chapter introduces several aspects that each contribute to the development of the overall purpose, and also contribute to the methodological and theoretical decisions that underpin the empirical research. Based on the purpose identified in the literature review and the pilot study, Chapter 2 lays the theoretical foundations for the research and generates the specific research questions. In Chapter 3 the methodological considerations and choices are explained, leading to the description of the research design.
1 INTRODUCTION

Over the past two decades the phenomenon of outsourcing of resources and activities has emerged as an important trend in a wide range of organizations across the globe (Mol, 2005; McIvor, 2005). The total value of deals is large, estimated to $320 bn and growing at 7-9 % per annum (Barthelemy and Quelin, 2006). Initially organizations outsourced non-strategic activities but increasingly many companies are today outsourcing business critical resources and activities (McFarlan and Delacy, 2004; Kakabadse and Kakabadse, 2005; Nordigård, 2007). Furthermore, outsourcing contracts can involve large financial commitments as the examples of Shell’s US$ 4 bn total IS/IT outsourcing in 2008 demonstrates (Crooks and Parker, 2008). The early outsourcing contracts were often focused primarily on cost reduction (Clegg et al, 2005). Whilst cost reduction is still a key focus organizations are seeking strategic and operational performance improvements of business critical resources and activities through outsourcing to specialist suppliers. Higher business criticality increases the consequences of difficulties and problems.

A review of the outsourcing literature identified that risk is a central concern in outsourcing research. The specific phenomenon studied in this research is outsourcing of complex technological systems that are highly business critical to the outsourcer. Increased complexity increases the likelihood of difficulties and problems (Merali and McKelvey, 2006) and hence the risks.

Categorizing outsourcing based on the dimensions of business criticality and complexity identifies different types of outsourcing. For example, outsourcing manufacture and supply of components and sub-systems has a degree of complexity and business criticality. A more business critical and complex level of outsourcing is PCs and application servers with business software that are important for running the business. Even more business critical and complex outsourcing occurs when the outsourced activity is the revenue generating structure. For example, in the banking industry the data servers, network and software are an integral part of the revenue generating process as services and therefore money are transacted with external parties via computers and the network. Banking systems are complex with real time transactions of large sums of money across the globe and with a large number of other counter parties in the
financial flow. In the case of telecom networks the network is the revenue generating structure and it is highly business critical for the telecom operator. This study extends the research frontier by studying risks in outsourcing business critical activities of telecom networks and infrastructure. Figure 1 below describes a conceptual model of different types of activities being outsourced.

![Business criticality vs. complexity](image)

**Figure 1.** Business criticality vs. complexity

The specific phenomenon studied in this research is the outsourcing of complex technological systems that are highly business critical to the outsourcer. The combined effect of complex systems and business criticality suggests that management of risks must be approached with this in mind. In order to identify the research frontier as outsourcing develops towards more business critical and complex undertakings the outsourcing literature is reviewed from an historical perspective. The review identifies that research must move beyond viewing outsourcing as a make-or-buy decision towards a more fine grained understanding of outsourcing as an ongoing process with a number of key stages. This leads Kern and Willcocks (2000) to call for a social exchange perspective as a means to understand how to manage outsourcing relationships. Furthermore, this thesis has identified that as the complexity of the outsourced activity increases the potential supply market for capable suppliers is getting smaller. This is a factor not only for the decision to outsource but also the approach taken in the decision of which activities should be included in the outsourcing deal, the selection of potential suppliers, and how the negotiations should be conducted. The literature review also identifies that limited outsourcing research has been conducted based on the perspective of both the outsourcer and the supplier.
The shift in outsourcing scope toward higher business criticality and complexity has three implications:

1. The increased criticality increases the negative consequences of poor performance
2. The increase in complexity of the undertaking increases the difficulty in managing the relationship between independent parties in a web of relationships
3. The combination of increased criticality and the complexity, increases risks in managing business critical outsourcing

The literature review and context of the research is detailed in chapters 1 and 2 leading to the overarching aim of the research articulated as:

The purpose of the research is to describe and explain how supplier and outsourcer manage risks in business critical outsourcing.

1.1 Outsourcing in an historical perspective

An historical review of the phenomenon of outsourcing in the literature forms an important basis for developing the theoretical frame for this research. A search by this researcher in the academic literature identifies the first mention of outsourcing in the context of manufacturing in 1978 (Kaufman and Galberaith, 1978) which discusses the capital budgeting process and suggests outsourcing of non-core activities rather than making internal investments. By 1990 the number of academic papers on outsourcing is increasing and the duration of outsourcing contracts was getting longer with an increased interdependence between buyer and supplier in manufacturing (Lyons et al, 1990). In the IS/IT field Earl (1991) connects outsourcing to the subcontracting of information services to third parties and quotes research that suggests an annual growth of 20% in outsourcing of information technology. Over the next two decades the rate of papers on outsourcing increases substantially. The follow the development of outsourcing in the literature the review is presented in an historical perspective in five year periods.

Outsourcing 1990-1994
The business practice of outsourcing had started with high profile deals such as Kodak’s outsourcing in 1989 of it’s IS infrastructure to IBM (Loh and Venkatraman, 1992). Papers discussing methods for assessing suppliers, service criteria, and critical factors were central to the
discourse on what to outsource in this early stage of a new phenomenon (Gupta and Gupta, 1992; Benko and Cathleen, 1993; Jones and Capers, 1994; Foxman and Noha, 1994). Cross (1995) explores the approach taken by BP in a multi-vendor deal. LaLonde and Maltz (1992) discuss the drivers for logistics outsourcing and lift the debate toward the strategic level rather than seeing it as an operational decision. Although the practice of outsourcing was increasing (Loh and Venkatraman, 1992), Bettis et al (1992) raised a warning that improper use of outsourcing, particularly in manufacturing, could cause a continued decline in competitiveness among Western companies. The paper contrasts a market position approach with the aim of reducing costs, with gaining competitive advantage through competence and skills. This is also the period when the resource-based view of strategy emerges and finds its way into the mainstream managerial discourse through Prahalad and Hamel's 1990 article 'The Core Competence of the Corporation'. In the outsourcing literature this is built upon by Quinn and Hilmer (1994) who suggest that non-core and non-critical activities should be outsourced to allow the organization to focus on their core competence. Risks and hidden costs of outsourcing are discussed (Martinsons, 1993) but do not form a major part in the discourse. It is notable that the papers generate lists of what companies should or not do with only limited reference to the theoretical platform that underpins the research (Klepper, 1995). With the exception of Quinn and Hilmer (1994), words such as competence or core are used but not grounded in a theoretical stance.

**Outsourcing 1995-1999**

The number of outsourcing contracts was increasing at a high pace (Currie and Willcocks, 1998). The papers continue to add knowledge to the outsourcing decision (Willcocks et al, 1995), but there are also several papers raising the issue of risks (Earl, 1996; Lonsdale and Cox, 1997; Lonsdale, 1999; Kliem, 1999; Willcocks and Lacity, 1999). The balance of papers is now on the side of caution. De Looff (1995) suggests to not outsource should the activity have strong links with other activities. Issues identified include: outsourcing of critical activities (Earl, 1996; McFarlan and Nolan, 1995; Alexander and Young 1996; Lonsdale, 1999), dependency on the supplier (Cross, 1995; Lonsdale, 1999; Willcocks and Lacity, 1999; Kliem, 1999), measuring performance (Cross, 1995; Willcocks et al, 1996), hidden costs (Ellram and Maltz, 1995; Earl, 1996; Lonsdale and Cox, 1997; Willcocks and Lacity, 1999), reduced innovation capacity and loss of knowledge (Earl, 1996; Lonsdale and Cox, 1997). The strategic dimensions of outsourcing are brought out (Willcocks et al, 1995; Alexander and Young, 1996) with a focus on core competence but with the caution that it is nearly impossible to predict what competences will be
important in the future (Alexander and Young, 1996). Models for calculating the costs of outsourcing were developed (Ellram and Maltz, 1995) with Vining and Globerman (1999) basing their model explicitly on transaction costs. The majority of papers are surveys or case studies with an operational focus. A limited number of papers explicitly applied transaction costs in the decision to outsource, (McFarlan & Nolan, 1995; Alexander and Young, 1996; Vining and Globerman, 1999; Lonsdale, 1999), or the core competence perspective to establish the strategic importance of the outsourcing decision (Alexander and Young, 1996; Lonsdale, 1999). Whilst academics were vocal on the risks and problems identified with outsourcing, the number of outsourcing deals continued to rise (Currie and Willcocks, 1998). At the end of the period, Quinn (1999) clarified some of the assertions in Quinn and Hilmer (1994) by acknowledging that the concept of core and non-core had a strong component of knowledge and this results in valid concerns regarding a decision to outsource. This period should also be seen in the context of an economic boom in general and the growth in information technology in particular, as well as the use of the Internet by business and the general public.

Outsourcing 2000-2004

In 2000 the church bells rang in the new Millennium and this was shortly followed by the dot com crash which reverberated through the general economy over the next few years. However, interest in the subject of outsourcing continued to grow. Early out in the new Millennium is Hirschheim and Lacity (2000) with their paper titled ‘Myths and Realities of IT Insourcing’ where they argue that the economic and strategic advantage of outsourcing could equally be met by retaining IT in-house. Some researchers report a swing of the pendulum with organizations taking back previously outsourced activities such as JP Morgan not renewing its $5bn outsourcing contract with IBM (King, 2005). A noticeable difference is a more finely grained perspective on the outsourcing process (Balwin et al, 2001; Barthelemy, 2001; McIvor, 2003) referring to the stages in the relationship from negotiation, transition, and operation of the contract to termination. Similarly, Lindskog (2003) provides a review of stages in logistics outsourcing.

In this period the general theme in the literature moves some of its focus to the properties of the dyadic relationship between outsourcer and supplier (Kern and Willcocks, 2000; Natovich, 2003; Kishore at al, 2003; Salonen, 2004). In this context Carr (2004) cautioned that too close relationships can endanger the ability to compete and Lonsdale (2001) argues that the balance of power in the relationship can shift in favour of the supplier over time. Whilst there is an interest
in the dyadic relationship the literature review identified that such papers stood firmly on the side of the outsourcer. One notable exception is Levina and Ross (2003) who explore the value proposition of the outsourcing supplier and their ability to deliver on economics of scale and other benefits that the outsourcer anticipates. Several papers report that the prime reason for outsourcing is to reduce costs and headcounts (Barthelemy and Geyer, 2001; Benson and Littler, 2002; Bailey et al, 2002; McIvor 2003; Quelin and Duhamel, 2003). Bailey et al (2002) report that companies outsource approximately 10% of turnover with an average cost saving of 11%. This should be set in contrast with the hidden costs in an outsourcing agreement. Barthelemy (2001) report that the total costs for a $5million outsourcing contract is around 15-20% of contract value and 8-10% in a $100 million contract. This sum is the direct cost and does not include the risk of consequential costs from poor performance, or from opportunistic behaviour such as excessive prices for additional services charged by the supplier. Other hidden costs identified in the research are significant under-estimation of the managerial effort needed to make the agreement work operationally, or to re-negotiate to adjust to a changing environment (Kern and Willcocks, 2000; Quelin and Duhamel, 2003). Driving a hard bargain in the negotiation stage can create ‘The Winner’s Curse’ (Kern et al, 2002) with negative consequences if the suppliers either reduce their level of service to reach acceptable profitability or charge excessive prices for additional services.

The theoretical foundation for research into outsourcing became more explicit in this period. Two perspectives dominated the debate. The first was transaction cost economics (Lonsdale, 2001; Barthelemy, 2001; Auguste et al, 2002; Bahli and Rivard, 2003; Aubert et al, 2004) together with the core competence perspective McIvor (2003). In this period relational contracting (Kern and Willcocks, 2000) and agency theory (Logan, 2000) make valuable contributions to our understanding of outsourcing as the complexity and business criticality of the relationship increases.

In this period the human dimension of outsourcing begins to get attention among researchers. The word offshoring appear in the literature and becomes an established description of transferring white collar jobs to lower cost locations such as India. Discussions on knowledge transfer as well as the importance of seeing outsourcing as creating long-term dependencies and the need to manage complex relationships emerged. The papers reflect that outsourcing comes closer to the core of business and that the complexity of managing and executing outsourcing contracts is increasing. As a consequence, the skills and competences among particularly IS/IT
staff changed (Lewin and Peeters, 2006; Manning, 2008) and a modular design of organizations through a web of outsourcing relationships is predicted (Lewin and Peeters, 2006).

**Outsourcing 2005-2007**

Although this time period is three years compared to five years in the previous periods under study, the number of papers continued to show strong interest in outsourcing as a phenomenon. The practice of outsourcing continues with the number of deals increasing as well as the size, such as Fiat’s $7 bn deal with IBM (Kakabadse and Kakabadse, 2005) and Shell’s $4 bn total IT outsourcing deal in 2008 (Financial Times, 2008). The Shell deal exemplifies the complexity of multi-vendor outsourcing deals of this type. Three thousand people were transferred to AT&T, T-systems (Deutche Telekom) and EDS, of which over one thousand were based in Malaysia.

The literature continues to develop around the risks of outsourcing (Sullivan and Ngwenyama, 2005; Dahr and Balakhrisnan, 2006; Kremic at al, 2006; Gewald et al, 2006), with further studies concluding that the major driver for outsourcing is reduction in costs and twice as important as the second most important decision factor (Clegg et al, 2005). Hoecht and Trott caution that outsourcing is inherently prone to information leakage (Hoecht and Trott, 2006b) but also that outsourcing creates risk of information leakage when core innovation processes are being outsourced (Hoecht and Trott, 2006a).

This latter point is important as 20% of drugs development in the pharmaceutical industry is outsourced (Kakabadse and Kakabadse, 2005), supporting Quinn (2000) who argues that outsourcing innovation is the new engine for growth. Harlan et al (2005) broadened the perspective on outsourcing from the individual deal to the industry level with reference to large scale outsourcing of manufacturing in the computer industry in the 1990’s creating a new sub-sector – “contract manufacturing”. This supports Agrell et al (2004) in their analysis of the potential risks in outsourcing to contract manufacturers by telecom equipment suppliers and Bergren and Bengtsson’s (2004) argument that the outsourcing trend should be re-considered based on a comparative study in the telecom industry. Whilst critical voices are raised, the practice of outsourcing is moving from peripheral activities to more business critical areas (Kakabadse and Kakabadse, 2005; Hoecht and Trott, 2006a; Zeng et al, 2007).

In the previous periods the literature on outsourcing mainly used transaction cost theory and the core competence perspective to identify the types of risks. Now the focus is on the inherent complexity of business critical outsourcing. Zeng et al (2007) concludes that “The most significant risks lie in the need to develop new management competencies, capabilities and decision-making processes” (p 839)
and further asserts that “knowledge is lacking inside the organization when moving from an [internal] operation to an outsourced relationship” (p845). This notion is supported by Ahlstrom and Nordin (2006) who find that “there is a lack of empirical studies that explicitly address the problems of establishing service supply relationships” (p 76) where as most of the existing studies did not explicitly focus on the supply relationship (p77). They argue that managing outsourcing relationship require a perspective that recognises different stages in a dynamic relationship development (Ahlström and Nordin, 2006). The IS/IT literature increasingly discusses the changing nature of work for IS/IT professionals, such as sophisticated contract management skills (King, 2004), and a move from a technical discipline to a provider of services to the business (Willcocks and Feeny, 2006). Lewin and Peeters (2006) suggested that outsourcing may be a stepping stone towards a fundamental transformation of organizations into hybrid forms, based on a range of relationships from around the globe delivering essential services to the organization. A notable point is that the literature continues to focus its attention on the outsourcer and not on the supplier although the discussion increasingly centres on relationships and how to make them work.

This historical review gives an indication of the development of outsourcing in the academic literature. In summary, the initial period 1990-1994 is primarily focused on the decision to outsource where issues such as the driving forces, vendor selection, and critical factors dominate. The following two periods (1995-1999, 2000-2004) brings out some of the risks and complexities that organizations must manage in outsourcing relationships. Gradually a more nuanced view develops of the issues beyond cost reductions that must be considered for successful outsourcing and in the last period under review (2005-2008), the key word that stands out in the literature is relationship. The literature review in this thesis provides direction for the research and identifies the following:

- A need to understand how to manage risks in addition to just identifying the risks
- Both the outsourcer and the supplier perspective is important in the research frame
- An understanding of how the risks are managed in a relationship throughout the outsourcing contract period.

One industry that displays a move toward outsourcing of complex and business critical activities is the telecom industry. The next section describes the development of outsourcing in the telecom industry.
1.2 Outsourcing in the telecom industry

We will introduce the research setting by the quote from the Operations Director at Telfort Telecom.

“Our mobile telephone network is core to our business, but it is not our core business. Marketing and development of mobile services is our core business”.

Operations Director – Telfort Telecom, Holland

Telfort Telecom is trail blazing a trend by telecom operators to outsource the operations of its mobile telephone infrastructure to concentrate their resources on marketing mobile telephone and data services. Telecom network operations are complex undertakings which have traditionally been seen as the “nervous system” of telecom operations and a core part of the business. The network is also business critical for the operator as it is the revenue generating part of the business. The trend to outsource the network operation is a fundamental shift in the value adding activities in the telecom industry. Hence managing the risks this entail is of critical importance. In the case at hand, Ericsson has, since 2004, signed 70 large outsourcing contracts such as the 2009 contract with Sprint Telecom in the US, which involves the transfer of 6000 people from Sprint to Ericsson in $5 bn deal over 7 years. By any account, these are very large and complex contracts both to negotiate, and above all to execute to the mutual benefit of the outsourcer and the supplier.

The telecommunications industry is a large global industry that touches almost every person in the world, both in a private and in a business context. It is also an industry undergoing rapid change driven by globalization of markets, technological shifts and price pressures (Shaw, 2000). In response to these pressures the telecom operators are rapidly consolidating and creating ever larger organizations. In response to this consolidation trend the suppliers are consolidating to match the global footprint of the operators and to have the financial strength and economies of scale for R&D investments and support of products and services in all corners of the world.

1 Based on press releases from Ericsson AB
2 Internal documents from Ericsson
3 Examples of recent mergers are Alcatel-Nortel and Nokia-Siemens
However, not only is consolidation taking place but also a major shift among actors in the supply chain of the telecom industry. A paper on Risk, Information, and Incentives (Agrell et al, 2004) describe the development in the telecom industry and how outsourcing in various stages of the value adding chain is reshaping the industry. The research presented in Agrell et al (2004) focus on the risks that OEM’s (original equipment manufacturer), in this case telecom equipment suppliers, face when they outsource the manufacture of major components and systems. In this shift within the value chain a new player in the industry appears. The new type of player was the electronic manufacturing service provider (EMS). This shift in the value chain with outsourcing of component supply and sub-systems took place throughout the 1990’s not only in the telecom industry but in electronics manufacturing generally (Harland et al, 2005). The next step in the development of the industry occurs when the operator takes the step of outsourcing their network operations to a provider of outsourcing services for mobile network operations.

The picture below shows a simplified supply chain in the telecom industry with the scope of Agrell et al’s (2004) research highlighted in grey. The research on business critical outsourcing in this thesis is between the OEM and the Operator and shown by the dotted line in blue.

![Value chain in the telecom industry.](image)

*Figure 2. Value chain in the telecom industry.*

Adapted from Agrell et al (2004)

It should be noted that this dissertation is not about outsourcing in the telecom industry per se but the phenomenon of business critical outsourcing more generally. The focus is on how the outsourcer and supplier manage risks in an outsourcing relationship.

Outsourcing of business critical resources and activities is a business practice that affects the strategic direction of firms (Quelin and Duhamel, 2003; Linder, 2004), it involves large sums of
money, often the transfer of many hundreds of employees, and it creates long-term contractual inter-dependencies between outsourcer and supplier. To be viable these long term contracts must provide financial and strategic benefits that exceed the perceived risks for both outsourcer and supplier. Business critical outsourcing in this thesis is defined as:

Business critical outsourcing includes activities and resources that if not available or performed at the expected level would have a substantial and negative impact on the financial and strategic performance of the business.

The convention in this thesis is to use the term outsourcer for the party that transfers an activity to the supplier and purchases it back as a service under contract. In this thesis the outsourcer is a telecom operator and the supplier is a telecom equipment supplier who is offering managed services to telecom operators.

1.3 Identifying the research gap

Three guiding principles have led to identification of the research gap. Firstly, this thesis is about management of risks in outsourcing, secondly, that an outsourcing decision has a strong focus on cost leading to a shift in the boundary of the firm, and thirdly, that a relational perspective has been identified as important in recent outsourcing literature. Figure 3 below shows the underlying literature that generates the research gap.

![Generating the research gap and purpose](image)

The pilot study identified the initial decision to consider outsourcing is a decision of make-or-buy kind whereas once the negotiations commence, the decision has two parties involved and both takes a perspective on the management of risks. The importance of distinct stages in outsourcing emerged and this raised the question if one theoretical perspective is sufficient to study the stages in outsourcing. The stance in this thesis is to approach the initial decision to engage in negotiation for an outsourcing contract as a make-or-buy decision. With the focus on risk and costs the literature identified transaction cost analysis as a suitable lens with which to consider how the outsourcer perceive risks in the stage before commenting negotiations.

The literature review showed that outsourcing relationships develop over time (Kern and Willcocks, 2000) and once the negotiations commenced both outsourcer and supplier takes risks into account. This research identifies outsourcing as a long-term strategic alliance (Contractor and Lorange, 2002) governed by contract and the literature on strategic alliances and risk provides a platform for studying the relational aspect of business critical outsourcing. This led to establishing the Das and Teng (2001) framework on risk, trust, and control as a suitable lens with which to study how both outsourcer and suppliers manage risks in the developing outsourcing relationship. The Das and Teng (2001) framework has not been widely applied in empirical research and it became clear in correspondence with T.K. Das that this would be an important gap to address.

In this research the telecom industry is an example of an industry with a high level of complexity and business criticality in its operations leading to a decision to study business critical outsourcing in the telecom industry (Ch 1.2). Business critical outsourcing in the telecom industry is a new phenomenon hence a study of outsourcing of large IS/IT systems were conducted. The IS/IT industry’s longer history of outsourcing forms an important source of background in the research, however the IS/IT study is not included in the main empirical research and is reported in an abbreviated version in Chapter 3.

A pre-understanding that informs the research is the pilot study at Telfort Telecom in Holland. The pilot study and the literature review indicate that outsourcing develops in stages (Andersson and Norrman, 2002), defined in this research as Scoping & Search, Negotiation, and the Transition stages. This raised the prospect that applying the study stage by stage could support the aim of providing a sharper lens for the research. The Scoping & Search stage is the internal deliberations of the outsourcer prior to engaging in formal negotiations. In the Negotiation and
Transition stage both the outsourcer and suppliers are involved and the Negotiation stage begins when formal negotiation with potential suppliers commence. The Transition stage begins immediately after the contract has been signed. It is a shorter initial period of the total contract period during which the formal transfer of activities and resources takes place.

The literature review brought the realisation that if we seek a more fine grained understanding of how to manage risks in business critical outsourcing we must study the stages separately through different theoretical lenses and we must do so from the perspective of both the outsourcer and the supplier. The next section defines the purpose of the research reported in this thesis.

1.4 The purpose of the research

The literature review in this thesis identified that organizations are outsourcing increasingly business critical and complex activities (Kakabadse and Kakabadse, 2005), leading to a focus on risks and, importantly, a need for detailed studies of how organizations manage risks (Zeng et al, 2007). Kern and Willcock (2000) identified the need for a social exchange perspective in addition to the prevailing perspective of a make-or-buy decision. Based in the literature and on the state of practice in outsourcing:

The purpose of this dissertation is to describe and explain how supplier and outsourcer manage risks in business critical outsourcing.

Breaking the purpose down to the stages in the research lead to first address the purpose in the Scoping & Search stage with the following research question:

RQ1 How does the outsourcer perceive and manage risks in the Scope & Search stage before entering into formal negotiations for an outsourcing contract of a business critical activity?

The second question addresses the risks in the Negotiation-and Transition stages seen from both the outsourcer and the supplier is expressed as:
RQ2  How do the outsourcer and supplier manage risks in the Negotiation and Transition stages of a business critical activity?

Having identified a gap in our knowledge and understanding of risks in business critical outsourcing and proposed important research questions for study, the next step is to discuss in detail the theoretical underpinning of the research. However, before we proceed the next chapter gives an overview of the thesis and its structure.

### 1.5 Structure of the thesis

In chapter 1 the research gap, the purpose, and the research questions have been established through the literature review and through studying outsourcing as a phenomenon. This is followed in chapter 2 with the theoretical underpinning and the analysis model for the research.

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**Figure 4.** Thesis structure

Chapter 3 includes the research methodology and the rationale for the selected cases. The pilot case and the IS/IT outsourcing study is introduced and how this informed the researcher’s design of the case studies and selection of theories for the main research. Chapter 3 gives a chronology of the research project and how the researcher has handled the twists and turns in the journey towards this thesis.
In Chapter 4 the main cases in Chapter 5 and 6 are introduced. The case studies are not only a description of the case data but offer a first level of analysis as a starting point for the cross case analysis presented in Chapter 7. In the cross case analysis the two cases are compared and contrasted based on the analysis model in the research.

Chapter 8 presents the findings and propositions related to the research questions that were established in Chapter 1. This is followed in Chapter 9 where insights and reflections additional to the research questions are presented and discussed. This leads to a discussion on the implications for practice and suggestions for further research.
2 THEORETICAL UNDERPINNING AND ANALYSIS MODEL

The purpose of this chapter is to develop the theoretical underpinning for the research and the development of the analysis model. The theoretical approach adopted is a reflection of the research gap identified in Chapter 1.3 and research purpose as discussed in Chapter 1.4. The first two chapters discuss the literature on outsourcing and the driving forces behind outsourcing. This is followed in Chapter 2.3 on stages in outsourcing followed with three chapters that discuss risk in outsourcing research and the definition of risk applied in this research. Chapters 2.7 and 2.8 discuss the two theoretical perspectives applied in the thesis which links to the development of the analysis model. The final chapter reflects on the level of abstraction and operationalisation in the research.

2.1 Outsourcing in the literature

Outsourcing has grown in prominence in the public’s mind and in the academic community (see Chapter 1.1). In the perspective on outsourcing it is important to consider the definition used in the research. This is not always explicitly stated in the literature, hence some caution must be observed when building our knowledge based on prior research. Where the definition is clarified in the literature it displays a wide range of perspectives. The example below illustrates the point.
<table>
<thead>
<tr>
<th>Definition</th>
<th>Author</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>“The transfer of previously in-house activities to a third party”</td>
<td>Lonsdale (1999, p176)</td>
<td>With this definition outsourcing is a transfer process of assets and activities.</td>
</tr>
<tr>
<td>“Outsourcing is defined as the situation in which part or all of the IS activities an organization needs are performed by one or several external suppliers”</td>
<td>De Looff (1995, p282)</td>
<td>This definition focuses on the activities an organization needs that could be performed by external suppliers.</td>
</tr>
<tr>
<td>“Outsourcing is broadly defined as a decision taken by an organization to contract-out or sell the organization’s IT assets, people and/or activities to a third party supplier, who … manages assets and services for monetary returns over an agreed time period.”</td>
<td>Kern &amp; Willcocks (2000, p322)</td>
<td>This definition clarifies that outsourcing is a decision leading to a contractual relationship with a start and an end. It also specifies that both assets and services are outsourced.</td>
</tr>
</tbody>
</table>

**Figure 5. Definitions of outsourcing**

[underlining by the author]

The research studies the initial outsourcing contract where there is a transfer of an activity from the outsourcer to the supplier. The convention used in the research is to term the organization that transfers out an activity the outsourcer. The organization that takes over the activity and offers it back as a service is termed the supplier. Furthermore, this research studies a time bound agreement with a clear start and finish and the agreement refers to the transfer of assets and resources. This research is concerned with how risks are managed in outsourcing and it takes a stage based perspective. It sees outsourcing as a sequential set of decisions, each with its own risks and management of actions to mitigate those risks. Hence in this dissertation outsourcing is defined as:

*The transfer of resources and activities from the outsourcer to the supplier in a time bound contract.*

**Business critical**

In studying outsourcing it becomes clear that the word outsourcing covers a very broad range of activities, some of critical importance to the outsourcer and some of trivial importance to the outsourcer. For example, the consequential risks of outsourcing the whole IS/IT infrastructure in a bank means that management of risk is of high importance whilst outsourcing management of the management of facilities in the bank requires comparably less focus on risk management. The definition of business critical used in this dissertation is expressed as:
Business critical activities are activities and resources that if not available or performed at the expected level would have a substantial and negative impact on the financial and strategic performance of the business.

Complexity
In addition to business criticality the research is concerned with technological activities that have a high degree of complexity (Merali and McKelvey, 2006). In this the context of this thesis complexity is defined as:

Technological systems with many interlinked parts and sub-systems connected across organizational boundaries.

This thesis makes its contribution to the outsourcing literature and the next section gives an overview of the outsourcing literature and the theoretical perspectives applied in the outsourcing research.

The literature review identified aspects of outsourcing such as the driving forces (Kakabadse and Kakabadse, 2005; Gonzales et al, 2005; Kremic et al, 2006; McIvor 2003), the selection process (Barthelemy and Geyer, 2001; Kern and Willcocks, 2000), decision criteria (McFarlan and Nolan, 1995; Willcocks et al, 1996; Baldwin et al, 2001), and types of risks (Gonzales et al, 2005; Harland et al, 2005; Quelin and Duhamel, 2003; Kern and Willcocks 2000; Lonsdale, 1999; Earl, 1996). The literature has generally taken a static view of outsourcing, a what question rather than a how question, and seen the issues from the outsourcer’s point of view. A notable contribution to the discourse on how to manage outsourcing is Kern and Willcocks (2000) who introduced a relational perspective based on social exchange and relational contracts theory. McIvor (2005) set out a framework of decision criteria based on relational strategies linked to competitive advantage. What is missing in the literature on outsourcing is how organizations manage risks in the relationship, seen from the perspective of both the outsourcer and the supplier.

Outsourcing has also been examined in the literature from an industry perspective, a country perspective, and a functional perspective (Harland et al, 2005). Research has identified the financial services, telecom, automotive, pharmaceutical industries, and wood products as industries where outsourcing has affected the boundary of the firm (Gonzales et al, 2005; Clegg at al, 2005; McIvor, 2005; Nordigården, 2007). The following is a quantitative approach to investigate which theoretical perspectives have been applied and in which business functions.
The analysis was carried out by this researcher reading a large number of papers in the early days of his literature review. A significant number of these papers were not explicit about the theoretical perspective or whether the research covered the whole organisation or a function such as IS/IT or manufacturing (Mfg) and operations, however, those that did have been tabulated below. A summary of the study of papers is shown in figure 6 below.

<table>
<thead>
<tr>
<th>Theoretical perspective</th>
<th>Sales</th>
<th>IS/IT Dep</th>
<th>Marketing</th>
<th>Procurement</th>
<th>Tax</th>
<th>Legal &amp;</th>
<th>Mfg &amp; Operation</th>
<th>HR</th>
<th>General</th>
<th>Finance &amp; Control</th>
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<td>Organization Theory</td>
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<td>TOTAL</td>
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<td>9</td>
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<td>7</td>
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<td>19</td>
<td>5</td>
<td>85</td>
<td>223</td>
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</tr>
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</table>

Figure 6. Theoretical approaches in outsourcing research

The quantitative approach taken here reveals that two theoretical perspectives dominate namely transaction cost economics and a core competence perspective. TCE and the core competence together with resource-based view account for 85% of papers in the period studied. Taking a functional perspective provides a similar picture showing that 70% of papers with outsourcing in the abstract and citation have investigated outsourcing within the functions of R&D, IS/IT, Mfg and operations.

The approach taken in this research provides a compatible but different perspective compared to the functional perspective. Some of the outsourcing of R&D activities in the pharmaceutical industry such as contracting R&D to research universities is business critical for the outsourcer’s future prospects (Quinn, 2000). However, it is also the case that some aspects of outsourcing R&D are primarily the use of low cost labour in some of the routine activities in drug development such as sample testing. Repeating the argument for IS/IT outsourcing identifies that, for instance, outsourcing of PC help desk support to countries such as India may be less business critical whereas outsourcing the whole IS/IT infrastructure of a bank or insurance company is highly business critical. The research in this thesis takes an industry perspective as outsourcing of operations & management of telecom networks is a relatively new phenomenon compared to others such as IS/IT outsourcing. Although the research could be classed as operations outsourcing it cuts across the functional domain as it asks the question: is the outsourced resource and activity business critical rather, than asking within which functional domain it belongs.
The debate on the merits and risks in outsourcing depends in part on the perspectives of the decision taker. Quinn and Hilmer (1994) argue that the firm should outsource most, if not all, non-core and non-strategic resources and activities whereas others caution against the potential hollowing-out of the firm (Bettis et al, 1992). The latter view argues that in a changing business environment the loss of competence can be problematic and undermine the future strategic position of the firm. As Hal Varian\textsuperscript{4} argues “If certain suppliers are critical to your success, you want them inside, under your control, not outside, where their objectives may differ from yours.”

Hal Varian’s comment raises the important point of the perspective of the supplier. In fact, the pilot study in this research showed that the decision on the merits and risks in outsourcing is not a one-sided decision by the outsourcer but a joint discovery process where either party can walk away if the risks exceed the benefits from the deal under negotiations. This research has identified that suppliers generally have very clear views of what they want from an outsourcing deal, and how to approach the question of benefits and risk. The research shows that the suppliers has formalised processes when assessing risks, and accumulate knowledge and experience for each deal they negotiate. This is less so in the case of the outsourcer for whom large scale outsourcing often is a new or infrequent event.

This discussion leads to the question on the driving forces for outsourcing as a means to understand some of the risks in business critical outsourcing.

### 2.2 Driving forces in outsourcing

The relevance of this section is to identify whether the driving forces for outsourcing change over time as the perspective of outsourcing is of an increasingly complex and business critical phenomenon. Using data from Nordigården’s (2007) literature review of the driving forces for outsourcing as a basis, the data has been divided the data into two time periods, 1990-1997 and 1998-2005. Applying a quantitative analysis of the first half of the period and comparing it with the second half’s result the analysis has enabled answer the question if the driving forces has changed over time. By calculating the proportion of papers that identified each driving force the following observations can be made:

\textsuperscript{4} Quoted in Carr 2004
Cost reduction is by far the most important driver in the two periods.

Operational quality, capacity, flexibility, and improved performance are consistently second.

The data from the analysis is presented in appendix B and a summary shown in figure 7 where the percentages reflect the degree to which a driving force is present in the literature identified by Nordigården (2007).

<table>
<thead>
<tr>
<th></th>
<th>Cost reduction</th>
<th>Financial leverage; fixed to variable cost conversion, reduced size balance sheet</th>
<th>Operational quality, capacity, flexibility, response and performance</th>
<th>Focus on core competencies and core business</th>
<th>Accessing external competencies and resources</th>
<th>Increased company focus on fewer activities</th>
<th>Risk reduction or risk sharing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-1997</td>
<td>83%</td>
<td>33%</td>
<td>61%</td>
<td>11%</td>
<td>33%</td>
<td>22%</td>
<td>17%</td>
</tr>
<tr>
<td>1998-2005</td>
<td>80%</td>
<td>53%</td>
<td>60%</td>
<td>60%</td>
<td>60%</td>
<td>7%</td>
<td>33%</td>
</tr>
</tbody>
</table>

**Figure 7.** Driving forces in the literature.

Adapted from Nordigården (2007)

The analysis is done by counting the driving forces identified by each author divided by the number of research papers in the two periods presented as a percentage figure. The total number of papers that explicitly consider the question of driving forces for outsourcing is 31. Nordigården (2007) identified cost reduction, financial leverage considerations, capacity and operational considerations, accessing external competencies and resources as driving forces for outsourcing. In the analysis of the literature review by this researcher two further driving forces were identified. The two additional driving forces were: 1) applying outsourcing to increase the focus on fewer activities and 2) a means to reduce risks or the sharing of risks.

Focus on core competence and core business is an increasingly important driving force identified by 11% of papers in the period 1990-1997 and by 60% in the period 1998-2005. This apparent increase could be explained by an actual increased focus in organizations on core competences and the core business with the consequence that the non-core parts of the organization are increasingly outsourced. This was the argument of Quinn and Hilmer (1994). However, we should also take into account that the notion of core competence and the resourced based view
emerged in the academic literature from the 1990’s (e.g. Prahalad and Hamel 1990) hence the increase in the literature could partly be explained by the interest in this theoretical basis for assessing outsourcing and the time lag involved in publishing academic papers.

What is notable is the apparent decrease from 22% to 7% in the focus on fewer activities in organizations. In some ways the focus on fewer activities could be interpreted as a focus on core business assuming that a firm has a few rather than many core businesses and competences. This finding shows an opposite result of what could be interpreted as the same driver. It could possibly be that researchers have focused their attention on the question of core business without explicitly commenting on the fact that this implies that the organization is reducing the number of activities it retains within the hierarchy.

- Financial leverage, conversion of fixed to variable costs and balance sheet considerations as drivers for outsourcing increases from 33% of researchers 1990-1997 to 53% of researchers in the period 1998-2005. This aspect is linked to cost reductions. For example, a reduction in capital investment by outsourcing activities that require high capital investment has the potential to reduce costs through providing the supplier scope for economies of scale.

However, conversion of fixed to variable costs is also linked to transfer of risks as outsourcing has the potential to transfer risks from volume uncertainty for the outsourcer to a risk of volume uncertainty for the supplier. In the data analysis reported here the transfer of risk as a driving force for outsourcing increases from 17% to 33%.

- Accessing external competencies and resources increases from 33% to 60% from the first to the second period. This is a slightly different issue compared with core competencies and core business. One way to understand this is that outsourcing to specialists suppliers can provide access to scarce resources and skills such as the increasing use of IT skills and resources from countries such as India.

Looking at the driving forces in this quantitative way suggests that the initial drivers for outsourcing were cost reduction in combination with operational improvements in quality, flexibility in capacity and performance more generally. In the second time period increasingly important driving forces are: financial leverage considerations, core competence and a focus on core business, and access to external competencies and resources. The analysis suggests that the
number and types of important driving forces for outsourcing is increasing over time. The analysis identifies that risk and the transfer of risks are an important drivers for outsourcing and the research will focus its attention on this aspect whilst being mindful of other important drivers.

The next section discusses the approach of seeing outsourcing as a set of sequential stages and the consequences of this for the selection of theoretical underpinning.

### 2.3 Stages in the outsourcing relationship

The pilot case was instrumental in identifying the different stages as an important aspect of outsourcing and the development of the relationship between outsourcer and supplier. However, suggesting that outsourcing contracts that last many years have stages in their development is not a novel observation and has been reported by other researchers (see Andersson and Norrman, 2002; Lindskog, 2003; Moses, 2009). It raises the question whether there are identifiable stages that can be used as scaffolding for the analysis of outsourcing risks. It also brings forward the question of whether it would be useful to apply the same or different theoretical perspectives in the respective stage.

The literature on alliances and partnerships developed several perspectives on organizational relationship development. At a simple level, the stages in this research could be (i) the selection and formation of the relationship, (ii) the implementation of the relationship and (iii) the dissolution of the relationship. As there are usually investments in resources and capital by all parties in selecting, forming and implementing an inter-organisational relationship it seems reasonable that an important goal of the two parties is to sustain the relationship until a measure of positive return has been achieved. Van de Ven (1976) sets out a theoretical framework of inter-organizational relationships based on the premise of a social action system. The literature identifies a set of sequential stages in the development of an inter-organizational relationship such as outsourcing. Gulati (1998) identifies five key issues for the study of alliances: (i) the formation, (ii) the choice of governance structure, (iii) the dynamic evolution, (iv) the performance, and (v) the performance consequences of firms entering into alliances. In a longitudinal study of strategic alliances Doz (1996) identifies the environment, task, process, skill, and goals as dimensions in a process of learning, re-evaluation and readjustment. Lindskog’s
(2003) overview of stages in the logistics literature offers a similar sequence of stages for logistics outsourcing. Moses (2009) established five stages in the make or buy process, finding it to be an iterative process shaped by the context and characteristics such as time, complexity of product and customer and supplier relationship.

This research begins by studying the outsourcer in the stage before formal negotiations with potential suppliers have commenced. It is part of the formation of the relationship but is only concerned with the internal deliberations of the outsourcer. Activities in this stage are: (i) establishing what activities and resources could be outsourced, (ii) decision criteria, (iii) search for potential suppliers, (iv) and the structure of the negotiation process (Andersson and Norrman, 2002). This stage is termed the Scoping & Search stage in the research. It should be noted that during the Scoping & Search stage outsourcing suppliers are marketing their products and services with the hope that this will convert into a decision by an outsourcer to engage in formal negotiation. This is a marketing process of outsourcing services and is outside the scope of this research.

The notion that the initial stage is an internal deliberation does not mean that informal contacts and discussions between outsourcer and suppliers take place. The purpose of the Scoping & Search stage is to assess the potential benefits, costs and risks such that the organization can decide whether or not to engage in formal negotiations with suppliers. It is therefore in principle a make-or-buy decision from the point of view of the outsourcer as once a decision to engage in negotiations has been taken; significant time, money and resources for the negotiations are committed and used. The questions that occupy the outsourcer are comparing production costs in at least two alternative governance structures and making decisions based on the transaction costs and risks associated with outsourcing a business critical activity. This insight translates into the decision to apply transaction costs analysis in the Scoping & Search stage in the research.

Once a decision to enter formal negotiations with potential suppliers is taken, the character of the outsourcing decision changes from a single perspective by the outsourcer to a perspective where both outsourcer and suppliers exchange information, relationships are formed and sense making processes affect the perception of risk. At this point the perception of risks does not only concern the outsourcer but the suppliers also takes risks into account seen from their perspective. This stage is termed the Negotiation stage in this research and has three possible outcomes. One is that the outsourcer finds the risks and costs of an outsourcing deal too high.
and withdraws from the negotiation. A second outcome is that the suppliers withdraw from the negotiation should they find that the risks and the cost of negotiating a deal would not leave a minimum required profit margin for the contract.

The third possible outcome is that one supplier finds the potential profit sufficient to take the risk of entering into a deal at the price offered by the outsourcer. A contract is signed. This point in the outsourcing relationship changes the character of the relationship compared with the Negotiation stage as the details of the contract are agreed, service levels are agreed (termed service level agreement (SLA) in this research), and the outsourcing decision can be communicated to the wider organization and to other stakeholders that have not been privy to the negotiations. In the contractual sense the assets, staff and operational responsibility of the outsourced activity is transferred to the supplier with immediate effect. In practice however there are many contractual and legal obligations that will take time to transfer to the supplier. Although important aspects of the outsourced activity are still formally with the outsourcer the supplier has full responsibility for the outsourced activity and meeting for the agreed performance targets and key performance indicators (KPI). This is an important stage and is subject to a range of risks which may influence the long-term success of the outsourcing relationship. Special attention has developed among participants in outsourcing negotiation for this interim period where special clauses regulate the relationship. This period is termed Transition in this research.

The Transition stage is a relatively short portion of the total contract duration and is followed by the Operational stage. The fifth and final stage is the termination stage when the outsourcer decides to either take the resources and activities back in-house, re-negotiate a new contract with the original supplier or appoint a new supplier. The three stages covered in the research are the Scoping & Search, the Negotiation, and the Transition stages. The Operations stage and the Termination stage are not covered in the research due to limits in resources and the time scales in a PhD dissertation. The five step sequence described above is shown schematically shown below.

![Figure 8. Stages in outsourcing](image-url)
At the end of the contract period the outsourcer has a decision to make: either take the activity back in-house or re-negotiate with the incumbent supplier or open up negotiations with several external suppliers for the next contractual period.

The question this approach to the research raises is the selection of theoretical stance in the thesis. Outsourcing is a long-term inter-organizational relationship governed by contract that in the strategy literature is termed often strategic alliance (Contractor and Lorange, 2002) and sometimes non-equity alliance (Jorde and Teece, 1989; Gulati and Singh, 1998). The strategic alliance theory acknowledges the joint interest and unilateral commitments for the success of the alliance (Gulati et al, 1994) as well as process (Gulati et al, 1994; Doz, 1996), and creating joint value (Doz and Hamel, 1998). Risk is a central construct in this thesis and the strategic alliance literature has developed a frame of reference of how to manage risks (Baird and Thomas, 1990; Das and Teng, 1996, 1998a, 1998b, 1999, 2001, 2002, 2004; Delerue, 2004). Taking the point of departure in the strategic alliance literature identifies the framework developed by Das & Teng (2001) as the basis for studying how outsourcer and supplier manage risks in business critical outsourcing, discussed further in section 2.8.

So far we have discussed risk in broad terms and the next sections introduce a theoretical basis for the construct risk. The first part is a review of the literature on outsourcing risks followed by a section that establishes the definition of risk used in the research and finally how the risk construct is operationalised as part of the analysis model.

### 2.4 The literature on outsourcing risks

The literature review identifies a focus on benefits such as lower costs, increased flexibility, and access to skills and knowledge as well as on risks such as opportunisms, loss of knowledge and skills, dependence on the supplier, poor level of service in outsourcing. The outsourcing literature has identified a range of risks associated with outsourcing seen from the outsourcer's perspective.
<table>
<thead>
<tr>
<th>Outsourcing risks</th>
<th>Authors</th>
</tr>
</thead>
<tbody>
<tr>
<td>The other party not acting in good faith (opportunism)</td>
<td>Lonsdale and Cox, 1997; Lonsdale, 1999; Sullivan and Ngwenyama, 2005; Hoecht and Trott, 2006b; Bailey et al, 2002;</td>
</tr>
<tr>
<td>Loss of competence</td>
<td>Sullivan and Ngwenyama, 2005; Gonzales et al, 2005; Earl, 1996</td>
</tr>
<tr>
<td>Dependence on the supplier</td>
<td>Gonzales et al, 2005; Bahli and Rivard, 2003; McIvor, 2003; Bailey et al, 2002; Lonsdale and Cox, 1997;</td>
</tr>
<tr>
<td>Low adoption of new technology</td>
<td>Gonzales et al, 2005; Earl, 1996;</td>
</tr>
<tr>
<td>Lack of decision making processes and accountability</td>
<td>Harland et al, 2005;</td>
</tr>
<tr>
<td>Loss of staff morale and cohesiveness</td>
<td>Lonsdale and Cox, 1997; Kern and Willcocks, 2000;</td>
</tr>
<tr>
<td>Information leakage</td>
<td>Hoecht and Trott, 2006b; Bailey et al, 2002;</td>
</tr>
<tr>
<td>Hidden costs</td>
<td>Earl, 1996; Lonsdale and Cox, 1997; Barthelemy, 2001;</td>
</tr>
<tr>
<td>Not meeting the contractual performance levels</td>
<td>Willcocks et al, 1995; Lacity et al, 1996; Lonsdale, 1999;</td>
</tr>
</tbody>
</table>

Figure 9. Outsourcing risks in outsourcing

The review of the outsourcing literature on risks is in line with the dominant theoretical perspectives of transaction costs (e.g. opportunism, dependence on the supplier, hidden costs, technology risks) and RBV/Core competence (e.g. outsourcing core competences, loss of competence, information leakage). The work by Harland et al (2005) is one of very few that considers relational risks in the form of decision making processes. Another observation is that the identified research is almost exclusively from the perspective of the outsourcer, also the research by Harland et al (2005).
The following summarises the surveys on outsourcing risks reviewed in this thesis.

<table>
<thead>
<tr>
<th>Authors(s)</th>
<th>Survey</th>
<th>Risks discussed in the papers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gonzales et al, 2005</td>
<td>Survey 4416 Spanish firms. 357 respondents (8%)</td>
<td>Top 3 rated risks 1) Dependence on the contractor (61.8% of respondents) 2) Loss of critical skills (36.6%) 3) Providers’ lack of ability to adopt new technologies (35.9%)</td>
</tr>
<tr>
<td>Renner and Tebbe, 1998</td>
<td>Survey of 990 smaller size companies &lt;$500m sales. 180 responses</td>
<td>Risks were decrease in quality and that the provider would not know the business of the company.</td>
</tr>
<tr>
<td>Barthelemy and Geyer, 2001</td>
<td>Questionnaire to 500 largest companies in Germany and France. 160 respondents (32%)</td>
<td>Compare approach and concerns for risks between German and French firms that had outsourced the IS/IT function.</td>
</tr>
<tr>
<td>Bailey et al, 2002</td>
<td>Survey of 200 organizations with more than 250 employees. 46 private and 12 public responded (29%)</td>
<td>Problems and risks identified were:  ▪ Loss of control  ▪ Exploitation by supplier  ▪ Legal problems  ▪ Confidentiality  ▪ Industrial relations  The average cost savings 11%</td>
</tr>
<tr>
<td>Quelin and Duhamel, 2003</td>
<td>Survey with 180 respondents in large European manufacturing companies</td>
<td>▪ Risks identified in the research  ▪ Dependence on the service provider  ▪ Service provider capabilities</td>
</tr>
<tr>
<td>Aubert et al, 2004</td>
<td>Survey of 335 firms followed by expert panel to evaluate asset-specific IT activities followed by new survey to the same 335 firms.</td>
<td>▪ Survey suggested more specific assets lead to more outsourcing. The expert panel suggested the opposite result.  ▪ High uncertainty reduced level of outsourcing  ▪ Not significant; business skills requirement has limited impact on level of outsourcing.  ▪ High technical skills requirements supported level of outsourcing</td>
</tr>
</tbody>
</table>

Figure 10. Survey on outsourcing risks

This researcher’s conclusion from the literature review is that research has identified a range of risks such as dependence on the contractor, loss of control and skills as important risks. The majority of the research on outsourcing and risk are case studies, often multiple-case studies, and the findings follow similar lines to the survey type research. The picture emerging is that the theoretical perspective is not always made explicit and when this is the case it is primarily based on TCE (for examples see Earl, 1991; Jurison, 1995; Alexander and Young 1996b; Berthelemy and Geyer, 2001; Auguste et al, 2002; Bahli et al, 2003; Aubert et al, 2004; Hui and Tsang, 2006; Marshall et al, 2007) or alternatively RBV/core competence (Quinn and Hilmer, 1994; Lonsdale,
This literature review identified two dominant risks (i) dependence on the contractor reflecting the risk of opportunism and small numbers bargaining based in transaction cost economics and (ii) the loss of control and skills reflecting a core competence perspective on the risks in outsourcing.

Furthermore, the term risk is mainly used in the description of the context or the findings in the research. Risk is generally inferred from statements in the papers such as potential problems or costs, including hidden costs or loss of operational control as well as terms such as strategic risks. Problem statements such as these are a first step towards evaluating the risks in a decision to outsource but it does not provide descriptions of how to minimise or mitigate the risks. Jurison (1995) combines TCE and a financial investment model, capital asset pricing model (CAPM) with the argument that both TCE and CAPM assumes economically rational decision makers, yet acknowledges that “in many decisions, particularly in outsourcing, it is unlikely the outcomes and the probabilities are known, thus making it difficult to deal with risk quantitatively” (Jurison, 1995, p243) There is little doubt in the mind of the researcher that there are real risks in outsourcing but research to date offers limited guidance on the quantification of the risks, be it the probability, the variance relative to the potential savings or the subjective perception of risks.

However, risk and reward is not something that only concerns the outsourcer. Two aspects stand out in the literature review of outsourcing research in general and outsourcing risk in particular. Firstly, research has not taken the perspective of risk from both the outsourcer and the supplier; it seems reasonable to assume that also the supplier considers the risks and rewards from an outsourcing contract as part of their decision processes. Secondly, research has taken a rational choice model of risk whilst there are arguments in the literature that actual behaviour deviates from this model.

## 2.5 Risk as a theoretical construct in the social sciences

Risk is a central construct in this thesis and this section discusses risks in the context of business critical outsourcing. The word risk is one of those words we happily use everyday, feeling quite comfortable that others know what we mean. However, the word risk in the social sciences is far from unambiguous and the purpose of this chapter is to pin down what it means in this research context and setting. The first part deals with definitions of risk and different perspectives on risk.
in the social sciences. The second part is a review of the literature on risks in outsourcing followed by a discussion on the perspective applied in this dissertation.


- Risk: Situation involving exposure to danger
- Uncertainty: Not known, reliable, or definite.

Risk as a construct in the social sciences

The purpose here is not to develop a new theoretical perspective on risk but to compare and contrast different perspectives so that the definition used in this dissertation is sufficiently distinct to support clarity in the analysis. Hansson (2000) identifies five different ways of defining risk:

1. **Risk = an unwanted event which may or may not occur.**
   An example of this usage is: “Lung cancer is one of the major risks that affect smokers.”

2. **Risk = the cause of an unwanted event which may or may not occur.**
   An example of this usage is: “Smoking is by far the most important health risk in industrialized countries.” (The unwanted event implicitly referred to here is a disease caused by smoking.) Both (1) and (2) are qualitative senses of risk. The word risk also has quantitative senses, such as the following example:

3. **Risk = the probability of an unwanted event which may or may not occur.**
   This usage is exemplified by the following statement: “The risk that a smoker's life is shortened by a smoking-related disease is about 50%.”

4. **Risk = the statistical expected value of an unwanted event which may or may not occur.**
   The expected value of a possible negative event is the product of its probability and some measure of its severity. It is common to use the number of killed persons as a measure of the severity of an accident. With this measure of severity, the “risk” (in sense 4) associated with a potential accident is equal to the statistically expected number of deaths. Other measures of severity give rise to other measures of risk.
5. **Risk = the fact that a decision is made under conditions of known probabilities**

The first four definitions are ‘decisions under uncertainty’ and the fifth definition is ‘decisions under risk’ as the latter assumes that the probability of the unwanted event is known. In the case of the previous four definitions there is no knowledge of the probability of the unwanted event, it is uncertain. From an epistemological standpoint risk is a tricky construct. “When there is risk, there must be something that is unknown or that has an unknown outcome. Therefore, knowledge about risk is knowledge about lack of knowledge”\(^5\).

Risk has been described quantitatively in research as the probability of an event multiplied by the severity of the event (Norrman and Jansson 2004) which corresponds to the fourth risk definition above. Greater loss and greater event likelihood result in a greater overall risk. This approach seems straightforward but on closer examination puts obstacles in our way. Firstly, they both imply a calculative value of the probability and the severity (or loss) of the event and secondly, it assumes a rational choice model of decision making. To the first point, Knight (1921) argues that:

“To preserve the distinction…between the measurable uncertainty and an unmeasurable one we may use the term ‘risk’ to designate the former and the term ‘uncertainty’ to the latter”\(^6\)

Knight (1921) made the case that risk relates to objective probabilities and uncertainty to subjective probabilities, where objective interpretations of probability are real and subjective interpretations of probabilities are human beliefs (Holton 2004). This latter point on subjective interpretations begs the question if risk in management decisions regarding future events is measurable as decisions under risk or unmeasurable as decisions under uncertainty. Uncertainty as expressed by Knight (1921) is lack of certainty, the possibility that there could be more than one possible outcome. Uncertainty is silent on the consequence of the outcome whereas risk implies a negative outcome.

However, in the definition of risk in the Concise Oxford Dictionary the word ‘exposure’ is important. It seems logical that although a course of action or decision is uncertain, if the decision-taker does not have any exposure to the outcome of the action or decision there is no risk (to the decision taker). Yates (1992) proposes that the elements of the risk construct are: (i)

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\(^5\) Sven Ove Hanson 13 March 2007, http://plato.standford.edu/entries/risk/#DefRis

\(^6\) Quoted in Holton (2004)
potential losses (ii), the significance of these losses, and (iii) the uncertainty of those losses. The Yates’s definition combines the three elements of probability (potential loss), size (significance of loss), and uncertainty.

In the management field Baird & Thomas (1990, p 21) argue that risk is a multifaceted concept encompassing elements such as probabilities, size, nature of outcomes, lack of information, goals involved, unpredictability and uncertainty. In the financial literature the term ‘risk’ is an integral part of the discourse and research. Development in financial instruments and trading use portfolio theory to diversify risk and use the capital asset pricing model to separate risk into systemic (market) risk and unsystemic (unique, residual or specified) risks. Unsystemic risks are unique to each firm or investment, and are a reflection of the firm’s variability of returns. However, as Baird and Thomas (1990) point out, much risk calculation in the finance industry is based on historical data and applies statistical techniques to estimate a likely range of outcomes in the future. Baird and Thomas (1990) propose that in the context of management the term ‘risk’ has no single meaning (Baird and Thomas, 1990, p22) and Hanson (2000) argues that the term ‘risk’ has no single meaning in any context, and that it is a futile form of linguistic imperialism to attempt a uniform definition of risk (Hansson, 2000, p3). The views of Baird & Thomas and Hanson could on the one hand be liberating as this thesis could select freely how to approach the term risk, and on the other hand, it offers a difficulty in the analysis of the empirical material. The empirical data in this research is based on written plans, instructions, and transcripts of interviews with managers, in other words their subjective perspective on risk. However, further study of the literature may point to a way forward.

The focus of this thesis is how outsourcer and supplier manage risk hence bringing the managerial perspective into the picture. In the 1980’s the literature debated the issue of risk from the perspective of economics and decision theory (Kahneman et al, 1982; March and Shapira, 1987). In the paper ‘managerial perspectives on risk and risk taking’ March and Shapira (1987) discuss the literature on risk and report how managers view and deal with risk in decision making. Some interesting findings emerge; firstly, that a) managers view possible “gains” when assessing the attractiveness of alternatives, and b) “risks” when assessing negative outcomes. It seems managers see the variance as an opportunity or risk rather than the statistical meaning of a variance of the probability distribution. Secondly, managers do not seem to view risk as a probability concept, but rather look upon the amount lost (or expected to be lost); Kahneman et al (1982) define this as loss aversion. Thirdly, managers have limited interest in reducing risk to a
single quantifiable construct or a distribution of numbers. Although managers see parts of their job as taking risks to gain a return their attitude towards the risk is dependent on the position they find themselves in at the decision point. March and Shapira (1987) found that if the performance is just above a performance target the focus of attention is on not falling below target and limited attention is on opportunities for gains. This leads to risk aversion. This is markedly different for managers that are just below, or expect to be below target, where the focus of attention is generally on risk taking to climb back to target performance. Finally, in situations where performance is close to bankruptcy, managers become risk averse in the face of complete failure. Figure 11 below demonstrates how managers perceive risk and opportunity dependent on the position relative to a target.

Figure 11. Target impact on perception of risks.
Adapted from March and Shapira (1987)

March and Shapira’s (1987) findings suggest that the relationship between an objective probability estimate is not linear, with the subjective estimate of risk depending on the position relative to a set target a manager seeks to achieve. This indicates that the rational choice model for decisions under risk may not hold in practice. In a similar stance, Tversky and Kahneman (1986) argue that: (i) actual behaviour deviates from theory, (ii) that the deviation is systematic, and (iii) that relaxing the normative system is not a solution to the deviations. Tversky and Kahneman (1986) propose a Prospect theory which applies a two-phase approach in the choice process. The first phrase is termed framing and the second termed editing. In the framing phase a preliminary evaluation of the decision problem takes place, which frames the effective acts, contingencies, and outcomes. Tversky and Kahneman (1986) suggest that framing is affected by the manner in which a problem is presented and by norms, habits, and expectancies. In the second phase the highest value alternative is selected by either detecting which alternative dominates the other or by comparing their values.
From the discussion above it seems there are alternative ways of considering how outsourcers and suppliers perceive risks. On the one hand there is a normative theory based on on estimates of probabilities and expectation values (variance) with decisions made through rational reasoning and numerical estimates and on the other hand, a more complex set of theories informed to a large extent on observed behaviour and testable examples that refute the rational choice model.

In the next section the risk construct is defined and operationalised for the purpose of the research.

### 2.6 Defining the risk perspective in this dissertation

An aspect that guides the stance to risk and its definition in this thesis is the operationalisation of the construct of risk. Examples of outsourcing in the telecom industry are few in numbers and the sample sizes would be too low for a quantitative approach. Even if probability and variance estimates were used by managers in their decisions, the small sample sizes suggests there are insufficient *a priori* probabilities or homogenous data to apply objective interpretations of probabilities to the definition of risk (Holton, 2004). The research purpose is to describe and explain the approach to risk rather than aim to quantify the risks perceived by the parties in the outsourcing relationship. The findings are presented in a descriptive form based on the theoretical foundation akin to Knight’s (1921) subjective uncertainty based on human belief.

In this dissertation the author follows the route of March and Shapira (1987) of ‘decisions under uncertainty’ rather than the rational choice theory of ‘decision under risk’. The research describes the decisions and considerations related to risks managers include in their outsourcing decisions. It applies Hansson’s (2000) first and second definitions of risk such that:

<table>
<thead>
<tr>
<th>Risk type</th>
<th>Definition</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Risk = <em>an unwanted event</em> that may or may not occur. For example: the unwanted event is dependence on the supplier.</td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>Risk = <em>the cause of an unwanted event</em> that may or may not occur. For example: the cause of the dependence on the supplier could be that there is few capable suppliers in the supplier market</td>
<td></td>
</tr>
</tbody>
</table>

**Figure 12.** Risk types applied in the research
It should be noted that the term risk used in the dissertation is an expression of subjective uncertainty and not a numerical expression of probability. This should be kept in mind when reading this chapter on theoretical underpinning. In transaction cost analysis the term uncertainty has specific meaning relating to the unknowable character of the future. In this thesis the term risk is used to describe the subjective uncertainty expressed by managers and is termed perceived risk. The term uncertainty is used to describe the fact that the future is unknowable rather than linking it directly to the term perceived risk.

With risk defined, the next section describes outsourcing risks in each stage leading to the selection of theories in the research. It follows the stage based approach starting with the development of the theoretical model in the Scope & Search stage followed by the theoretical model used in the Negotiation and Transition stages.

### 2.7 Risks in the Scoping & Search stage

The Scoping & Search stage deals with the initial decision of the outsourcer of whether to engage in formal negotiations for an outsourcing contract with potential suppliers. Whether or not an actual contract is signed is determined in the Negotiation stage and this is dealt with separately in the next section. Nevertheless, in principle, the decision to engage in negotiations is a make-or-buy decision seen from the outsourcer’s point of view.

The initiation and driving forces of the internal discussion can come from many sources and the literature review and identified cost reduction as the main driver (Chapter 2.1). The implicit argument is that the driving forces have an impact on perception of risks and that the decisions taken in the Scoping & Search stage aim to mitigate these risks. The table below is a composite of the literature review on driving forces in outsourcing by Nordigården (2007) and this author’s review of the outsourcing literature. It should be noted that in some cases an author is identified against more than one driving force in the list.
### Main Driving Force

<table>
<thead>
<tr>
<th>Main Driving Force</th>
<th>Author</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost reduction including conversion of fixed to variable costs</td>
<td>Abrahamsson et al, 2003; Clegg et al, 2005; Ellram and Maltz, 1995;</td>
</tr>
<tr>
<td></td>
<td>Kakabadse and Kakabadse, 2005; Lonsdale and Cox, 1997; McIvor, 2003;</td>
</tr>
<tr>
<td></td>
<td>Quelin and Duhamel, 2003;</td>
</tr>
<tr>
<td>Focus on core activities</td>
<td>Lacity et al, 1996; Quinn and Hilmer, 1994; Harland et al, 2005;</td>
</tr>
<tr>
<td></td>
<td>Heywood, 2005;</td>
</tr>
<tr>
<td>Improved operational performance and quality, increased flexibility and speed</td>
<td>Benson and Littler, 2002; McFarlan and Nolan, 1995;</td>
</tr>
<tr>
<td>Access to skills and resources</td>
<td>Gonzales et al, 2005; Beaumont and Costa, 2002; Deavers, 1997;</td>
</tr>
<tr>
<td></td>
<td>Harrison and Kelley, 1993;</td>
</tr>
<tr>
<td>Risk reduction or risk sharing</td>
<td>Deavers, 1997; Higgins, 1955; Ellram and Billington, 2001; Gilley and</td>
</tr>
<tr>
<td></td>
<td>Rasheed, 2000;</td>
</tr>
</tbody>
</table>

**Figure 13. Driving forces in outsourcing**

The literature review identified two primary theoretical approaches to outsourcing research (Chapter 2.1). One approach asks if the intended resource and activity contribute to achieving sustainable competitive advantage. The other asks what could be the cost differential between keeping the activity in-house or outsourcing, less the specific transaction costs relating to the decision. The former applies a resource-based view (RBV) of the firm (Wernerfeldt, 1984; Barney, 1991) and the latter applies transaction costs economics (TCE) (Williamson, 1975, 1985, 1991) to answering the question: “should the outsourcer engage in negotiations with a supplier for an outsourcing contract”. RBV could conceivably assist in determining what should not be outsourced by identifying an activity as core to the business (Barney 1991). But RBV has limited power to advice on risks related to non-core but business critical resources and activities which is the focus of this thesis. Furthermore, RBV is not able to assist in determining at what relative cost difference an organization should outsource a business critical resource or activity. Transaction costs analysis on the other hand is focused on costs and cost differentials. It is also concerned with risks and uncertainties, which is the focus of the research. Having considered the options for the choice of theoretical stance the researcher will pursue the analysis based on transaction costs analysis in the Scoping & Search stage.

### Transaction cost analysis in the scope of outsourcing

An outsourcing decision is in essence a make-or-buy decision, a decision to transfer to an external supplier activities previously carried out in-house. This same activity, now in the form of a service, is subsequently purchased back from the supplier for an agreed period of time. All else being equal, the comparison between alternatives is about the internal cost of cost of production
and the price from an external supplier. Provided the service is produced at the right level of quality and is able to meet the changing demands of volume and technological development, it seems a straightforward decision of comparing internal production cost with the price of external supply. However, if the contractual detail does not have the foresight of all future requirements, and are not able to adjust sufficiently to changing requirements or are unable to meet the expected level of quality or the supplier acts opportunistically under some circumstances, there is a cost attached to the decision. If a situation is reached where the outsourcer is no longer in a position to take the activity back or transfer the activity to another supplier, then the outsourcing decision may in fact a decision to sell the activity and resource (Bleeke and Ernst, 1995). Walker argues that “supplier relationships involving higher value inputs and operations have higher levels of strategic risks” (Walker, 1988, p62). Managing the risks associated with deciding the scope of a business critical activity, the search for appropriate suppliers, the negotiation, and the on-going performance of the service are costs related to the transaction of purchasing the service. These costs are described as transaction costs (Coase, 1953) and have an impact on the make-or-buy decision.

Transaction cost analysis …[is] the analysis of the comparative costs of planning, adapting, and monitoring task completion under alternative governance structures.

Williamson (1985, p2).

Transaction costs analysis (TCA) takes a perspective of the decision to outsource based on three principal alternatives: the resource and activity remains in-house (hierarchy), is spot purchased in the market (market), or is provided through long-term contracting with an external provider of services (hybrid) (Williamson, 1991). Spot purchase in the market takes place when there are numerous suppliers providing similar and interchangeable services of short duration such as general legal advice. In the case of outsourcing, a decision to outsource creates transaction costs if there are a limited number of suppliers, the service is specialised and specific to the outsourcer, and the service is provided in a long-term incomplete contract. Incomplete contracts differ from complete contracts in that all aspects and future contingences can not be specified in advance in the contract. Examples of contingencies are changes in future volumes of work, technical developments, changes in cost associated with providing the service, and changes in the future strategic direction affecting the requirement of the service. This type of incomplete and long-term contract, of which outsourcing is an example, is the type discussed in this research.
Writing incomplete contracts under uncertainty and asset specificity (Williamson, 1975) would not present a problem were it not for two human behavioural characteristics, namely bounded rationality and opportunism. Opportunism is a central construct in the transaction cost theory developed by Williamson (1975, 1985). The proposition is that some individuals will take self-interested decisions to the detriment of the other party. The argument is not that all people are opportunistic but that some, from time to time, are and that it is impossible ex ante to determine who may be opportunistic, when, and to what extent (Williamson, 1985).

“The pairing of uncertainty with bounded rationality and the joining of small numbers with what I shall refer to as opportunism is especially important.” (Williamson, 1975, p8)

The stance in this thesis is that opportunism is a factor in outsourcing decisions. The stance taken is that of Williamson (1975) where the presence of opportunism is described as the ‘atmosphere’ creating the possibility of risks, rather than a risk in its own right. Bounded rationality is a construct used in economic theory to recognise people’s limitation in grasping complex and difficult concepts and ideas under conditions of uncertainty. It refers to neurophysiological limits on the one hand, and to language limits on the other.

In this thesis the decisions in the Scoping & Search stage are analysed using transaction costs analysis. The analysis is structured around what is included in an outsourcing contract (the scope), search costs (Williamson, 1975), negotiation processes such as bargaining, drafting, safeguarding, and monitoring (Williamson, 1975, 1985), and transaction costs drivers such as asset specificity and uncertainty (Williamson 1975). Figure 14 below illustrates the approach taken in this dissertation.
In the Scoping & Search stage an outsourcing decision is a comparison between the cost of internal production and the price for external supply plus the governance cost of the external relationship. In this thesis the *ex ante* transaction costs of the scope and search is analysed through the lens of transaction cost analysis. The negotiation process is analysed in the Negotiation stage and the theoretical perspective for the Negotiation stage is presented in Chapter 2.8.

**What should be outsourced and what should stay in-house (the scope)**

A transaction cost *ex ante* is the scoping of the outsourced activity. This is the decision on what activities should be outsourced and what activities should remain in-house. Applying TCA identifies asset specificity, uncertainty, bounded rationality, dependence, and opportunism as transaction costs drivers (Williamson, 1985).

**Asset specificity**

In transaction cost analysis assets can be divided into six categories: (i) site specificity, (ii) physical assets specificity, (iii) human asset specificity, (iv) brand name capital, (v) dedicated assets, (vi) temporal specificity (Williamson, 1991). The degree of asset specificity is derived from how specific the asset is to the performance of the outsourced activity. Conversely, specialised
investments result in uniqueness and lower economics of scale and hence higher asset specificity. If an asset can easily be put to an alternative use or sold at a price close to the asset value then it has low asset specificity. If an asset is highly specialised and has little value when in alternative use then it has high asset specificity. For example, providing office cleaning services has generally lower human asset specificity than with providing specialist technical maintenance of complex telecom networks. Physical and site assets such as network infrastructure and specialised telecom equipment have higher asset specificity than general purpose office equipment such as PCs and printers. Dedicated assets such as bespoke network software have higher asset specificity compared with industry standard software such as MS Word. In the context of outsourcing, high asset specificity suggests the asset is not outsourced and kept in-house (McIvor, 2005). In this thesis, site, physical and dedicated assets are all referred to as physical assets and not analysed separately. In the context of this research brand name capital is not being outsourced and temporal specificity applicable hence will not be included in the thesis.

Should an activity and resource of high asset specificity be considered for outsourcing, in general it would result in higher transaction costs in the form of time and effort to negotiate an appropriate contract and to govern the relationship. However, it is the combination of opportunism and small numbers bargaining (Williamson, 1975) that creates additional transaction costs \textit{ex post}. If the supplier has taken ownership of assets or resources of high asset specificity, the possibility of opportunistic behaviour and of dependence on the supplier increases the risk to the outsourcer and results in transaction costs \textit{ex post}. For example, if assets of high specificity have been transferred to the supplier, the supplier may withhold or make it difficult to transfer the asset back to the outsourcer or to another supplier at the end of the contract hence causing transaction costs for the outsourcer. The challenge in the case of opportunism is that it is not possible to estimate the probability of the supplier acting opportunistically.

**Uncertainty**

Uncertainty can be divided into volume and technological uncertainty as Walker and Weber, (1984) states:

- \textit{Volume uncertainty increases costs in outsourcing through uncertainty of volume predictions or fluctuations. High volume uncertainty leads to keeping a business critical activity in-house}
Technological uncertainty raises costs in outsourcing through uncertainty in predicting future technological developments.

Walker and Weber (1987) identified that the level of competition in the supplier market and the level of uncertainty has an influence on the transaction costs. "When market competition is low, adjustment costs for suppliers caused by changes in volume requirements raise transaction costs...but adjustment costs caused by changes in product specification (technology) do not have an effect on transaction costs.” (p593)

Technological uncertainty

Business critical outsourcing contracts involve technology and are therefore subject to technological uncertainty. Technological uncertainty can be divided into (i) changes in specifications and (ii) technological improvements (Walker and Weber, 1984). Vining and Globerman (1999) suggest that determinants of outsourcing transaction costs (the sum of bargaining, monitoring and opportunism costs) are product/service complexity, contestability and asset specificity. Technological uncertainty varies with the degree of product/service complexity according to Vining and Globerman (1999) which creates transaction costs related to:

- uncertainty in the specification of the product
- information asymmetry
- externalities in technology development

In business critical outsourcing, product/service complexity generates transaction costs such as:

Product/service complexity and uncertainty

Product/service complexity specifies the degree of difficulty in specifying and monitoring the outsourcing contract. A product/service such as the purchase of a ball pen can easily be described and hence has a low degree of complexity, a good experience such as food in a restaurant can only be judged as to its quality at the time of consumption and a post-experience product/service is when the price/performance is difficult to measure and may have a significant time lag between activity and outcome. An example of a post-experience product/service is contracted out R&D. The more complex a product/service the higher the transaction costs in negotiating and monitoring the performance of the product or service.
Product/service complexity and information asymmetry

Complex product/services in conjunction with information asymmetry result in transaction costs related to opportunism both in the negotiation phase by the outsourcer and in the termination phase by the supplier who at that point may have significantly better understanding of the product/service. Once the product/service is outsourced, the outsourcer may lack the insight and ability to evaluate and benchmark the service both in relation to changes in specifications and technological developments. Information asymmetry and the transfer of information asymmetry create transaction costs.

Product/service complexity and technological externalities

The transaction costs related to externalities and product/service complexity are particularly problematic in relation to technological developments. Firstly, future developments are not possible to predict and secondly, it is difficult to envisage writing contracts that instruct the supplier to continuously invest in and develop the service to introduce new technological developments; in particular, to devise a formula that would make allowance for the post-experience type of complex products/services where there is a great deal of uncertainty and time lag in the success of a development initiative would be difficult.

Walker (1988) identifies appropriation, technology diffusion, and end product degradation in relation to technology and transaction costs. Walker defines appropriation as “the potential for decline in equitable exchange relationships”; technology diffusion is defined as “the likelihood of competitors imitating the firm’s distinctive value-creating asset”, and the risk of product degradation is defined as “the risk that important product attributes will be distorted, ignored, or impaired”. (1988, p64)

In summary; transaction costs described above (Walker, 1988; Vining and Globerman, 1999) are abstract constructs where dependence, opportunism and uncertainty is affecting the assessment of costs in different governance modes.

However, there are also other transaction costs relevant to the decision to engage in the negotiations for an outsourcing contract such as the cost of searching for a suitable supplier and the design of the negotiation process. These are non-trivial costs (Barthelemy, 2001) and must be assessed relative to the potential cost savings and to the transaction costs associated as discussed above. We are interested in these types of costs as the purpose of this research is to understand
how the outsourcer manages risks in outsourcing decisions. The risks related to the search process are discussed in the next section.

**Analysis of the risks in the search process**

Building on the analytical model based in transaction costs analysis, there are costs incurred in the make-or-buy decision related to the search of suitable suppliers and the negotiation process. For example, the organization can make assumptions on how many manhours are required for the search and negotiation processes, allocate a cost per hour and make a judgment of the merit of considering outsourcing. Or the other way around, it gives an indication of how much lower the price offered by an external supplier must be to cover these costs. Research by Barthelemy (2001) indicates that the search and contracting cost is relative to the size of the contract. Search and contracting for a small outsourcing contract of $2.5 million is 4% of the contract price and for a contract of $500 million it is 0.4% of the contract price. The assumption is that managers in their deliberation on whether to engage in outsourcing negotiations weigh up the estimates of potential benefits such as lower costs against the costs of search and negotiation. Another explicit assumption is that other transaction costs are subject to subjective uncertainty, i.e. reflecting the definition of risk adopted in the research. One such risk is *the unwanted event* of not completing the process and not signing an outsourcing contract. The effort and cost spent becomes a “sunk” cost for the organization. Aborting the process could be due to *the unwanted event* of not agreeing terms with a supplier during the contracts negotiation or that the supplier withdraws from the negotiation.

*The unwanted event* – Transaction costs (sunk cost) associated with not concluding the negotiations once they have commenced

The literature has identified reasons (*the cause of an unwanted event*) for not completing a negotiation such as:

- Not agreeing desired cost reductions (Clegg at al, 2005)
- Too short a time to complete the negotiations (Das, 1991; Barthelemy and Quelin, 2006)
- Lack of commitment from the supplier (withdrawal from the negotiation)
- Information leakage (Hoecht and Trott, 2006b)

On the one hand not agreeing terms could be seen as the elimination of a risk by not signing a contract with the “wrong” supplier. On the other hand a transaction cost element in the search is
the risk that the search may not identify a competent supplier that could be invited to negotiate an outsourcing contract. This kind of transaction cost could not be calculated using cost accounting but is a matter of probability. The organization does not know with certainty beforehand how likely it is to find potential suppliers during the search, it recognizes this as a risk but has little means to estimate its probability with any degree of accuracy. Transaction cost drivers that could impact the transaction cost are: not finding a competent supplier, or that the potential supplier has the technical know-how but has acted opportunistically in the past.

Reminding ourselves that we are seeking to operationalise the risk construct in the search stage where managers weigh up the benefits, cost savings and risks related to a decision to engage in outsourcing negotiations. For example: not finding a potential supplier to invite for negotiation is an unwanted event and results in transaction costs in the form of a sunk cost. The cause of the unwanted event could be that i) the potential suppliers lack competence or ii) the outsourcer does not have sufficiently good contacts to identify suitable suppliers. In the former the outsourcer has limited possibility to affect the situation whereas in the latter case there is the possibility of improving the situation by extending the search for a suitable supplier. Understanding the cause of the unwanted event can identify the risk mitigating actions that could improve the situation.

The Unwanted event – Transaction costs (sunk cost) associated with not finding a suitable supplier in the search process

The cause of the unwanted event could be:

- Lack of competence by suppliers (McIvor, 2003)
- Limited previous experience with suppliers (Gulati, 1995)
- Poor reputation of possible suppliers (Barthelemy and Quelin, 2006)
- Limited number of suppliers (Abrahamsson et al, 2003; McIvor, 2005)
- Outsourcer with limited knowledge of the supplier market

Should the internal deliberation in the Scoping & Search stage conclude that the potential benefits and reduction in costs are larger than the transaction costs and associated risks then one could assume that managers in the outsourcing organization invites potential suppliers for negotiations. The next section studies the Negotiation and Transition stages but now from the perspective of both the outsourcer and the supplier.
2.8 Risks in the Negotiation and Transition stages

The next two stages in an outsourcing relationship are the Negotiation and Transition stages. These two stages are different compared with the Scoping & Search stage. In the Scoping & Search stage the decision taker is the outsourcer only; whilst in the Negotiation and Transition stages both outsourcer and supplier take decisions in a process of interactions (Ring and van de Ven, 1994). In the Negotiation stage more generally: (i) the negotiation is a multi-party process between the outsourcer on one side and a number of suppliers on the other side, and (ii) it is a multi-round conversation where the outsourcer communicates the requirements for an outsourcing contract and the suppliers respond with either acceptance of the details of the contract or offer alternative ways of achieving the requirements in the contract. Once the suppliers have been invited to negotiation, they also make assessments and decisions related to the profits, benefits and risks associated with the proposed outsourcing contract.

Business critical outsourcing creates interdependencies between outsourcer and supplier. This suggests that the theoretical perspective shifts from a one sided view in the Scoping & Search stage to one where both the outsourcer and supplier take a relational view of the Negotiation stage. As Kern and Willcocks (2000) find there is, “A wealth of views but no common answer to how to develop and maintain a successful [outsourcing] relationship” (Kern and Willcocks, 2000, p341. This shift from a buyer-centric transaction cost perspective suggests that we need to consider carefully the theoretical basis for researching the Negotiation and Transition stages.

Furthermore, in the Transition stage the decisions taken in the Negotiation stage are translated into operational actions by the outsourcer and the selected supplier. A distinct difference between the Transition and the Negotiation stage is that whilst the Negotiation stage is fluid and evolving with no certainty of the final outcome, in the Transition stage the successful supplier and the details of the contract are known to both parties. The perceived risks that were identified in the Negotiation stage are addressed in the Transition stage. Hence the research applies the same theoretical model in the Negotiation and Transition phase as a device to analyse and understand how the parties manage risks in the two stages.

It should be noted that the research in this dissertation is not about business negotiations more generally. The purpose here is to describe and find explanations for the actions taken by the parties to mitigate risks, not to how outsourcing contracts are negotiated.
The first step in developing the theoretical base for risks in the Negotiation stage is to study the literature on inter-organizational relationships. In particular, the literature on non-equity alliances and partnerships includes the study of long-term outsourcing contracts (Contractor and Lorange, 2002). In this perspective both parties are important in the relationship as contracts must meet both parties’ objectives and goals for the relationship to be successful (Child and Faulkner, 1998). Barthelemy (2003) argues that there is a choice in outsourcing relationships between relying on the hard side (contractual) and the soft side (relational) in achieving the goals of the contract. The literature on outcome success in inter-organisational relationships has applied a range of theoretical perspectives such as transaction costs (Parkhe, 1993; Gulati, 1995), core competence (Prahalad and Hamel, 1990; Afuah, 2000) relational contracting (Kern and Willcocks, 2000), social exchange (Dyer, 1997; Young-Yabarro and Wiersema, 1999) to explain success. Specific aspects such as contracts negotiation (Arino and Ruer, 2004), selection (Dierickx and Koza, 1999), and the on-going relationship (Doz, 1996) have been studied and inform the theoretical base for the research.

Research by Arino and Ruer (2004) on alliance contract negotiations suggests that it pays to incur costs of introducing provisions aimed at controlling the partner’s behaviour and specifying terms regarding foreseeable contingencies. However, it does not pay to incur costs of establishing procedures that address non-foreseeable contingencies, nor the costs of provisions aimed at controlling the alliance operations. This suggests that tight contracts are drawn for aspects that are foreseeable but that loose contract mechanisms should be used for aspects that are unforeseeable. Arino and Ruer (2004) conclude that the costs of negotiating contractual provisions are higher when partners have no prior ties (Gulati, 1995) and that the presence of prior ties does not influence the extent to which partner control provisions are put in place - but lead to fewer provisions relating to operational controls. Barthelemy and Quelin (2006, p1790) find that contract complexity can mitigate characteristics of specificity and environmental uncertainty.

An important aspect in the negotiations is the partner selection process. In general, this starts in the Scoping & Search stage with the formation of a long list of potential suppliers who are invited to submit quotations against a Request for Proposal (RfP). Depending on the response rate and the details of the supplier’s proposal, all or some of the bidders are invited to formal negotiations. However, companies involved in outsourcing deals are up against a fundamental problem when they negotiate; the information is asymmetrical i.e. unequally divided between
outsourcer and supplier (Balakrishnan and Koza, 1993). The dilemma for the outsourcer is to communicate sufficient information about the scope of what is being outsourced yet retain enough information to ensure a strong position in the negotiation. The supplier on the other hand has to relay and trust the information provided by the outsourcer with limited ability to assess the validity of the information and the risks inherent in the outsourcing deal: adverse selection (Dierickx and Koza, 1999) is present in outsourcing negotiations and the parties have to make decisions on how to manage this type of risk.

An overall concern in the literature is the issue of risks of failure in inter-organizational relationships, cited by many scholars to be very high (Bleeke and Ernst, 1995; Das and Teng, 1999, p50). Prominent writing and theorising by Das and Teng in the past 15 years (1996, 1998a, 1998b, 1999, 2001, 2002, 2004) has developed theoretical models for managing risks in inter-organizational relationships. However, limited empirical research on outsourcing has been applied to the models developed by Das and Teng. This thesis makes a contribution by applying their work on empirical data from outsourcing relationships. The following explains the theories developed by Das and Teng and how they are applied in this dissertation.

Risk as performance risk and relational risk
This study seeks to answer the question how the parties engaged in negotiations manage risks given that the Scoping & Search stage has identified important risks. What sets an outsourcing agreement apart from risk assessments more generally is that two parties are intrinsically linked through a long-term contract and the perception of risk is dependent on both parties positive contribution to a shared understanding (Das and Teng, 2001, p251). It therefore seems logical that these risks must be understood and acknowledged by both outsourcer and supplier during the Negotiation stage and that both parties’ endeavour to find solutions that could mitigate the risks. The dependence created is of great importance in an outsourcing relationship (Kern and Willcocks, 2000) hence it alerts us to the creation of common goals and joint responsibility. The performance of the outsourced activity continues to be of importance to the outsourcer after the outsourcing contract is signed whilst operational control of the resource and activity has been handed over to an independent supplier. This is setting a frame such that risk is acknowledged and that the focus is on performance- and relational risk and specifically on reducing downside risk. Das and Teng argue that:
there are two independent yet equally important considerations for entering into an ‘inter-organizational relationship’: relational-(risk) and performance-(risk).” (1996, p830)

Performance risk refers to “the probability that intended strategic goals of an alliance may not be achieved, even though cooperation between parties is satisfactorily”. Relational risk in this research is “concerned with cooperative relationships, or the probability that the partner does not comply with the spirit of cooperation” (Das and Teng, 2001, p253).

Das and Teng (2001) contend that trust and control are inextricably linked with risk in strategic alliances and other inter-organizational relationships such as outsourcing, and that trust and control are the two principal antecedents of risk.

Control in this dissertation is defined as “a regulatory process by which the elements of a system are made predictable” (Das and Teng, 2001, p258) and hence reduce the perceived risk. Trust is defined as “a subjective state of positive expectations” (p225).

Furthermore, each construct has certain key dimensions such as (i) goodwill trust and competence trust linked to Trust and (ii) behaviour control, output control, and social control linked to Control. The definition of the dimension of trust and control of risks in inter-organizational relationships is described in the table below.
### Trust & Control mechanisms

<table>
<thead>
<tr>
<th>Trust &amp; Control mechanisms</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill trust</td>
<td>One's good faith, good intentions, and integrity</td>
</tr>
<tr>
<td>Competence trust</td>
<td>High probability of success</td>
</tr>
<tr>
<td>Behavioural control</td>
<td>Appropriateness of processes - high task programmability and low output measurability</td>
</tr>
<tr>
<td>Output control</td>
<td>Ability to measure outcomes in an objective way - high output measurability and low task programmability</td>
</tr>
<tr>
<td>Social control</td>
<td>Establishment of shared goals, values, and beliefs - low output measurability and low task programmability</td>
</tr>
</tbody>
</table>

*Figure 16. Trust and Control mechanisms.*

Adapted from Das & Teng (2001)

The identified mechanisms affect performance and relational risks differently. According to Das and Teng (2001), performance risks can be reduced through building competence trust in the other party’s ability to deliver on the agreed details of the contract, and through prior relationships, references from other similar outsourcing agreements etc. Output control is an integral part of the contract negotiation through establishing budgets, cost levels, pricing structures, performance measures against agreed base lines in the service level agreement. Social control can reduce risks through the creation of shared goals, values and beliefs. It forms an important part in reducing the performance risks. Various mechanisms to reduce relational risks can be applied in the development of the relationship such as goodwill trust-building supported through establishing mutual interests, creating individual and team-level trust and establishing joint dispute resolution processes. Behaviour control mechanisms can be described in the contract in the policies and procedures, the reporting structure, training and development etc. Social control influences people’s behaviour through measures such as creating shared values, sharing of goals and plans together with activities that establish norms and beliefs.

Das and Teng (2001) refer to relational risk as “*opportunistic behaviour is exemplified in shirking, cheating, distorting information, appropriating resources.*” (Das and Teng, 2001, p253) with reference to both parties in the relationship, and akin to opportunistic behaviour as described by transaction costs theory (Williamson, 1975). Performance risk is referred to performance risk as “*. the probability and consequences that alliance objectives are not achieved, despite satisfactory cooperation among partnering firms.*” (Das and Teng, 2001, p 253). The argument in this thesis is that the underlying theoretical basis is similar in TCA and the Das and Teng (2001) framework. The table below divides risk into performance and relational risk and maps the risks in outsourcing as identified
in the literature. For example, a hidden cost as identified by Barthelemy (2001) is a performance risk. The risk reduction mechanism suggested by Das and Teng (2001) is output control in the form of objective setting through planning and budgeting processes. The table gives examples of the link between type of risks in the Das and Teng (2001) model and outsourcing risks.

|-------------------|-------------------------------------------------------------|-----------------------------------------------------|
| Outsourcing Risk (from the literature) | Competence trust-building | • Proactive information collection  
• Benchmarking |
| Loss of core competence | | |
| Low adoption of new technology | | |
| Dependence on other parties | | |
| Not meeting contractual performance levels | Output control mechanisms | • Setting objectives  
• Planning and budgeting  
• External |
| Hidden costs | | |
| Loss of staff morale and cohesiveness | Social control mechanisms | • Decision-making processes  
• Frequent Interaction |
| | | |

**Figure 17.** Performance risks.

|------------------|-------------------------------------------------------------|-----------------------------------------------------|
| Outsourcing Risk (from the literature) | Goodwill trust-building | • Establishing mutual interest  
• Individual and team level trust  
• Joint dispute resolution |
| The other party not acting with good intentions (opportunism) | | |
| Lack of decision making processes and accountability | Behaviour control mechanisms | • Policies and procedures  
• Reporting structure  
• Staffing and training |
| Information leakage | | |
| Loss of staff morale and cohesiveness | Social control mechanisms | • Decision-making processes  
• Rituals, ceremonies, and networking |
| | | |

**Figure 18.** Relational risk.

With this approach we have been able to link risk through performance and relational risks with risks identified in the literature. By applying the Das and Teng (2001) framework for risks mitigation, we can operationalise the risks in the Negotiation and Transition stages in outsourcing. Das and Teng (2001) take a normative stance in their theory development and argue that competence trust-building, output and social control can reduce performance risks to a high degree. Furthermore, in the case of relational risks applying goodwill trust-building and
behaviour control will reduce risks to a moderate degree, whilst social control has the potential to reduce relational risk to a high degree.

With the theoretical foundation in place the next step is to consider an analysis model in which the empirical data can be applied. This is discussed in the next section.

### 2.9 Developing the analysis model

The literature study generated important insights not only into outsourcing but also inter-organizational relationships, transaction costs analysis, and the concept of risk in the social sciences. The literature generated a picture of numerous approaches and possibilities but also gaps in our knowledge and understanding of the perception of risks in business critical outsourcing. This section draws together the discussion on the theoretical perspective and provides a framework for the analysis of the empirical material in the research.

An important insight from the analysis in this chapter is that outsourcing goes through a set of stages where the character of perceived risk differs. This insight led to a more focused search for appropriate theoretical frames to study risks in the identified stages. Furthermore, the literature review led to the insight that using the same theoretical frame of reference is not suitable when the interest is to understand perceived risk in the different stages. The approach taken in this thesis is to apply transaction cost analysis in the Scoping & Search stage where only the outsourcer is the relevant party. In the Negotiation and Transition stages applies Das and Teng’s (2001) framework for analysis of performance and relational risks.

![Figure 19. Theoretical perspectives taken in the stages under study](image-url)
2.9.1 The analysis model in the Scoping & Search stage

We shall remind ourselves of the research question in the Scoping & Search stage.

RQ1  How does the outsourcer perceive and manage risks in the Scope & Search stage before entering into formal negotiations for an outsourcing contract of a business critical activity?

In the Scoping & Search stage the question of risks are addressed by the outsourcer alone as no decision to actually formally engage in negotiations has been taken. It is therefore a buyer centric perspective and the literature review suggests that transaction costs analysis is an appropriate theoretical perspective to apply.

The analysis applies transaction cost analysis to answer the question and the analysis model is described by the figure 20 below.

![Figure 20. Transaction costs applied in the thesis](image)

The specific interest in this dissertation is the perception of risk by managers in the outsourcing organization when they decide: (i) which parts of the in-house activities and operations that should be offered for negotiation for an outsourcing contract (the Scope), and (ii) the design of the search process. It is within the power of managers to take this type of decisions and the proposition is that risk is a component in the decision. Theory suggests that the potential production costs savings from outsourcing must exceed the transaction costs and risks (in cost terms) for managers to take the decision to engage in negotiations (Williamson, 2005, p27). Taking decisions under uncertainty is a role managers are generally willing to accept and they generally believe they have the ability to mitigate the identified risks in the decisions they take (March and Shapira, 1987).
Guided by the theoretical stance taken in this thesis the perceived risks in two transaction cost categories are studied, namely:

| Transaction costs that determine what is outsourced and what stays in-house (the Scope) | ▪ Decisions on the type of activities to be included in the outsourcing contract to balance the risk with the benefits. |
| Perceived risks in the search process for potential suppliers | ▪ Identification, benchmarking and selection of potential suppliers with the capability to successfully take over a business critical activity over a defined period of time.  
▪ The design and execution of the search and negotiation process. Decisions such as number of suppliers to invite, type and level of information provided, service levels, pricing structure and contractual safe guards.  
▪ Decisions on the governance process, monitoring and termination processes. |

**Figure 21. Transaction cost in the Scoping & Search Stage**

**What should be outsourced and what should stay in-house (the Scope)**

The analysis model in this research addresses the transaction costs related to physical and human assets, as well as technological uncertainty. The analysis seeks to answer the question what risk mitigating actions managers take to mitigate the transaction cost by addressing the transaction costs drivers. In business critical outsourcing in the telecom industry the research has found that is volume uncertainty is not a major transaction cost and is not covered in this thesis.

**Physical and Human Assets**

The decision of what should be outsourced relates to physical and human assets and the degree of asset specificity. Transaction cost theory argues that high asset specificity result in high transaction costs and assets of low asset specificity results in low transaction costs. In addition, the outsourcer has to consider the consequences of dependence on the supplier and the risk of opportunism (Williamson, 1975, 1985). In business critical outsourcing dependence on the supplier should be considered carefully (Lonsdale, 1999) as the activity is an integral part of the business of the outsourcer. Dependence in combination with opportunism can cause transaction costs throughout the contract period but especially at the termination stage where the outsourcer has to decide whether to renew the contract, contract with another supplier, or bring the contract back in-house. Opportunistic behaviour by the supplier may make it difficult and costly to bring the contract back in-house.
Human assets have somewhat different characteristics compared with physical assets. Physical assets are generally registered in the asset register of an organization. Human assets on the other hand are not registered as assets but are connected to the organization through employment contract laws giving mutual notice periods and rules for conduct and behaviour. However, some people involved in business critical activities may have high degree of specificity, such as expertise or training or knowledge and learning-by-doing (Williamson, 1991). Unlike physical assets, human assets involve people with specific competences that are free to leave the organization. It is therefore not possible to outsource people in the same sense as physical assets can be outsourced. What can be contracted for is the performance of a specific activity with specified levels of performance, not generally who is carrying out the activity. Business critical outsourcing can include physical and/or human assets of varying degrees of asset specificity.

The combination of human asset specificity and opportunism creates transaction costs on termination as the contract specifies the activities and services levels but not the human assets that could carry out the outsourced activity. The result could be that staff with particular knowledge useful within the supplier’s organization may not be offered to transfer back to the outsourcer or even more pertinently, may not be transferred to a competitor of the supplier.

The high degree of complexity in the outsourced activity in combination with information asymmetry results in transaction costs as the knowledge and expertise in the business critical activity gradually shift over time from the outsourcer to the supplier (Vining and Globerman, 1999). Over time the supplier may develop efficient and effective procedures and routines which may not be specified in the contract hence this may create dependence on the supplier and reduce the possibility of taking back the activity by the outsourcer.

Based on the literature review the analysis will consider the transaction costs from the transaction cost drivers related to physical and human assets and risk mitigating actions taken.
<table>
<thead>
<tr>
<th><strong>Transaction costs drivers</strong></th>
<th><strong>Physical assets</strong></th>
<th><strong>Human assets</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset specificity</strong></td>
<td>The extent to which specialised equipment or assets that provide competitive advantage is retained in-house or outsourced</td>
<td>The extent to which specialised human resources are outsourced and any risk mitigating actions taken to secure retention of competence and knowledge</td>
</tr>
<tr>
<td><strong>Dependence</strong></td>
<td>What actions and decisions are taken to mitigate the risk of dependence on the supplier</td>
<td>What actions and decisions are taken to mitigate the risk of dependence on the supplier</td>
</tr>
<tr>
<td><strong>Opportunism</strong></td>
<td>The extent to which opportunism is acknowledged and any action taken</td>
<td>The extent to which opportunism is acknowledged and any action taken</td>
</tr>
</tbody>
</table>

**Figure 22.** *Transaction cost drivers – Physical and human assets*

**Technological uncertainty**

Outsourcing of business critical activities such as telecom networks includes a high degree of technology complexity. A transaction cost is generated though the combination of technology and the uncertainty of future development of products and services. The transaction cost can be divided into several transaction cost drivers. One relates to the uncertainty in future technological requirements to meet market needs (Vining and Globerman, 1999), another of technology diffusion (Walker, 1988), and a third of appropriation (Walker, 1988).

<table>
<thead>
<tr>
<th><strong>Transaction costs drivers</strong></th>
<th><strong>Technology uncertainty</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Future technology requirements</strong></td>
<td>The extent to which the outsourcer considers the risks of losing competitive strength through the loss in, or reduction of, technological leadership and any risk mitigating actions taken</td>
</tr>
<tr>
<td><strong>Technology diffusion</strong></td>
<td>The extent to which the specific knowledge of the technology dissipates into the supplier’s organization and becomes unavailable to the outsourcer at the end of the contract</td>
</tr>
<tr>
<td><strong>Appropriation</strong></td>
<td>The extent through which the supplier appropriates an inequitable share of the value created from the outsourced activity, and the actions taken to mitigate the risk.</td>
</tr>
</tbody>
</table>

**Figure 23.** *Transaction cost drivers – Technological uncertainty*

The above transaction costs drivers and risk mitigating actions will be analysed in the cases.
The search process

Given that the outsourcer decides to engage in search and negotiations, time and money is committed and the assumption is that there is a) some degree of confidence of completing the negotiation and b) that there are possible and suitable suppliers willing and able to sign the contract. Based on the literature review the two issues that have been identified in the previous chapter to incur transaction costs are: (i) the sunk cost of not completing the contract negotiation and (ii) the cost of searching but not finding a suitable supplier. The case material regarding the Search & Negotiation design process will be analysed based on the following two unwanted events which are linked to the causes of the unwanted event that was generated from the literature.

<table>
<thead>
<tr>
<th>An unwanted event</th>
<th>The cause of the unwanted event</th>
</tr>
</thead>
</table>
| Transaction costs (sunk cost) associated with not concluding the negotiations once they have commenced | ▪ Not agreeing desired cost reductions  
▪ Too a short time to complete the negotiations  
▪ Lack of commitment from the supplier (withdrawal from the negotiation)  
▪ Information leakage |

**Figure 24. Transaction costs in the Search stage**

Following the same format the second question regarding transaction costs of not finding a suitable supplier is shown in the figure 25 below.

<table>
<thead>
<tr>
<th>Risk type A The unwanted event</th>
<th>Risk type B The cause of the unwanted event</th>
</tr>
</thead>
</table>
| Transaction costs (sunk costs) associated with not finding a suitable supplier in the search process | ▪ Lack of competence by suppliers  
▪ Limited previous experience with suppliers  
▪ Poor reputation of possible suppliers  
▪ Limited number of suppliers  
▪ Outsourcer with limited knowledge of the supplier market |

**Figure 25. Transaction costs in the Search stage**

In summary, the overarching purpose of studying the Scoping & Search stage was to provide insights into the perception of risks before commencing formal negotiations with selected suppliers. The analysis model described above is applied in the case study and the findings reported in Chapter 8. In the next section the analysis model in the Negotiation and Transition stages is described.
2.9.2 The analysis model in the Negotiation and Transition stages

We shall remind ourselves of the research question in the Negotiation and Transition stages.

RQ2 How do the outsourcer and supplier manage risks in the Negotiation and Transition stages of a business critical activity?

The central question in the research is how the outsourcer and supplier perceive risks and how they apply risk mitigating mechanisms to reduce the risks. Risk is again divided into performance and relational risks (Das and Teng, 1999). Das and Teng (2001) suggests that Trust and Control are antecedent to risk perception and link these to five dimensions; goodwill trust and competence trust linked to Trust and behaviour control, output control and social control linked to Control.

Linking the findings in the literature review on outsourcing risks with the Das and Teng (2001) framework offers a way forward to operationalise outsourcing risks. For example, a hidden cost as identified by Barthelemy (2001) is a performance risk. The risk reduction mechanism suggested by Das and Teng (2001) is output control in the form of objective setting through planning and budgeting processes. With this approach we can link performance- and relational risks with different types of risks identified in the literature. Furthermore, with reference to chapter 2.5 the definition of risk adopted in this thesis refers to two types of risks.

Type A Risk = *an unwanted event* that may or may not occur
Type B Risk = the cause of an unwanted event that may or may not occur

In the Das and Teng (2001) framework the performance and relational risks link the identified outsourcing risks (*unwanted events*) which in turn are linked to *the cause of the unwanted event*. This approach provides a step-wise process linking the risk mitigating actions aimed at *the causes of an unwanted event* and therefore provides a more fine grained analysis of the risk mitigating actions.

For example, the risk of loss of competence and low adoption rate of new technology is a risk has been identified in the literature. This is therefore *an unwanted event*. From the perspective of the outsourcer, the lack of competence and expertise by the supplier or ‘over-promises’ that they have the competence and expertise are *causes of the unwanted event*. 
The analysis is guided by the Das and Teng (2001) framework and the analysis is aimed at identifying those risk mitigating actions that the outsourcer takes to reduce risks such as the lack of competence should a business critical activity be outsourced. The table below show an example of the analysis model and how the data is displayed in the analysis.

**Performance Risks**

<table>
<thead>
<tr>
<th>An unwanted event</th>
<th>The cause of the unwanted event</th>
<th>Risk reduction mechanisms</th>
<th>Risk mitigating actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outsourcing risk (from the literature)</td>
<td>Generated from the literature and empirical material</td>
<td>Proposed by Das and Teng (2001)</td>
<td>Competence trust-building</td>
</tr>
<tr>
<td>Loss of core competence</td>
<td>Lack of expertise</td>
<td></td>
<td>Risk mitigating actions generated from the empirical data</td>
</tr>
<tr>
<td>Low adoption rate of new technology</td>
<td>Lack of competence</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Over promising</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Figure 26. Analysis model in the Negotiation and Transition stage**

The same analysis model is applied to both the outsourcer and the supplier respectively. As mentioned above the risks that are analysed have been generated from the literature and identified as important risks to consider in outsourcing. The stance taken in this research is that outsourcer and supplier have a joint interest in mitigating those risks. The analysis studies the same *unwanted event* for both outsourcer and supplier although it is acknowledged that there may be other and specific risks that concern only the outsourcer or the supplier.

The analysis is carried out first for the outsourcer and then for the supplier and for each dimension related to performance risk and relational risks. The analysis is summarised in a table at the end of each case. In Chapter 7, a cross case analysis compares and contrasts the findings in the two cases.
3 METHODOLOGY AND RESEARCH DESIGN

This chapter describes the selected methods and research design for the thesis. The chapter begins with a discussion on the role of theory in the context of the research followed by a description of this researcher’s journey and some of the important decisions taken leading to the thesis. The next section discusses case based research and the design criteria that have been used in the research. It also covers the selection of cases including an introduction to the pilot case and the two cases in the IS/IT that are not part of the empirical material but did have an input into the research design and the research question. The final part discusses the data collection and analysis model applied in the research.

3.1 Research strategy and process

The research strategy and process as described in figure 27 is the principal sequence of the research presented in this thesis. It starts with the phenomenon of interest and finishes with a statement on the contribution the thesis has made to our understanding of the phenomenon of interest. The process in itself is a theoretical construct. However, in retrospect I can now see and confirm that the journey has followed the structure as outlined by Lekvall and Wahlbin (1997).

Figure 27. Research strategy and process.

Source: Lekvall and Wahlbin (1997)
This thesis is grounded in a new phenomenon that is important in the world of business and of interest to me as a researcher. The specific purpose and research questions are generated through the literature which also informs the choice of theoretical frame with which to study the phenomenon. The chosen methodology leads the process of gathering the empirical data followed by the structuring of the data such that the empirical data can be analysed. The two last steps connect back to the purpose and research questions as a link to establish the extent to which the findings answer the questions and the contribution this makes to our knowledge and practice. An important element in the research process is the two-way arrow relationship between the building blocks of the research which illustrate how early chapters support later chapters in the thesis. The double headed arrows also indicate the iterative nature of this type of research. The next section tells the story of the journey, partly to give the reader an understanding of how the research was conducted, but also as a way for myself to reflect on the journey I have taken towards becoming a researcher.

3.2 How this particular study developed

Despite the time that has passed from the initial review of the literature under the supervision of Professor Mitchell Koza at Cranfield Business School, it is with some satisfaction that I can trace the original ideas and thinking that led to the thesis at hand. The following extract is taken from the preface to the 1st formal review at Cranfield in August 2003. “The strategic implications of inter-organizational relationships (IOR) be it competition versus collaboration, the creation of interdependencies, or the blurring of the boundaries of the organization, are complex and problematic (Contractor and Lorange, 2002). This is particularly the case when the desired outcome of the relationship requires the parties to move from an arms-length relationship to one of collaboration in matters of strategic importance to one or several parties. Increasingly, organizations in both the private and public sector are connecting their business processes and expanding their contact points geographically and across the business environment through the means of information technology (IT) enabled inter-organizational information systems. Empirical research suggests that IT enabled inter-organizational systems are problematic to implement for organizations”

Further on the 1st review concludes:
“…focus on the potential advantages of inter-organizational relationships, while very little attention is devoted to the potential disadvantage” and furthermore comments that “…very little research has been devoted to how inter-organizational relationships are managed”.
Barringer and Harrison (2000, p395)
The broad based literature study identifies risk as an important aspect of managing inter-organizational relationships. The literature search and study led to the work of T.K Das and Bing-Sheng Teng on alliance risks. Das and Teng have built a theoretical foundation with which to study inter-organizational risks. In correspondence with T.K. Das it transpires that few empirical studies have used to their framework. The initial literature review was presented at the British Academy of Management conference in 2003 (Malmgren 2003) followed with a full paper presented at the British Academy of Management in 2005 (Malmgren 2005).

Whilst the academic perspective developed through the literature study, I was at the same time developing and running management development programmes for Ericsson Global Services in Sweden, US and China. It quickly became clear that Ericsson Global Services was developing its capabilities through a major shift in the traditional boundary between telecom operators and telecom equipment suppliers. In other words, the boundary was changing through what in this research is termed business critical outsourcing. The question then developed into how this boundary is managed when the boundary shifts to an external supplier.

This insight spurred on a second wave of literature search and study under the heading of outsourcing and outsourcing risks. The literature study is reported in this thesis and identified a gap in our knowledge of how to manage risks in outsourcing, and especially business critical outsourcing. At that point the research gap was identified and the research question was established as:

- How do organizations manage risks in business critical outsourcing?

Figure 28 below shows the journey from initial interest in the boundary of the firm through the literature study that resulted in the original research question. What it demonstrates is a journey that includes close proximity with practice and a pre-understanding of the phenomenon of study, but also that the original interest and focus of the research remains several years later.
3.3 Case based research

This research study addresses how organizations manage risks in business outsourcing. The fundamental question this research seeks to answer is therefore a how type of question.

"..case studies are the preferred strategy when “how” and “why” questions are being posed, when the investigator has little control over events, and the focus is on a contemporary phenomenon within some real-life context" (Yin, 1994, p1). Yin continues … “the distinctive need for case studies arises out of the desire to understand complex social phenomenon.” (p3).

Another point is the connection between the phenomenon and the context within which the questions are studied. In my view the context is essential for the understanding and tracing of how and why certain decisions are taken (Mintzberg, 1979). Case studies provide a basis for taking in contextual information that other methods and research designs could have missed. As such an experimental design would be less suitable. However a survey design could be used but this would run into difficulty as business critical outsourcing of the kind this research is studying is a new phenomenon and there are a limited number of business critical outsourcing contracts that could be studied. Therefore I decided to pursue a case study design to capture the specific contextual settings in the cases through semi-structured interviews of several people involved in the cases. With the decision made that case study research is the preferred research strategy the question turns to which organizations to study, how to select them and should it be a single case
study or multiple case studies. But before we do, there is a need to consider the researchers' perspective on theory and its role in research.

3.4 The role of theory and empirical data

The role of theory is an important part of this research, not as a goal in itself but as a means to an end. To me, theory is a description of a reality deduced from logic and intellectual deliberations supported by observations of the reality as the observer sees it. In this sense it is a ‘retroductive’ research strategy:

“The retroductive research strategy involves the construction of hypothetical models as a way of uncovering the real structures and mechanisms which are assumed to produce empirical phenomena” (Blaikie, 1993, p168)

The retroductive strategy is based on a cyclical process of constructing hypothetical models of reality; testing them against empirical data; and, based on results, either modifying the models or, if confirmed, attempting to move deeper into the phenomenon under study (Blaikie, 1993). In this study the theoretical foundation that was established in the initial literature review has evolved in symbiosis with the empirical data and the research project as a whole. Further theories have been added over time as a means to better capture the data in the empirical research and to give understanding of the research findings. An attempt is made to construct models that describe the connections between theories, hence capturing the contributions to our knowledge of the phenomena in this research.

Whetten (1989) suggests there is no distinction between a model and a theory he proposes a set of criteria for theory development under the headings of ‘what, how and why’, where what and how describe and why explains. Descriptions such as who, where, and when sets the limitations to the propositions generated from a theoretical model and hence set boundaries for the generalizability of the theory. Whetten does not distinguish between qualitative and quantitative research and takes the position that it is the value-adding properties of the contribution, not the method that matters. Eisenhardt (1989) describes the process of building theories from case study research where data provides the intimate connection with reality and permits the development of a testable, relevant and valid theory. The process appears as if it is linear and sequential with a clear start and finish, however the detailed description reveals an iterative and “opportunistic”
approach to collecting data and subsequent analysis (Eisenhardt, 1989, p533). Mintzberg (1979) describes the research process as emergent in a stream of decisions by the researcher, as inductive interspersed with creative leaps. He contends that as we grasp the complexity of the phenomena we study, the more we accept that we are in an exploratory phase. Mintzberg (1979) insists that systematic data is supported with anecdotal data, and this implies that we need to spend sufficient time to understand the context within which the data resides. On this point this researcher concurs. It becomes clear when analysing the data that one’s personal experience forms an important and intuitive source of the creative leap that the data triggers (Mintzberg, 1979). This insight also points to the need of the researcher to adopt a reflexive stance to the empirical data and the analysis process.

3.5 Case study selection

Returning to the research design and selection of cases, one objective of this research is to achieve external validity and a degree of generalizability. One way of achieving this is the use of replication logic in a multiple case study (Yin, 1994). The research design uses empirical data from one supplier that has outsourcing contracts with two different outsourcers. The idea behind this is to keep one variable fixed such that the perspective of risk is seen from one supplier organization, Ericsson in this study. It should be pointed out that from a research design point of view there are two main cases, not one. The purpose of the design of two main cases in the research is aimed at achieving “‘analytic generalization’ meaning that a previously developed theory is used as a template with which to compare the empirical results of the case study. If two or more cases are shown to support the same theory, replication may be claimed” (Yin, 1994, p31). The two cases allow the researcher to compare and contrast the case data. This is carried out in the cross case analysis hence supporting the purpose of answering the how question.

“A research design is the logic that links the data to be collected (and the conclusions to be drawn) to the initial questions of the study” (Yin, 1994, p18).

Figure 29 below gives a schematic view of the cases.
The Telfort pilot case

The initial case was a pilot study of the outsourcing contracts between Telfort⁷ and Ericsson in Holland. This case provided valuable insights into outsourcing in the telecom industry and was instrumental in the refinement of the theoretical basis and subsequent research design. The pilot case highlighted the complexity of outsourcing in the telecom industry, the character of the stages in outsourcing and the business criticality of outsourcing network operations, maintenance and design.

Short introduction to the Telfort case

Telfort Telecom in Holland was the third largest telecom operator in the Dutch market. Although the third largest, Telfort was significantly smaller than the dominant player KPN Telecom and was struggling to run the network and at the same time focus on marketing and bringing new products to market. This was especially the case for the introduction of third generation (3G) technology.

Ericsson was a major supplier to Telfort but Nokia had also supplied important parts of the network. At the end of 2001 and during discussion between Ericsson and the CEO of Telfort the idea of outsourcing was floated. Such an initiative would free up investment capital and

⁷ During the initial discussion on an outsourcing deal Telfort was known as O2 in the Dutch market.
would allow the management at Telfort to focus its attention on marketing. This is reflected by comments made by the CEO of Telfort:

“The agreement with Ericsson is an important step in Telfort’s strategy, in which we can focus more on our business, offering our customers the service they want, and less on running an increasingly complex technology…as a result of this strategy we will also realize cost savings as well”.

Ton ann de Stegge
CEO Telfort Telecom

Figure 30 below shows the connections and interactions between outsourcer and supplier, demonstrating the complex and multi-level relationships in business critical outsourcing.

The pilot case identified the following questions in relation to risks from Telfort’s perspective:

- Cost savings were a key driver for the deal but were there hidden or unexpected costs?
- How could loss of technical competence impact future development?
- What could be the consequences of information “leakage” to other telecom operators with which Ericsson works?
- Would other key equipment suppliers not want to bid for equipment supply as Ericsson would be involved in the evaluation process? In other words, how could “Chinese walls” be secured in the outsourced operation?
From Ericsson’s perspective, the perceived risks were:

- Was there enough understanding and information to be sure that the profitability calculations would hold? The initial savings offered to Telfort were a 25% cost reduction, with a potential for up to 40% over time.
- Would there be higher transition costs?
- 3rd party suppliers of service network, will they co-operate?
- The future strategy of Telfort – what would be the effect on Ericsson?
- Financial uncertainty at Telfort – what were the financial risks?

The pilot case informed the development of the research design and firmed up the theoretical approach with outsourcing risks as the central construct for the research.

**Outsourcing in the IS/IT industry – mini cases**

In parallel with planning the research on outsourcing in the telecom industry many questions were raised of how the IS/IT industry had dealt with risks in outsourcing. The IS/IT industry has a longer history of outsourcing large systems and activities and hence could be of interest in the research. Via Ericsson Australia, contact was established with Computer Sciences Corporation (CSC), a large supplier of IS/IT outsourcing services with around 100,000 employees around the globe. CSC offered access to two of their long-standing clients. The CSC clients were AMP, Australia’s largest insurance company, and DIMIA (Department of Immigration and Multicultural and Indigenous Affairs). In both cases the whole information system infrastructure was outsourced to CSC. Interviews with the CIO and deputy CIO of DIMIA and the executive responsible for outsourcing at AMP provided accounts of the relationship development over time and how risks were addressed when the initial contract was re-negotiated. The supplier’s perspective was represented through interviews with senior executives at CSC and the teams managing the day to day relationship with AMP and DIMIA. The initial findings from the IS/IT cases were presented in a paper at the British Academy of Management conference 2005 (Malmgren, 2005). The case material in the CSC/AMP and CSC/DIMIA cases are not reported in this thesis but have informed the researchers understanding of outsourcing risks as the relationship develops in the stages from negotiation, operation through to the termination stage, followed by renegotiation of outsourcing contracts.

In addition to providing data on a complete cycle of the relationship, the IS/IT case research developed the notion of business criticality. Both the AMP and the DIMIA cases demonstrate
the importance of the performance of the IS/IT infrastructure for the two organizations, however, in neither case is the network itself the revenue generating structure, but a support structure. The performance criteria of telecoms and IS/IT networks can be compared in two ways to identify the business criticality of outsourcing.

Firstly, availability of telecom networks is typically 99.996% compared with 99.0%8 for an IS/IT network. This may not sound much but converted to downtime for the network in a year gives a perspective of the importance. In the case of a telecom network the expected downtime is 21 minutes per year compared with 87.6 hours year for an IS/IT network. The importance from a business perspective is that in the case of the telecom industry the network, is the revenue generating infrastructure and any loss of network capacity will affect the revenue directly.

The second aspect is the degree of complexity in telecom networks. In IT the underlying technology is interoperable. In other words, whether the network server is a Hewlett-Packard or Dell server is not the important point as the application software is where the functionality is located and it can run on any hardware. In contrast, a telecom switch or radio base station is proprietary to the equipment supplier. The only thing that follows a common standard is the output; the equipment is a “black box” which runs all the functionality internally. This means there is significant knowledge and expertise to run networks with a multitude of equipment from many different suppliers. In addition, the telecom network interfaces with many IT based sub-systems such as billing systems, CRM9 systems and the like.

3.6 Empirical data collection

The central data collection takes place in the main cases A and B where the data is analysed based on the developed analysis model as described in chapter 2. The empirical data consists of internal documents from Ericsson such as commercial contracts, performance reports, policy manuals, strategic plans, presentations of plans and external communication. Furthermore, information in the public domain such as annual reports and public statements etc., form part of the empirical material. The archival material is in excess of 2000 pages and the coding of the documents has allowed referencing to each document as part of the analysis. Some of the

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8 Data from the Hutchison contract – Appendix G (E64)
9 Customer Relationship Marketing system
documents are commercially sensitive. However a listing of the documents can be found in appendix G.

A total of 29 people were interviewed for between one and two hours. The interviews have been recorded digitally and are available as part of the empirical data. The interviews have been transcribed verbatim and form an important source for the analysis. The transcripts have been coded and data has been extracted into a coding sheet according to my analysis model (Miles and Huberman, 1994). This allows a structured process of data reduction and analytical sharpness in the interpretation of the data. I was at one point considering using a text analysis software such as nVivo, however I did not pursue this option for two reasons: firstly, much of the archival material is in print copy only hence the task of transferring this to a computer readable format was not feasible, and secondly, the analysis apply abstract constructs such as opportunism and social control which required me to interpret the data in the coding process. Appendix C gives an example from a coding sheet. Quotations from the interviews have been used to illuminate specific points in the case write-up and the text has been read by the main contributors in the cases and their comments have been incorporated to further enhance the description of the cases.

Coding and analysis model

Each dimension in the Das and Teng (2001) framework was analysed using the coding framework. For each individual data an assessment was made by the researcher to the extent that the action mitigates perceived risks. For example in the TSIC case; to what extent did the joint data discovery process in the negotiation reduce the risk of agreeing poorly designed SLAs? A range of data was assessed from low – medium – high as to the degree to which actions reduced the risk of poorly designed SLAs in the output control dimensions. This process was repeated for each dimension using the coding sheets in the Negotiation- and Transition stages. The process was carried out for both the outsourcer and the supplier resulting in a total of 48 assessments of risk mitigation, each consisting of 3-8 pages of coding sheets.

The data was validated in three ways:

1. Through the use of the literature as the basis for theory and the construct applied in the analysis model
2. Participant’s views which where reviewed and their comments incorporated
3. The interpretation of the data by me, the researcher.
To deal with the amount of data, the result is displayed in a spider web diagram. The figure 31 below gives an example of this for the TSIC case.

![Spider web analysis (example)](image)

**Figure 31. Spider web analysis (example)**

Displaying the data in this way provided the means for a qualitative assessment of the empirical material and means to compare and contrast the cases. It should be noted that the purpose of this thesis is not to measure risk mitigation but to understand the specific actions that were taken in each of the cases. The spider web diagram is merely a device to handle the large amount of data and to provide an aggregated qualitative overview of the risk mitigating actions. The spider web diagrams for Hutchison are shown in Appendix D.

The unit and level of analysis.

To ensure quality in the analysis the choice of unit of analysis is important. In this research study the unit of analysis is the outsourcing relationship between outsourcer and supplier. The level of analysis is of the functions and people that were directly involved in the outsourcing decision, at the negotiation stage and at the transition stage. The picture below demonstrates the unit and level of analysis.
The filled arrows indicate important stakeholders that influence not only the decision to outsource but the perception of risks. These stakeholders are included in the research and the empirical material has brought to bear the importance of senior management in terms of setting the goals and the timeline for taking the outsourcing decision.

The dotted lines indicate that there are important relationships other than those that negotiate and implement the outsourcing contract. This includes internal staff not directly involved in the outsourcing relationship but playing a role in delivering the performance of the contract. It also includes all the sub-contracts that underpin many aspects of the technical delivery of the contract. In many cases, these sub-contractors are direct competitors of the supplier. It should be noted that these stakeholders are not included in the empirical material in this research and the researcher acknowledges their importance for the outcome of the outsourcing contract over time.

Two other points are important in the research design. One is the construct validity and the other is the reliability in the findings. On the first point, this research is based on an extensive literature research hence the theoretical perspectives and the constructs used are theoretically generated. On the second point, all the archival material is coded and interview material transcribed hence the data is available making replication of the analysis possible.
3.7 Quality of research design

The quality of the research design has been at the forefront of my mind throughout the journey. Firstly, the choice of cases allowed the data to be collected during a relatively short period of time between August and December 2004 hence the market situation and the development of outsourcing in the telecom industry were at a similar stage. Secondly, the outsourcing decisions were taken in a similar time period of mid-2002 and end 2003 hence the interviews where conducted with people who were present during the period under study.

Outsourcing decisions are taken in a complex environment under uncertainty and there are many factors that influence the decisions. It is also a characteristic of this type of large scale outsourcing contracts that only a small group of managers are involved in the Scoping & Search and Negotiation stages. Wide access was provided not only to the key managers but also to internal documents at Ericsson both in Sweden and in Australia. Several decisions in the design of the case study were aimed at providing a high degree of reliability in the findings. Firstly, interviewing several people in the outsourcer and the supplier organizations in each case provides a degree of triangulation. Quotations from the interviews have been used to illuminate specific points in the case write-up and the text has been read by the main contributors in the cases and their comments have been incorporated to further enhance the quality of the data. The initial findings were presented to the sponsoring staff at Ericsson and the case study text has been reviewed and approved by staff at Ericsson.

An important aspect of the research has been the audio recordings of the interviews. By listening back on the conversations the researcher have been able to “re-live” the interviews during the analysis process which has provided high quality interpretation of what has been said, the intent and verification of the content. All the interviews have been transcribed verbatim to provide research material for the analysis process.

Construct validity
The research design provides a framework based on theoretically derived constructs to capture and understand the underlying mechanisms that inform managers of the perceived risks in an
outsourcing decision. The theoretical perspective in this research applies transaction cost analysis and an IOR risk framework and the constructs used are derived from the literature.

3.8 The research problem and rationale: from the researcher viewpoint

This thesis is the culmination of several years of research and study. The research however, does not reside in isolation from the knowledge, experience, and interest of the researcher. In fact, staying the course of a long and sometimes lonely journey including a change of university institution mid-way through the research, delivering on the day-job and a family life, should be evidence enough that this research is grounded in a genuine interest in the research questions. But why this question when so many other questions are still unanswered? Well, here is my rationale for putting myself through the joys and pain of the journey.

Since graduating from the Royal Institute of Technology in Stockholm with a MSc in Engineering I have always been interested in and involved with technology. My early years were spent designing and commissioning computer-based measurement and control systems for process plants all over the world. After a couple of years I was offered the MD role at a small subsidiary in Australia and for the next 12 years my focus was to run technology companies in several countries, rather than on the technology itself. Whilst completing an Executive MBA at London Business School in the second half of the 1990’s the Internet began to emerge as a powerful force in the business environment. Early indications were that this new network infrastructure would fundamentally change the way we do business and even the foundations for how organizations work. Driven by unprecedented levels of available risk capital, the Internet and the World Wide Web developed into a global system for communication in a short few years. An investment boom was created. However, the boom imploded in year 2000, and although a huge amount of investments lost their value, the infrastructure is now built and continues to function and evolve. Few organizations today would consider not to be connected to this communications infrastructure hence its strategic importance has certainly been demonstrated. It is this point which connects my initial interest in the Internet and telecom infrastructure. Today, a telecom network is entirely digital and to a considerable extent uses Internet Protocols and technology to route and switch both voice and data over networks around the globe.
“IT is playing an increasingly important role in the development and management of organizations and is critical to multiple internal and external relationships and to a firm’s competitive advantage”, (Demarie and Hitt, 2000, p427) who further assert that “Information technologies, combined with human capital, represent a key component of organizational competitiveness in an increasingly dynamic, global business environment”.

With my insight into the business school world and a new fascinating phenomenon emerging I entered the academic world in 1999. In my new role as business school lecturer and consultant I have observed continued development and experimentation by organizations, large and small, to harness the new inter-organizational connectivity. As Grandori and Soda (1995) comment:

“Information technology networks deserve a place among inter-firm coordination mechanisms, firstly because of the spectacular cost reduction in communication they bring…and secondly, because [IS/IT] networks may be employed as a stand-alone co-ordination mechanism – based on machines rather than on human or organizational means – in an inter-firm relationship”.

The latter point is where my viewpoint deviates. I have observed how little strategic consideration is afforded when organizations select, form and implement electronic network-enabled inter-organizational connections. Decisions are often taken to reduce costs without consideration of the strategic implications, with incomplete understanding of how the connections affect the organization design and governance structure, and how little consideration is given to the expertise and knowledge that resides among the people that run and use the infrastructure. There is only an emergent understanding of the challenges in managing a collaborative relationship rather than the strictly competitive relationship between organizations that often prevails. Collaborative relationships are particularly problematic (Child and Faulkner, 1998) and a potential obstacle to meeting stated or implicit objectives of the network-enabled inter-organizational relationship.

This PhD research forms the platform with which this researcher intends to develop a broad and a deeper understanding of a phenomenon that will be increasingly important as the web of interdependencies proliferate around the globe.
Part 2  The case study

This part describes the two main cases in the study. The first part is a brief overview of Ericsson AB as the supplier in the two cases, followed by the case descriptions of the TSIC and Hutchison cases. Each case begins with an introduction to the outsourcer and the context at the time of the research.
4 ERICSSON AB

The period from 1970 to 1999 was probably the most eventful in Ericsson’s history. From having been a traditional telecom supplier, Ericsson was transformed into a leading-edge company in communications and information transmission. This development was the result of a systematic structuring and adaptation of the organization to changes in the market and investments in technical development. The effects are evident in the strong growth in both sales and profit.

On the surface, this growth seems to have occurred during the 1990s, but the foundation for Ericsson’s expansion had already been laid in the 1970s. With its industrial base in electromechanical technology, Ericsson in the early 1970s had stable sales to customers throughout the world.

Starting in 1973, problems began to mount. The oil crisis and a deterioration in public finances in several countries led to a postponement of new investments and renewal of public telephone networks. Competition between telephone manufacturers increased. To stay in the running in bidding contests, it was not only necessary to press prices, but also at times to help the purchaser with financing. For Ericsson’s weak financial resources, this was often a significant problem.

As the telecom market began to be deregulated in the late 1970s, opportunities were opened for Ericsson to enter markets that had been closed previously. The greatest interest was focused on the huge North American market. However, deregulation of telecom markets also led to a sharpening of competition, as nationally focused companies were attracted to global markets.

Although Ericsson had fared relatively well during the weak business cycles during the 1970s, net sales in fixed prices declined and profits suffered. Uncertainty in currency markets and a high rate of Swedish inflation during these decades contributed not only to driving up Ericsson’s costs, but also to exchange losses. The situation did not improve until the Swedish currency was devalued in 1981 and 1982.
Towards the mid-1980s, net sales and profits rose somewhat. The improvement was primarily due to the introduction of the AXE system almost ten years earlier, but was also in part a result of the diversification of operations that was initiated in the late 1970s and early 1980s. Through these investments, Ericsson sought not only to retain its position in telecommunications technology, but also to establish itself in distributed data processing and office automation. This meant a broader product portfolio than previously, as well as the acquisition of companies that were not directly involved with telecommunications. These investments were made in parallel with an intensive research effort in data communications.

Successes for new technical platforms, including the AXE system, however, meant that Ericsson in the mid-1980s decided to concentrate its operations on the company’s core business. It was concluded that data and telecommunications would develop rapidly in the latter half of the 1980s and the 1990s and that it would be necessary to consolidate operations to be able to defend the positions the company had already attained in these areas. As a result, operations were divested that were not linked to communications and efforts were devoted to developing system solutions that corresponded to market demand and that could be adapted to specific customer requirements.

In the late 1980s and 1990s, Ericsson’s operations were concentrated on the most rapidly growing markets. The company’s production thus came to consist more of testing and assembly, rather than traditional manufacturing in which raw materials were refined into a finished product. The change resulted in a rationalization of the company’s operations and retraining of personnel, but also that less capital was tied up in inventories, machinery and property. In addition, the new strategy meant that investments in digital technology were even more evident.

Over the short term, this change meant that costs were incurred but that neither sales nor profits developed particularly favourably. The major change came in 1994, with the breakthrough for digital mobile telephones embodied by the GSM standard which resulted in sharply increased sales and earnings growth. By the end of the 1990s, Ericsson’s profit amounted to 8 to 10 percent of net sales, which can be compared with profit ten years earlier, which was between 4
and 5 percent. Through the 1990s sales increased and peaked in 2000 at SEK 273 bn\(^{10}\), profit of SEK 21 bn, over 100,000 people were employed in 140 countries.

**Years 2000-2002 – A changing business environment**

The economic environment changed abruptly in 2001 when the dot com bubble burst. The telecom industry was saddled with high levels of debt and an uncertain outlook on how new technologies and the use of the Internet would develop. There was a very different sentiment in the market place. Telecom operators reined in their capital expenditure (CAPEX) and focused their attention on reducing operating expenditure (OPEX). This development is easily traced in the financial results of Ericsson. The costs taken as restructuring charges are shown in figure 33.

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2001</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Sales(^{11}) SEK bn</td>
<td>145.8</td>
<td>210.8</td>
<td>221.6</td>
</tr>
<tr>
<td>Restructuring Mfg ops</td>
<td>-5.6</td>
<td>-4.8</td>
<td></td>
</tr>
<tr>
<td>Restructuring in O/head</td>
<td>-6.3</td>
<td>-6.2</td>
<td></td>
</tr>
<tr>
<td>Restructuring in Phone(^{12})</td>
<td>-0.2</td>
<td>-3.9</td>
<td>-8.0</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>-21.3</td>
<td>-27.4</td>
<td>30.8</td>
</tr>
<tr>
<td>Orders booked</td>
<td>128.3</td>
<td>221.5</td>
<td>292.3</td>
</tr>
<tr>
<td>Employees</td>
<td>64,000</td>
<td>85,200</td>
<td>&gt;100,000</td>
</tr>
</tbody>
</table>

**Figure 33. Ericsson financials 2000-2002**


The stock market reacted to the change in outlook and the Ericsson share price went from a peak of SEK 156 in January 2000 to a low of SEK 5.95 in March 2003. In response to the difficulties Ericsson accelerated a process of focusing its activities away from systems and hardware sales towards services. It is somewhat ironic that whilst the operators were outsourcing operational activities to reduce operating expenses and head count, Ericsson did likewise and outsourced electronics manufacturing and large parts of its own IT infrastructure and support.

\(^{10}\) Ericsson Financial report 2002

\(^{11}\) 2001 and 2002 results are re-stated based on accounting rule changes

\(^{12}\) Phone is the joint mobile phone joint venture with Sony
Ericsson Global Service

The first time Business Unit Global Services appear as a separately reported business is in the Ericsson annual report of 2004. However this in no way suggests that outsourcing and managed services such as running networks are new to Ericsson. In fact, the opposite is the truth. In 1918 SAT (Stockholms Allmänna Telefonaktiebolag) and L M Ericsson merged to create an integrated operator and manufacturer of telecom equipment. The new company expanded internationally in the 1920s onward through concessions to build and operate telecom networks in countries such as Finland, Poland and Russia but also in South America and Mexico.

Another important partner for the development of Ericsson’s capability to operate networks and services was the longstanding relationship with Televerket AB (re-named Telia AB and subsequently merged to form TeliaSonera AB). Televerket was a fixed line operator with effectively a monopoly in the Swedish market. Throughout the 20th century the two companies had many successful joint development projects that brought innovative technical solutions to market. This relationship gave Ericsson the opportunity to work closely with a telecom operator. During the 1950s the first mobile telephones were being developed in collaboration between Televerket and Ericsson. Historically, the Nordic counties Post, Telegraph & Telephone operators (PTTs) had good working relationships and in 1981 a Nordic mobile telecom network, the NMT system, laid the ground for a rapid growth in mobile telephone use. In 1991 the NMT network had 500,000 subscribers and was the largest mobile network in the world. The equipment and telephones were largely developed and made by Ericsson, although other companies also competed for the supply to the system. This cooperation across the Nordic countries and the close relationship between Televerket and Ericsson was not necessarily seen positively by other countries. There was a need to create a compatible pan-European network and the German and the French equivalents to Televerket joined forces and proposed a technical standard primarily for mobile systems in cars. The Nordic countries proposed a digital system based on GSM technology developed by Ericsson. With GSM¹³, small and portable phones could be developed and the potential market was much larger than a car based system. The GSM system was adopted not only in Europe but in many countries in the world and it laid the foundation for Ericsson’s market position in mobile network technology.

¹³ Global System for Mobile communication
This development allowed Ericsson to move the focus of their business from fixed line switching equipment to mobile base stations, fixed-to-mobile switching equipment and to the development mobile phones. Ericsson therefore has an end-to-end capability to supply and operate equipment throughout the technology chain from a land line telephone via the fixed line network and mobile base stations to the mobile phone handset. With its global footprint and a supplier of complete systems it often took on build-operate-transfer (BOT) contracts especially in newly developing countries where the telecom operators did not have the experience and expertise to roll-out sophisticated mobile networks. With this as a base, Ericsson was well placed in the 1990s to consider managed services and outsourcing as a business in its own right. In 2006 Business Unit Global Service had 24,000 employees, nearly half of Ericsson’s total number of employees and operated in all of Ericsson 140 countries. It is notable that the 2006 Annual Report contained an equal amount of space in the report about Global Service as about the Systems segment (hardware and software systems).

Global Services divides their business into two main activities.

- Network rollout is a core part of system sales where Ericsson takes responsibility to install and commission Ericsson equipment for new sales.
- Professional services include managed services such as: managing networks and hosting solutions; systems integration from multiple vendors; consulting, education and customer support.

Official figures for Professional Services have only been available since 2002\textsuperscript{14}.

<table>
<thead>
<tr>
<th>Global Services Net Sales</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Network rollout</td>
<td>14.5</td>
<td>11.2</td>
<td>11.7</td>
<td>15.4</td>
<td>21.3</td>
</tr>
<tr>
<td>Growth in rollout %</td>
<td>-23%</td>
<td>4%</td>
<td>32%</td>
<td>38%</td>
<td></td>
</tr>
<tr>
<td>Professional services</td>
<td>19.5</td>
<td>18.5</td>
<td>19.3</td>
<td>24.9</td>
<td>32.3</td>
</tr>
<tr>
<td>Growth in Services %</td>
<td>-5%</td>
<td>4%</td>
<td>29%</td>
<td>30%</td>
<td></td>
</tr>
</tbody>
</table>

\textbf{Figure 34.} Global service financials 2002-2006.

Source: Ericsson Annual Reports 2002-2006

\textsuperscript{14} Ericsson annual reports 2002-2006
Behind these figures is a combination of services related to designing and installing systems which may or may not be related to a managed services contract or outsourcing. In particular network rollout is related to sales of systems. 2002 and 2003 Ericsson’s sales of systems were significantly affected by the reduction in capital investments by telecom operators as a result of over-investments in the late 1990s. This is reflected in Global Services figures with a reduction in sales of network rollouts. These figures should be set in context within the overall financial performance of Ericsson in the years 2000-2003. The figures also bear out that professional services were more resilient during the down-turn and provided Ericsson with a stable level of income from managed services contracts and other services activities.

What is not shown in the official figures are the gross and net margin of the services business. It has been an internal discussion for some time how to value services as gross margin can sometimes be lower than the sale of systems where Ericsson manufacturers part of the equipment. On the other hand, services require less money spent on research and development and are less capital intensive. As Global Service has grown its organization has developed over time. In 2003 the organization was shown as a matrix with line of businesses such as Manage and functional areas such as Global Service Delivery.

![Business Unit Global Service organization – 2003](image)

**Figure 35.** Business Unit Global Service organization – 2003

Source: Ericsson internal (E69)

In terms of revenue Global Service is approximately 25% of systems sales. Global service is an important internal partner to the business units responsible for sales of products and systems.
5 THE TSIC OUTSOURCING CASE

The first case in the study is the outsourcing agreement between TeliaSonera International Carrier (TSIC) and Ericsson announced in July 2003. It was the first outsourcing contract of pan-European field maintenance and operations in the telecom industry and both parties broke new ground as neither had done a similar deal before. Both TSIC and Ericsson acknowledge that the deal was full of difficulties and risks, yet the decision was taken and the contract was signed. This case describes the context and situation at the time and the description and analysis follows the 3-stage model adopted in this research. The empirical data is based on internal documents, documents in the public domain and interviews with the key decision makers in the outsourcing deal. The format is descriptive with quotations to illustrate the main points in the empirical material.

5.1 Overview of TeliaSonera AB

TeliaSonera International Carrier (TSIC) is an international carrier of telecom voice and data traffic. It is a fully owned subsidiary of TeliaSonera AB, a public limited liability company incorporated under the laws of Sweden. TeliaSonera was created as a result of the merger of the Swedish Telia AB and Finnish Sonera Corporation in December 2002, with TeliaSonera’s shares listed at the stock exchanges in Helsinki and Stockholm. In 2002 TeliaSonera had net sales of SEK 81,794 million, EBITDA of SEK 25,457 million and an operating income of SEK – 45,958 million. The operating loss was due to restructuring costs of SEK 53,278 million. (TeliaSonera AB, 2003)

Telia – A historic review

Telia – the telecommunications leader in Sweden - were earlier operated by the Swedish State as a public service corporation, Televerket. Government directives at the time stipulated that as a fundamental principle both operational expenses and investments should be financed from customer revenues, in effect, operating as a private enterprise and without subsidies from the Government.

Although the Swedish market has never been protected by a legal monopoly, Televerket was for a long while the only provider of public voice telecommunications services in Sweden. This
provided sufficient scale to be cost effective and to have the resources to invest in development of new and enhanced telecom services. In particular, the development was often carried out in partnership with Ericsson as the provider of technology and equipment.

Low thresholds for establishment and the high IT maturity of users caused new operators to enter the Swedish telecom market in the 1980s. In 1993, the government introduced a Telecommunications Act, which made it mandatory to apply for a licence to provide telecommunication services on a larger scale and a national regulatory authority was established to enforce the law. The Swedish State transformed Televerket from a state-owned public utility into a limited company and changed the name to Telia AB. In June 2000, the Swedish state sold 30 percent of the shares in an initial public offering and the Telia share was listed on the A-list of the Stockholm Stock Exchange. Telia became a private listed company.

Sonera – A historic review
Sonera - the telecommunications leader in Finland - originated from the state organization Telegraph Office of Finland, created shortly after the foundation of the independent state of Finland in 1917. The Telegraph Office initially operated a fixed long distance network and a number of local fixed networks and was merged with the Post of Finland ten years later and renamed Post and Telecommunications of Finland.

The Post and Telecommunications of Finland had a monopoly on long distance and international telephone services until 1992, when the state began granting licenses to competing operators. In 1994, the organization was converted into a limited liability company, PT Finland, and the businesses were divided into two corporations Finland Post and Telecom Finland. In December 1997, the Finnish Parliament approved a gradual and partial privatization of Telecom Finland and the name was changed to Sonera OY. In November 1998, the Finnish state reduced its holding to 77.8 percent in an initial public offering and the Sonera share was listed on the Helsinki Stock Exchange. The state further reduced its holdings in 1999 and 2000 and before entering the co-operation with Telia, the shareholding of the Finnish state was 52.8 percent.

The new entity TeliaSonera is the leading provider of fixed line telecommunications services, mobile services and data communication in the Nordic and Baltic region. It is a leading mobile telecom provider in Eurasia and has holdings in operators in Turkey and Russia.
The initial organizational structure was closely linked to the legal entities of the merged companies. In 2003 the structure was streamlined and duplication of functions and layers of management were removed. Major restructuring took place and redundancies reduced staff numbers in all geographical locations.

![TeliaSonera organizational structure.](Source: TeliaSonera AB Annual Report 2003)

The rationale for the merger was to create a pan-Nordic telecom company with the scale to ensure profitable operations and the means to invest in new infrastructure and services. On a proforma basis the combined net income in 2001 of Telia AB and Sonera OY was SEK 2,143 million (2.6%) on net sales of SEK 80,925 million. This is to be compared with British Telecom’s Profit before Tax of 7.1% indicating low profitability for TeliaSonera AB compared with other telecommunications operators (TeliaSonera AB, 2003).

The performance of different parts of the merged group varied significantly. The fixed and mobile business in Sweden and Finland were highly profitable, contrasting with poor performance in Sonera’s international 3G initiative and services business and Telia’s losses in the International Carrier division and the fixed line business in Denmark.

...we took a firm hold of the problem areas: ...[including] Telia’s international carrier services. This explains the negative net income.
Anders Igel, CEO in Annual Report 2002

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15 The proforma figure for 2001 is used as it represents the financial performance before restructuring in 2002.
16 BT figure is for FY 2002 as 2001 figures where affected by major restructuring costs.
TeliaSonera International Carrier

TeliaSonera International Carrier (TSIC) offers network services and network capacity to other operators via its wholly-owned broadband network, the Viking network. In order to adapt the operations to new market conditions\(^{17}\), restructuring efforts were initiated in the international carrier operations in 2002 and the book value of its assets was written down. Net sales for TSIC in 2002 were SEK 5,188 million with EBITDA -1,287 million. In the 3\(^{rd}\) quarter of 2002, TSIC announced a total restructuring reserve of SEK 3,500 million (TeliaSonera AB, 2003)

As part of the restructuring, TSIC unified the product set across all markets and terminated several unprofitable services in markets such as UK and the US. The overarching objective going into 2003 was to be a profitable player in the European wholesale market and to obtain positive cash flow, month by month, excluding restructuring costs. During 2003 network operations of Telia and Sonera were integrated and synergies and cost cutting reduced the operating income loss to SEK -298 million. The number of employees was reduced from 914 to 555.

TSIC provides wholesale, IP capacity and voice services in Europe and across the Atlantic. Customer categories are multi-country enterprise networks for companies such as IKEA, SAS, Nordea etc, fixed line infrastructure for mobile operators such as Vodafone, Telenor, BT, SPRINT, and internet based providers such as Yahoo, MS Hotmail and others. To service these customers TSIC has a network presence in 20 countries utilizing network equipment from seven major telecom equipment suppliers such as Ericsson, CISCO, Lucent, Alcatel, Marconi, Nortel etc. TSIC’s customers demand high levels of service and reliability as the telecom network is critical to the operation of the businesses. Most customer contracts stipulated penalties if the service is unavailable for more than 4 hours. TSIC had to fix any problem very quickly. The merger of Telia AB and Sonera OY increased the network reach but resulted in an even more complex and expensive organization that from time-to-time struggled to meet the exacting demands of TSIC’s customers.

\(^{17}\) After major investment in optical fibre and broadband capacity in the 1990’s the Internet bubble burst in 2001 causing significant over capacity in network infrastructure and a collapse in the price for network traffic.
5.2 Introduction to the TSIC case

The changing market environment with overcapacity and price pressure on wholesale capacity resulted in uncertainty regarding telecom traffic volumes and margins. Meanwhile, there were significant pressures from the stock market on the parent company management of TeliaSonera AB to deliver cost savings from the merger. Implicit in the drive to show shareholders that costs were reduced was a reduction in the number of staff. In particular TeliaSonera International Carrier was not producing positive results and was asked to significantly improve its profitability. At the end of 2002 the TSIC team was given go-ahead from the CEO of TSIC to engage in formal discussions with a supplier for the outsourcing of field maintenance operations. In the

TSIC’s strategy was to offer a high level of availability and service to its customers. A critical performance aspect to deliver service is fast and efficient field maintenance in all the geographical locations. To meet the high expectations TSIC had its own field maintenance organization in each of the countries where they operated. Since the network had many and different equipment suppliers in each location the field maintenance was often sub-contracted to local field maintenance suppliers either from the equipment suppliers or independent maintenance providers. Around 25 locally people employed to co-ordinated the nearly 400 sub-contracted field maintenance suppliers across Europe.

Figure 37.  TSIC network coverage.
Source: Document (TSIC 7)
case at hand the TSIC team had in-depth discussions with Ericsson, Nortel and especially Lucent to compare possible suppliers. With a strict and short deadline to meet the financial targets TSIC elected to invite Ericsson to formal negotiations: “We went through an informal tender process, we did not want to waste time on writing a large RfP” (VP and Head of Networks).

The Market Context
TSIC’s customers were asking for more advanced and technically complex services as their businesses took advantage of technological developments in IT and mobile connectivity. At the strategic level TSIC wanted to achieve competitive advantage by being the first operator that could offer single-point pan-European field support to its network. With a single point interface to the field maintenance operations and pooling of knowledge centrally, TSIC believed they could achieve higher and more consistent levels of service to their customers. The VP and Head of Networks at TSIC reported that they had received positive responses from their customers if they could deliver a seamless service across Europe.

The Organizational Context
The networks of Telia AB and Sonera OY had evolved over time and Telia’s and Sonera’s local subsidiaries had developed to serve the local markets: “The service organization had grown with the local subsidiaries and a mindset focused on serving the local customers rather than the whole network had developed.” (VP and Head of Networks). The knowledge of each site and equipment was local, often in the head of the technicians. This was a risky situation should key individuals leave. As such, the ability of the central control operations to manage the whole network was limited and it caused operational problems for international customers. The geographic spread and complexity of the network resulted in sub-supply from around 400 different suppliers across the network servicing different equipment under different contracts. Each month hundreds of invoices for work carried out made it difficult to check, reconcile and pay suppliers all across Europe. This resulted in high costs and difficulties keeping track of and monitoring performance of the suppliers’ work.

The network had grown organically over time and requirements for field service were different from country to country. Some countries offered network services only with other countries

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18 RfP; Request for Proposal
offering customer provision services such as connectivity to billing systems, routing etc. Some countries offered consumer and small business services whereas other countries offered wholesale of telecom capacity. There was no clear product and service strategy across the network.

After the merger of Telia AB and Sonera OY the strategic direction changed from a decentralised organizational model to a centralised model. This had an impact on the operational and financial control processes and decision processes. TSIC’s management realised they did not have full control of operations and often compensated for poor information flow and work processes by overworking their staff, both in the field and in central operations. Together with the pressure on cost reduction it was not a sustainable situation.

When the two networks merged in 2002/03 with the aim of offering the same products and the same level of service... “our capabilities were not the same [in all locations]. We found ourselves with a new global set of products and business model but with a field service set-up that did not match... we had 12 months to put the company on a financially viable footing”. (VP and Head of Networks)

The internal discussions on the possibility of outsourcing field maintenance began in the 2nd half of 2002. A small team of senior executives at TSIC was formed with the task of scoping an outsourcing agreement. The internal discussions identified a number of costs and risks that would need to be addressed in an outsourcing deal. Firstly, would a deal actually save money and how costly would it be to negotiate an agreement? Secondly, was there a competent supplier that could deliver the required performance? Thirdly, what would be the internal reaction to an outsourcing deal; would it negatively affect the operational performance? Fourthly, if the supplier could not perform, how could the decision be reversed?

The objectives that TSIC sought were communicated early to the potential suppliers19.

- Reduction in operating expenses (OPEX)
- Establishing simpler processes to run the field operation
- One point of contact and one Service Level Agreement (SLA)

19 Source: Document (TSIC 7)
More specifically, the expected operational benefits were:

- Improved flexibility at reduced cost
- Single global Service Level Agreement (end-to-end)
- Standardization of procedures and work flow
- Automation of procedures and work flow
- Implementing Operations Centres to manage day-to-day operations
- Expertise and multi-vendor capability
- Transparency in the use of 3rd party contractors
- A variety of Pricing Models for different services

The TSIC team set the goal of saving at least 15% of operating costs and a reduction in headcount.

The concern over the internal reaction to outsourcing played on the mind of the TCIS team. This concern should be seen in context of major restructuring taking place in several parts of TeliaSonera AB. There was a general feeling of unease in the TeliaSonera organization. TSIC was at the same time frantically trying to manage and get to grips with the field service operation to improve its financial performance. The choice of supplier for the field service operation and the reputation of the supplier in the opinion of TSIC staff did have a bearing not only on the decision to outsource but also on the choice of supplier. Prior performance and closeness to the TSIC negotiation team became supplier selection criteria as was a proven ability to handle staff matters and redundancies in a professional manner.

To ensure that TSIC quickly could take back the field maintenance or transfer it to another supplier no physical assets would be transferred to a supplier. A concern was with the ability to retain knowledge in-house and to monitor the supplier. To address the risk of losing competence and leverage TSIC decided to keep a number of key employees in-house thus adding some costs and reducing the potential savings.

The case reveal a complex and interlinked set of issues that informed the TSIC management team in the decision to outsource. The case also demonstrates the actions and mechanisms used to mitigate some of the considerable risks that outsourcing such a business critical activity as field service operations posed for TSIC.
The next section describes the decisions TSIC took in the 3 stages starting with the Scoping & Search stage prior to entering into formal negotiations with Ericsson.

### 5.3 Managing risks in the Scoping & Search stage

The Scoping & Search stage covers the period from initial idea of outsourcing to the commencement of formal negotiations with potential suppliers. It is an internal discussion between senior managers within the outsourcer where the potential benefits are discussed and set against the potential risks of outsourcing. In this stage the boundaries of what should be outsourced and what should stay in-house is decided but also the approach taken to the negotiation process. It should be noted that although the perspective is seen from the outsourcer, there are informal discussions and soundings taking place in parallel with various outsourcing experts and external parties including suppliers that may be invited for formal negotiations.

The case description follows the analysis model identified in the theory chapter.

- Decisions on what should be outsourced and what should stay in-house
- The search and selection of suitable suppliers and the approach to the negotiation process (the search and negotiation design process)

**What should be outsourced and what should stay in-house**

The first step was to decide what should be outsourced and what should stay in-house. An early consideration was the physical assets of the network and although it was not considered for outsourcing, the VP and Head of Networks commented that this may be something for the future when any competitive advantage in location of the network had been levelled out. Maintenance on the other hand is business critical to TSIC but “*did not provide a source of differentiation*” in the view of the TSIC team. It was generally the view that carrying out field maintenance was a commodity type activity; it was the skill of managing the business process that was the crux in the matter. Whilst TSIC was considering outsourcing field maintenance several equipment suppliers approached TSIC with suggestions to outsource design and planning of the network. However “*We had no interest in this, we felt it was to give up our core business*” (VP and Head of Networks).
Outsourcing to an equipment vendor had particular risks in relation to product sales: “When you have a vendor doing your planning they always have the tendency to push their own product and their product may not be the best for a certain service. That’s why it’s better to do this yourself” (VP and Head of Networks). This action served not only to reduce the technology risks but was also seen as a lever to manage the supplier’s performance of the contract.

One important risk in an outsourcing deal was the potential loss of knowledge and technological insights. The main way TSIC managed the risks of loss of technological insights was by retaining key individuals in-house with knowledge and expertise to understand the future technological requirements. Another device was to keep a competing supplier for a small part of the field service to (i) have access to other supplier’s expertise but also (ii) to safeguard from dependence and opportunism. However, dedicated investments in software and systems by the supplier may prove to have asset specificity in the future and create dependence at the end of the contract period.

There was recognition in TSIC that suitable suppliers were in short supply. This was recognised as a potential problem at the end of the contract if TSIC wanted to continue to outsource the operation. It also implied that it may prove difficult to create a highly competitive negotiation process to ensure best possible contract price. The dilemma was: either select a “traditional” service supplier but not achieve pan-European coverage or an equipment supplier who may not have demonstrated experience of field service operations but who had strong technology knowledge. Either way, TSIC recognised it was a considerable risk of poor network performance. An aspect that favoured the equipment suppliers was their R&D capability and the understanding of advanced technology to meet future needs. On the other hand it was an absolute requirement for the chosen supplier to have good relationships with other suppliers such that they could get access to technical specifications to service the equipment. This meant that selecting an equipment supplier would require other equipment suppliers to provide technical and operational information. On this basis Lucent was ruled out of the competition as TSIC was of the view that Lucent did not have extensive relationships with the other equipment suppliers.

TSIC made references to dependence on the supplier and to the fact they were prepared to outsource business critical activities that were non-strategic but not to outsource strategic assets.
such as the network itself. “I think as long as there is an imbalance, I can dictate to them, but if they think they’ve come up to speed to where I am, then they could say no, we know how to do it better” (VP and Head of Networks). Another device applied to reduce the risk is short duration of the contract with multiple break points. This, in combination with retaining key personnel, gives the outsourcer some protection from dependence on the supplier. However, over time the dependence increase as was recognized by TSIC. “I would at least, every time the contract is up, put the bid out in front of rival suppliers. This is the least we would do… In the long term, I would have to keep a certain amount of people that were expert in ops, so that I’m not totally at the mercy of that third party” (VP and Head of Networks).

TSIC was well aware of the problem with single supply negotiations but an explicit link to future business for Ericsson as a major supplier to other parts of TeliaSonera AB was used to leverage perceived power in the negotiation. Nevertheless, single supply negotiations create dependence of the supplier already in the negotiation stage.

There was significant uncertainty over the future market demands and hence a problem for TSIC was how to manage its own fixed cost base with an uncertain volume of income. The empirical material suggests that one attractive feature of outsourcing is the ability to convert fixed costs to variable costs in addition to applying economies of scale to reduce actual costs.

Considering the importance of field service operation and the fact that there was no “ideal” supplier in the market for this type of outsourcing it is somewhat surprising that TSIC decided on an outsourcing solution. What the case reveals is that the strong financial pressure to reduce costs and headcounts and the time pressures to complete by end of 2003 were higher than the risk in the limited supply market. The data also shows that TSIC took decisions on a) the scope of the contract, b) the choice of supplier to negotiate with, and c) the type of negotiation process it selected to mitigate some of the risks in an outsourcing decision.

**The search process**

After the initial and informal soundings of potential suppliers the TSIC team had to decide how to approach the formal negotiation. The major risk in the negotiation process was if months were spent negotiating, and no agreement was reached, and the TSIC team would not deliver on the expected savings by the end of 2003. Once formal negotiations had started the biggest
uncertainty facing the TSIC team was if they did not reach a satisfactory agreement and sign a contract with a supplier.

A feature of this case is the outsourcer’s pressure to complete the deal. The empirical material corroborates March and Shapira’s (1987) findings that the perception of risk and the willingness to take risks is influenced by the targets set by senior management, in this case to have in place a plan for reducing costs by end of 2003. There is no evidence of a detailed calculation determining that a 15% reduction in costs would cover the transaction costs and risks making it a profitable decision for TSIC. It seems it was large enough be meaningful for senior management of TeliaSonera, large enough to justify the risks for TSIC but not too large such that a supplier would not be able to make a profit. Pinning the figure of a 15% cost reduction as a pre-condition was risky in itself as it could have resulted in all potential suppliers declining to engage in negotiations. However, whatever the method of arriving at the required cost savings from a deal, the focus of attention from then on was to reduce the down-side risks associated with the negotiation process and subsequent contract. Decisions such as negotiating with only Ericsson served the multiple benefits of speeding up the process and reducing the manpower costs of the process. Minimizing the number of people involved reduced the risk of information leakage to the TSIC staff.

The selection of the right supplier for the outsourcing contract was important to TSIC. First and foremost, the supplier needed to meet current and future demands for fast and efficient responses to service requests across Europe. Secondly, the supplier must handle the transition from an in-house operation to an outsourced service in an efficient and effective manner. The need for a Pan-European footprint excluded several of the “traditional” telecom service suppliers as they tended to have strong presence only in a few neighbouring countries. “We were thinking about going to a traditional supplier for these services, however none of the traditional suppliers had the willingness to cover that many countries… the expansion they would be willing to make was at our expense, we would be financing their expansion”. The other alternative would be to approach the telecom equipment suppliers. “At the same time vendors like Lucent, Ericsson, Alcatel were approaching us to engage in managed services and their biggest interest was design and planning our networks. We had no interest in that, we felt that was core to our business to give up… we would be more interested in working in the field services area where we could work with them, taking on that kind of operational task…of the managed services vendors that
we’re talking to, who would be the best fit naturally without having to do a lot of reconstruction of knowledge and processes on the vendor’s side” (VP and Head of Networks).

The TSIC team recognised that outsourcing requires strong change management skills on behalf of the supplier. There was a view that Ericsson had managed its reduction in staff during 2001-2003 in a professional manner and there was an assumption that Ericsson would handle this well also for TSIC. *We decided to go with Ericsson, they showed a lot of eagerness and hunger, and they have proven to us [by] moving ahead into managed services business, they were putting a lot of effort and money and resources to go after this managed services business. Credibility … they assigned a lot of people to this immediately and it was not just some of the other vendors, they sent us templates, this is what we can offer. It was just like a regular sale, but Ericsson treated it as a special case because we were going to be the first pan-European for any vendor*” (VP and Head of Networks).

Another area of risk for TSIC was the base line data for the performance levels that would form the SLAs in the contract. With the merger of Telia and Sonera in 2002 some of the operational control was lost and TSIC’s management was struggling to get to grips with all aspects of the field service operation. The risk was that the service level agreement (SLA) in the contract would be set incorrectly. The TSIC team recognised that there was not only lack of data but also information asymmetry between TSIC and the supplier. “*It had to be open otherwise it would not have worked. It was a very open relationship, and we had agreed that together we would discover our costs and then we would get a discount to these costs, obviously because we were going to have less staff and we’re going to go through Ericsson who’s setting up themselves to be a wholesaler of these services*” (VP and Head of Networks).

The solution selected by TSIC to mitigate the risk was to approach the negotiation in an “open book” manner.

A risk that the TSIC team was focusing their attention on was the potential reaction of staff to an outsourcing deal. “*I figured the minute we broke the news …there would be chaos, a lot of staff whether they were impacted or not would be totally demoralised and discouraged, and we would have a sort of mass exodus*” (VP and Head of Networks). The solution to this problem was to keep a tight lid on the information flow and negotiate with a very small team of TSIC senior managers.
The empirical data is rich in its description of the decision criteria and perception of risks the TSIC team considered when engaging in negotiations for the contract. The decisions were based on strategic and abstract judgments of risk as well as operational risks where the outsourcer endeavoured to take decisions that could mitigate the risks. The data indicates that the complexity of the decision was a mix of highly strategic issues such as dependence of the supplier, judgments related to asset specificity, and environmental uncertainty regarding market volumes, future technology needs, as well as operational issues such as not having reliable performance data to establish a base line for the service level agreement.

The empirical material shows that external pressures had an impact on the perception of what is an acceptable risk. The empirical material indicates that the biggest risk the TSIC team took was when they proposed to the parent company management of TeliaSonera to engage in outsourcing negotiations in the first place. Once this decision was taken, there would not be time to deliver the savings should the negotiation fail hence the focus of attention thereafter was to manage the down-side risks of going into formal negotiations with Ericsson. Could TSIC have stopped the negotiations and walked away from a deal? We will never know but the comment from the VP and Head of Networks gives some indication: “When this was presented to the organisation and the President, then [the TSIC CEO] felt that ok, there are risks but we think there are measures in this contract to disengage quickly and find someone else if our services are going to be impacted, so then let’s go ahead” (VP and Head of Networks).

But what if Ericsson had pulled out of the negotiation at a late stage? The suppliers also have a perspective on risk and reward. Once the negotiation starts there are two parties in the tango. The next section discusses the case but now from the perspective of both outsourcer and supplier.

5.4 Managing risks in the Negotiation stage

In business relationships such as the one between telecom operators and major suppliers of telecom equipment there is often a long history of business dealings and on-going contacts between the organizations, whether for purchasing new equipment or in support of previously purchased equipment. As such, it is not always clear when formal negotiations for any sort of contract begin. TSIC had taken informal soundings regarding the field maintenance organization
with a number of potential suppliers during 2002. After the internal Scoping & Search stage TSIC took the decision to begin formal negotiations with Ericsson only. In the case of TSIC and Ericsson and for the purpose of this research the start time for formal negotiations has been established as November 2002.

5.4.1 Management of performance risks

Performance risks in this dissertation focus on the specific risks (unwanted events) which could prevent the successful conclusion of an outsourcing contract. This section presents the case data related to the management of performance risks first for the outsourcer followed by data from the supplier.

Performance risks as seen by the outsourcer

**Competence trust -building (high probability of success)**

One issue facing TSIC was that there was no “perfect” supplier of the field service operation. The traditional field service suppliers had the experience but could not operate pan-Europe. The equipment suppliers had the geographical footprint, but in the main did not see field service as a strategic priority. The exceptions were Ericsson and Lucent who were both keen to enter the field service domain. To establish how a potential outsourcing contract could be structured TSIC did some benchmarking: “we made comparisons to other managed services we buy for the network… We were buying services from Swedia and Flextronics, and we buy individual support from every vendor such as Cisco, Lucent, Marconi. It’s all a form of managed services. So we looked at the logic and schemes we had with those contracts and we used some of it to this [contract]” (VP and Head of Networks).

An issue facing TSIC was the low quality and range of operational and performance data in the field service operation. Early in the negotiations and when a Memorandum of Understanding had been signed it was decided to use an external consultant that provided performance data and advice on “best practice” to Ericsson. The consultant was paid for by Ericsson, and was a way to build confidence in the information that would underpin the contract SLAs.

The TSIC network was built over several years and consisted of equipment from many suppliers. A critical consideration was the potential supplier’s relationship with others, and in some cases, direct competitors. “The issue was going to be Lucent because Lucent wanted the same business [as
Ericsson]…at the time Lucent did not have the proper relationships [with other suppliers].” Also the willingness to invest time and resources in the initial contacts was a consideration favouring Ericsson. “Credibility...[Ericsson] immediately assigned a lot of people to this opportunity” (VP and Head of Networks). On Ericsson’s side this was the first outsourcing contract for field services and although Ericsson’s sales team claimed experience and put forward its global footprint as argument that Ericsson had the skills and experience for this kind of service, TSIC knew they took a risk that Ericsson actually did not have the required competence.

The contract stipulates a gradual roll-out across Europe as TSIC sought to reduce the performance risks backed by a break clause in the contract. The milestones in the contract were a six month trial period, and within that six months period the supplier takes on 3-4 countries. After successfully delivering the roll-out the contract continues for a further two years.

Output control (ability to measure outcomes in an objective way)
The ability to measure outcomes and performance of the in-house operation was a significant problem for TSIC. In the event of an outsourcing deal, this would be equally problematic for Ericsson at the outset. Although one could argue that outsourcing is a means to transfer out an activity and resource, it does not mean that the outsourcer transfers the risk. If Ericsson did not get to grips with the operation and meet the expected performance targets it would fail, but so would also TSIC until they could find a new supplier or transfer the operation back in-house. It is commonly the case that the outsourcer has more and better understanding of their own business than any potential supplier however, in this case TSIC openly admit they had poor internal visibility of many aspects of the field service operation: “we realised we really did not have 100% control of all transactions we were performing.” The solution was an “open book” negotiating process… “it had to be open otherwise it would not have worked. It was a very open relationship, and we had agreed that together [with Ericsson] we would discover our costs and then we would get a discount to these costs” (VP and Head of Networks).

The uncertainty in the data created difficulties in designing and agreeing the charging and pricing model, let alone the service levels in the contract. To ensure the contract delivered savings TSIC insisted on clause that said “if there are no savings, the contract is null and void”. The contractual design was such that TSIC had several break opportunities.
TSIC’s team was keen to avoid rumours and speculation in the TSIC organization. To reduce this risk the decision was made to negotiate the contract within a small team of TSIC managers and a team from Ericsson under strict non-disclosure agreements (NDA) and were asked not to communicate with the broader TSIC organization. This is a common approach as it prevents unnecessary disturbance in the organization should an outsourcing deal not be reached. However, it meant that the TSIC team were not able to seek verification of detailed data from the internal TSIC organization until the Transition stage.

The risks associated with output control have two elements. Firstly, TSIC acknowledged both to themselves and to Ericsson that their internal performance data were of questionable quality and not always suitable for an outsourcing contract. Secondly, neither party had experience of designing the SLAs and other performance measures required to ensure good output control. The selected solution was to apply an open book negotiating approach as a device to jointly discover and agree the output measures and controls. It was a pragmatic step which shows how important it was for TSIC to increase the quality of the SLAs and hence reduce performance risks. However, a joint discovery process when neither of the parties have previous experience of outsourcing this type of field operation does not in itself reduce the risks. The blind leading the blind means both could fall into a hole.

Social control (establishment of common cultures and values)

TSIC took the decision to negotiate with a small team of senior managers which limited the practical possibility to verify operational data and information. The empirical data indicates that neither team considered aspects such as understanding the cultures and values in Ericsson relative to TSIC, and the potential implications for the performance of the field service operation. Yet the reaction of staff was a major concern identified by the TSIC team. “I figured the minute we broke the news to the staff because we’re going to reduce staff, then there would be chaos, a lot of staff that whether they were impacted or not would be totally demoralised and discouraged, and we would have a sort of mass exodus. People would say, ok, we’re being replaced, our jobs are being taken away, so they just jump ship” (VP and Head of Networks). The dilemma was how TSIC could balance the perceived need to keep a tight lid on the negotiations whilst fully recognizing the impact it could have on the staff in the organization.
The interviews suggest that limited attention was placed on the social control dimension to reduce performance risks hence low degree of performance risk level reduction using social control.

**Performance risks as seen by the supplier**

For Ericsson the contract negotiation with TSIC was of strategic importance. Ericsson Global Services saw field service capability as a beach head towards a full offering of telecom outsourcing services. It was Ericsson’s first outsourcing contract of pan-European field services.

Whilst the strategic intent from Ericsson is clear, the role of individual’s motivation and drive can not be overestimated as business evolves; opportunities are created, or serendipitously appear in the minds of people. The Ericsson key account manager personifies aspects of the role the suppliers have in the outsourcing process: “We’ve always been able to be proactive and selling fairly new stuff to [TSIC]. And then there was this buzz about global services… [due to the financial situation] we would not be able to break in more business [at TSIC] if we did not find new grounds. I was not interested in continuing working with just maintaining a customer, I wanted to either expand or looking for something else. I saw that there was a possibility [for outsourcing]” Whilst outsourcing opportunities may turn up on an ad-hoc basis the empirical material demonstrates the very structured approach taken by the supplier to develop the business relationship: “Since you are in the corridor you can drop in, get 5 minutes here and 10 minutes here. Just build on what you said previously etc., so you move from an informal to a formal discussion. I think that was one of the prerequisites for being able to start up discussions. Secondly also that the customer was and still is in financial difficulties, so they were looking for ways and means how to save money, reduce OPEX staff heads” (Key Account Manager).

**Competence-building trust (high probability of success)**

The empirical material suggests that the idea of outsourcing as one solution to meet the required cost reduction was introduced by Ericsson. One can surmise that the financial drivers to take actions at TSIC were known to many suppliers. The initial approach of outsourcing the whole telecom infrastructure, planning and design was too close to TSIC core business, however, the idea of outsourcing field service operations was a possible opportunity: “They were not considering this alternative at this point when we started talking about it. They were looking at how to reduce their OPEX but they had not ventured into the thinking of should we outsource or not. When we introduced that to them that
was I think a very fresh idea, and there were no other vendors at that time. They came in 3-5 months later when we had already established our base” (Key Account Manager).

A difficulty for Ericsson was that they did not have a demonstrable track record as a field service operator. The risk of failing to deliver was both financial and strategic. Financial in terms of penalties and potential cancellation of the contract but also additional efforts needed to make the operation work according to contract specifications. At the strategic level, field service was an important component in the full service offering hence failing on the first attempt would cause problems for the overall strategy. The TSIC contract was a financial risk and strategic reward opportunity.

To address TSIC’s concern that Ericsson did not have the capability, broad and open access was offered to many people and resources within Ericsson. At the time, a good reference was the Telfort contract where Ericsson took over the whole network operation and 385 people. “Then, as we moved along during the fall of 2002, we also started using a former consultant of the customer and we placed him within TSIC’s organisation, got an agreement on that from the customer and paid for him. [his role was] to help work on the business case, and to give us access to information” (Key Account Manager).

The role of the consultant was two-fold: firstly, the consultant provided the required information to the Ericsson BPO process (Business Process for Outsourcing). The main steps in the BPO are shown in figure 38 below; secondly, support to TSIC with information to create the business case for presentation to senior management of TeliaSonera AB including the base line for SLAs and operating procedures.
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<th>Tollgate</th>
<th>Description of stage</th>
<th>Summary of output</th>
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<td>Summary of opportunity</td>
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<td>Ericsson business case development</td>
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<td>Chances of winning a bid</td>
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<td>Commitment from Ericsson units</td>
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<td>Fit with Ericsson strategy</td>
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<td>Steps taken to identify &amp; minimise risks</td>
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<td>Tollgate 1</td>
<td>Joint Business Foundation Settings</td>
<td>Presentation of potential outsourcing case to CEO/CFO in outsourcing organization</td>
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<td>Letter of Intent for feasibility study</td>
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<td>Outsourcing project organization set-up</td>
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<td>Tollgate 2A</td>
<td>Feasibility study &amp; Proposal development</td>
<td>Agreed scope of outsourcing</td>
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<td>Strategic benefits to Ericsson</td>
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<td>Financial analysis</td>
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<td>Current OPEX - OPEX savings</td>
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<td>Transition costs (redundancy costs)</td>
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<td>Investments</td>
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<td>Summary of savings potential</td>
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<td>Price model</td>
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<td>HR issues</td>
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<td>Ericsson Delivery capabilities</td>
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<td>Tollgate 2B</td>
<td>Due diligence &amp; Contract Negotiations</td>
<td>Confirmation of data and assumptions in feasibility study</td>
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<td>Business risk</td>
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<td>Operational</td>
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<td>Service delivery risk (Input data risk, process risk, output risk)</td>
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<td>Commercial risk rating model</td>
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<td>Business context</td>
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<td>Risk identification</td>
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<td>Risk analysis</td>
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<td>Assess &amp; Prioritize and Treat risks</td>
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<td>Contract signing</td>
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<td>Tollgate 3</td>
<td>Transition Setup</td>
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<td>Tollgate 4</td>
<td>Transition Execution</td>
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<td>Tollgate 5</td>
<td>Transition Finish</td>
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</tbody>
</table>

**Figure 38.** Ericsson OBP process.

Source: Document (E1)

The output including an identification of risks is progressively more comprehensive and detailed at each successive tollgate. The business case provided information to ascertain what price Ericsson could offer for the contract and a profit margin. It also specified at what price level
Ericsson should walk-away from a deal. For commercial and reasons of confidentiality the OBP is only described in principle, suffice to say that the process is comprehensive with detailed tools and highly structured in a step-by-step procedure.

This was the first field service outsourcing and it would cover 20 countries across Europe. A large part of the performance risk for Ericsson related to the appropriateness of internal resources, their availability and a commitment to make the operation work once the contract was signed. Much of the effort by the Ericsson team was to work with the broader Ericsson organization to secure understanding and commitment among the Ericsson units that would be involved in delivering against the contract. In part this was done together with TSIC to (i) share the same data and information and (ii) convey a commitment to TSIC. The use of an external consultant was an important device to provide (i) appropriate data, and (ii) provide independent data and hence build the confidence that outsourcing could be successful.

The case data shows that Ericsson spent significant effort to gain commitment from the internal organization including creating the business case using the external consultant to get a go ahead at tollgate stages. At the same time, they did not have first hand information on the TSIC organization. Neither did they have any conversations with the sub-suppliers to gauge their willingness to be sub-suppliers to Ericsson, keeping in mind that they were in many cases direct competitors of Ericsson.

Output control (ability to measure outcomes in an objective way)
From the perspective of the supplier this is an area of considerable risk. The underlying issue is information asymmetry. In most cases the supplier is reliant on information provided by the outsourcer, mostly in written form. Ericsson had limited opportunities to engage broadly with the operation of the outsourcer to gain insight and confirmation into its efficiency and effectiveness before having to accept the price for the contract that had been stipulated by TSIC.

In the TSIC case the decision to approach the negotiation with an “open book” approach provided unusually good opportunities to scrutinise and influence the contract and SLAs. The external consultant was again a supportive element in gaining insights and data for the design of the output measures and SLAs. The caveat as previously stated is the lack of access to the TSIC organization to confirm the assumptions underpinning the output measures.
Although the OBP process provides detailed instruction on the steps and type of information required to minimize risks, it does not provide detailed specification on e.g. output measures and SLAs. The OBP is a generic decision process with general guidelines. Each outsourcing case is unique as to the requirements and output control that would best serve successful performance hence it is a management decision whether a project should proceed to the next step. In the TSIC case the “open book” approach offered Ericsson the possibility to work intimately with TSIC in the design of the output measures. The down-side risk for Ericsson (and TSIC) was that the operational control had deficiencies and performance data was of questionable quality. On balance Ericsson had input into the design of the contract but could not verify the underlying assumptions due to limitations in measurement and control in place at the in-house operation of field service.

Social control (establishment of common cultures and values)
For Ericsson this implied deliberate and explicit inclusion of processes and activities aimed at creating common cultures and values among the TSIC staff that would be transferred to Ericsson. It would imply actively seeking to map and understand the culture in TSIC and compare it with the culture in Ericsson. The empirical material does not demonstrate activities on the part of Ericsson to address social mechanisms to reduce performance risks. In particular, the OBP process does not ask questions around organizational culture or values as part of its evaluation process.

5.4.2 Summary of performance risks
The data shown below in figures 39, 40 and 41 display a summary of the risk mitigating actions taken by the outsourcer (TSIC) and the supplier (Ericsson) during the Negotiation stage. It starts with competence trust-building followed by output- and social control.

Competence trust-building actions
Although the TSIC team had access to Ericsson’s organization to assess both competence and commitment, it is clear that field service operations were a new area for Ericsson. Seeking assurances from senior executives within Ericsson of commitments to make the deal work was one way to mitigate risks. Another was the short break clauses in the contract. Competence concerns may have been one reason to retain key staff to monitor Ericsson. However, neither of these actions could reduce the actual risk of unsatisfactory competence today or in the future as
technology develops. TSIC would have to take a leap of faith that Ericsson would provide the resources and money required to make it work.

On the one hand, Ericsson followed the OBP process in the approach to the negotiations; however, on the other hand, had limited possibilities to evaluate the actual performance of the TSIC operation. Ericsson does have significant experience of running network and does offer field service of its own equipment and systems. However, in this deal Ericsson would have to service any and all equipment in the field from a range of suppliers. This was an untested competence and Ericsson would have to rely on the competence of sub-suppliers whenever they themselves did not have the competence.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions TSIC</th>
<th>Risk mitigating actions Ericsson</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss of core competence</td>
<td>Lack of expertise, Lack of experience, Over promising</td>
<td>▪ Gradual roll-out of the operation, contract break clause as safeguard</td>
<td>▪ Applying the OBP process to the letter</td>
</tr>
<tr>
<td>Low adoption rate of new technology</td>
<td></td>
<td>▪ Seek commitment from suppliers senior executives</td>
<td>▪ Prior ties with outsourcer provided information on the business situation</td>
</tr>
<tr>
<td>Dependence on the other party</td>
<td></td>
<td>▪ Retaining key staff in-house</td>
<td>▪ Seeking commitment from internal organization</td>
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<td></td>
<td></td>
<td>▪ External expert advice</td>
<td>▪ External expert advice</td>
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<tr>
<td></td>
<td></td>
<td>▪ Checking suppliers relationship with sub-suppliers</td>
<td></td>
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</tbody>
</table>

**Figure 39. Competence trust-building actions to mitigate risks**

**Output control actions**

TSIC had already stipulated the discount required for a deal hence the negotiations were more about reducing the operational risks than to maximise the savings. However, TSIC’s desire to keep a tight lid on the negotiations with Ericsson meant there were limited possibilities to verify data and information on the field service operation during the negotiation. The solution to this information problem was to design the negotiation as a joint discovery process. The benefit of this approach was that Ericsson would be able to have input into the operational output measures and performance levels. The use of the external consultant that could access the TSIC organization without raising any suspicion offered Ericsson a degree of “due diligence”. The negotiation process may have assisted a reduction in risk of hidden costs.
Unwanted events | Causes of the unwanted events | Risk mitigating actions | Risk mitigating actions
--- | --- | --- | ---
Not meeting contractual performance levels | Misaligned budget planning Poorly designed SLAs Poor quality performance data | ▪ Joint data discovery ▪ Joint design of SLAs | ▪ Joint data discovery ▪ Joint design of SLAs ▪ External advice
Hidden costs |

**Figure 40.** Output control actions to mitigate risks

Social control actions

Outsourcing is a transfer of activities to another organization hence the empirical data suggests that although there was a need to inform the staff that would remain in-house the focus was not on the vision and goals of the outsourced activity. The contract provides detailed descriptions on performance measures and processes however, limited attention was placed on organizational culture and the staff dimension. Staff were discussed as to numbers and functions rather than organizational goals and processes to integrate the TSIC staff into the Ericsson organization. HR issues were discussed but it appeared to mostly concern the legal requirements of the various jurisdictions.

Unwanted events | Causes of the unwanted events | Risk mitigating actions | Risk mitigating actions
--- | --- | --- | ---
Loss of staff morale and cohesiveness | Unclear vision and purpose of the outsourcing decision Unclear goals broken down to sub-levels and individuals Lack of communication | ▪ Limited evidence of specific social control actions that could reduce performance risks. | ▪ Limited evidence of specific social control actions that could reduce performance risks.

**Figure 41.** Social control actions to mitigate risks

The analysis above concerns performance risks and the next step in the analysis framework is to consider how the outsourcer and supplier manage relational risks.
5.4.3 Management of relational risks

Relational risks in outsourcing can be seen from several perspectives. First and foremost, the contractual relationship between outsourcer and supplier is critical for the performance of the outsourced operation. However, there are also other important stakeholders where relational risks are relevant. One such stakeholder is the TSIC staff, both those who will transfer across, those that will lose their jobs, but also those that will remain with TSIC in some capacity important for the outsourced operation. The case data reveals that this is an important aspect of the success in outsourcing. However, the purpose of this dissertation is on the organizational relationship between outsourcer and supplier and not relationships at the individual level hence personal relationships are not covered in the dissertation. Another important stakeholder group is the sub-suppliers, many of whom are competitors of Ericsson’s and other areas of the business that interface with the outsourced operation. Again, as the empirical material shows, these relationships are important but are not the focus in the research.

Relational risks as seen by the outsourcer

Goodwill trust-building (one’s good faith, good intentions, and integrity)

The decision to go to direct negotiations with Ericsson and using an “open book” approach to negotiating the details of the contract resulted in significant relational risks. Would Ericsson act in the best interest of both parties or take advantage of the situation in some way?

TSIC have a long history of working with Ericsson going back to the early days of the telecom industry in Sweden. TeliaSonera is the largest telecom operator in Sweden and Finland and of significant importance to Ericsson’s sales in the region. Although a large customer is of importance for most businesses, in this case, Ericsson is also a very large company with a reputation to maintain and the relationship could be described as balanced both as to similarity in size and mutual importance for a long-term relationship. The TSIC team spent considerable time meeting with key executives at Ericsson including the Managing Directors in the countries where the field service took place: “[We got] commitment from the top, all the way from the CFO [of Ericsson], who showed up for the agreement signature, and committed to us that they will do their best to make this work. We got commitment from every exec and the head of managed services division, the VP is in that division. We were always getting royal treatment” (VP and Head of Networks). TSIC was seeking and
received confirmation at the highest level that Ericsson was committed to the outsourcing contract.

Receiving royal treatment sounds positive. However even more reassuring was the strategic direction that underpinned Ericsson’s reason for wanting to close the deal. “…we saw the hunger and the eagerness to make this work. Because it was going to benefit them, they did not only want to have a service to offer, but to get this [type of operation] under their wing” (VP and Head of Networks). The empirical material suggests that TSIC made considerable efforts to build its confidence in Ericsson’s commitment to outsourcing in general and this type of operation in particular. It seems that goodwill trust-building was an important dimension in the Negotiation stage.

**Behaviour control (appropriateness of processes)**

One characteristic of the TSIC case is lack of experience and knowledge of the outsourcing process and the field service operation for both negotiating teams. When knowledge of the transition process (i.e. the transfer of an activity from one organizational form to another) is combined with low outcome measurability, it is suggested that behavioural control is an effective mechanism to manage relational risks (Das & Teng 2001).

TSIC had relatively poor knowledge and documentation of the field service operation due to the merger between Telia and Sonera: “[we were] hostage to local systems or local spreadsheets, or even some people that had things in their head about the sites where we operate our business” (VP and Head of Networks). The outsourcing contract documents are in some aspects very detailed as to process and procedures. The TSIC team had the competence to run the overall business but the decision to negotiate only within a small senior team reduced TSIC’s ability to seek the available internal knowledge and information. The discussion in the Transition stage will highlight this point. The fact that TSIC chose a joint discovery process indicates awareness of the weakness in designing good and effective policies and processes for the contract. Credit should be given to TSIC for (i) acknowledging awareness of the weakness and (ii) acting in good faith towards Ericsson as a means to reduce relational risk.

**Social control (establishment of common cultures and values)**

As mentioned above the relational risks relating to the social control dimension can be viewed from several perspectives. There is on the one hand the perspective of the relationship risk in the
on-going outsourcing contract. On the other hand, there is the relationship within the negotiating team in terms of social control. As the focus of this thesis is of the on-going outsourcing relationships the analysis takes this perspective however, comments will be made to the social control dimension at the level of the team at the end of this section.

For TSIC one aspect of social control that emerges in the empirical data is the difference between being a telecom operator working 24/7 in the on-going operation, compared with being an equipment supplier where a sale is a project with a start and an end. The implication of this is the difference in organizational culture and modus operandi. The empirical material does not indicate that this aspect figured prominently in the negotiations.

Moving the perspective to the negotiating team itself creates a different picture. The empirical material demonstrates the very personal nature of intense negotiations over a considerable length of time. The requirement for a small negotiating team meant that very few people were involved and the scale of the task meant it consumed a large part of the working time of the negotiating teams. Beyond the personal relationships that developed during the negotiations there were structural decisions taken to manage the relational risk element in the negotiations such as the requirement for a high degree of discretion in the negotiation process. Correspondence and emails must not inadvertently be opened by others and meetings often took place in neutral locations so as not to raise unnecessary concerns and drive counterproductive speculation among the TSIC staff. The intense nature of the negotiations meant that individual trust was of high importance: “Trust and openness was a pre-requisite. If a person in the team did not fit in or had the same understanding and approach, we could call each other and ask the person to be removed from the team.” (Director Networks Operation and Maintenance). The action of asking a member to leave the team only happened once in the TSIC case but is an indication of the importance of a shared perspective needed to create win-win for both parties.

Based on the case material it is this researcher’s view that the openness, personal trust and respect in the negotiating teams were critical for a successful conclusion to the negotiation. The evidence of this is the expression of mutual respect and openness found among the team members toward members of the other team.
Relational risks as seen by the supplier

Much of the theorising on relational risks refers to opportunism in the form of cooperation of the partner and the risk of appropriation of technological and managerial know how (Das & Teng 2001 p270). Based on the research into outsourcing and the empirical material this author would argue that the relational risks are significant for the supplier. The reason is that activities and resources transferred to the supplier in business critical outsourcing are intimately dependent on cooperation by the outsourcer for the performance of the contract. Should the supplier apply its knowledge and processes in operating the activities, they could then be appropriated by the outsourcer at the end of the contract, or worse, be transferred to another supplier of outsourcing services.

Another risk is that outsourcing often relies on critical interfaces with external organizations or other parts of the outsourcing organization for successful execution of the contract. This latter point is not in the scope of this research but the empirical material shows that getting cooperation from competitors of Ericsson and other parts of TSIC turned out to be major relational risks. Reference will be made to this in the Transition stage analysis. In the following sections the relational risk for Ericsson in the outsourcing deal with TSIC is analysed.

Goodwill trust-building (one’s good faith, good intentions, and integrity)

From the supplier’s perspective, bidding for outsourcing contracts is an expensive affair. Internal estimates at Ericsson suggest it costs US$200,000 to US$2 million for the bid and negotiation process hence an important decision is to establish that the outsourcer is sincere and that they intend to sign an agreement. Seeking confirmation of genuine intention can take several forms. One is to get assurances at the highest executive level that the intention is genuine. Another is to have good knowledge of the business situation of the outsourcer to ascertain the strategic and financial drivers that underpin a desire to outsource the activity. In the Ericsson Outsourcing Business Process (OBP) the explicit view is to bid for activities that are non-core for the outsourcer. Seeking commitment from the CEO or equivalent senior executive is one of the important aspects of tollgate 1 in the OBP. As the cost of the bid escalates for each tollgate the good intentions of the outsourcer become increasingly important. Another important aspect is the integrity of the outsourcer; would the outsourcer pass on information or knowledge to other bidders during the negotiation, or mis-use the information supplied by the supplier? Comments
by outsourcing supply executives suggest that outsourcers on occasions have appropriated the
supplier’s knowledge in the bidding process and transferred it to the in-house operation. In the
case at hand Ericsson followed the OBP process hence achieved ongoing information and
feedback that built the confidence that TSIC acted in good faith and with integrity. Specifically,
the early decision to negotiate only with Ericsson and the “open book” approach was assurance
of intent and goodwill.

Behaviour control (appropriateness of processes)
One characteristic of the TSIC case is lack of experience of the outsourcing process generally
and the operational details of the field service operation and knowledge. The comprehensiveness
in terms of process guidelines of Ericsson OBP suggests that the Ericsson team had the means
to reduce the relational risk by applying behavioural control mechanisms. In fact, much time and
effort was spent working on procedures and policy for the governance of the outsourcing
contract. The outsourcing contract documents are in some aspects very detailed as to process
and procedures. The decision to negotiate with a small TSIC team prevented Ericsson from
seeking the available internal knowledge and information. The joint discovery process and the
use of the external consultant supports the quality of the behavioural control to some degree and
hence mitigates the lack of direct contact with the field service operation during the Negotiation
stage.

Social control (establishment of common cultures and values)
The Ericsson OBP describes processes, provides check lists, and a structure for stage gates that
must be passed towards contract signing. It includes HR issues such as legal requirements in the
case of redundancies and adjustments of pension provisions to match Ericsson’s provisions.
What are not covered are “softer” aspects such as measures and considerations of organizational
culture differences and actions that could support the transition of staff from the outsourcer to
Ericsson. There are processes for information dissemination but they seem to be geared toward
the legal aspect rather than motivational factors that may ease the transition of staff. The
individuals in the negotiating teams were quite aware of these aspects however, it seems that the
professional view of a job to be done rather than the feelings and concerns of individuals was the
over-riding focus in the negotiations.

20 Discussions with Executives at CSC Australia
A point to note is that the people in the negotiating team were not the same people that implemented the Transition stage. Furthermore, yet another team took the outsourcing operating forward on an on-going basis. Ericsson has developed specialist teams that negotiate the deal, a specialist team for the transition processes and then a third team that takes over the on-going operation. This is a way to provide specialist expertise and skills in the different stages. The question it raises is the mechanisms used to transfer not only the letter of the contract but the spirit of the relationship.

5.4.4 Summary of relational risks

The data below in figures 42, 43, and 44 display a summary of the risk mitigating actions taken by the outsourcer (TSIC) and the supplier (Ericsson) during the Negotiation stage.

**Goodwill trust-building actions**

The approach from TSIC was to build trust and goodwill in the negotiation process. This was reciprocated by Ericsson who offered access to senior executives and market company MDs as a means to demonstrate goodwill. Both TSIC and Ericsson placed much emphasis on the strategic importance of a deal and securing commitment from senior executives was important. Ericsson had supplied TSIC for many years hence provided experience and knowledge of how each organization worked and acted in business dealings.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions TSIC</th>
<th>Risk mitigating actions Ericsson</th>
</tr>
</thead>
</table>
| The other party not acting with good intentions (opportunism) | Not keeping promises, Leaking of information, Lying, cheating dishonesty | ▪ Seeking to understand the strategic importance for the supplier  
▪ Building on previous contacts and interaction  
▪ Seeking external references to check supplier integrity. | ▪ Seeking to understand the strategic importance for the outsourcer  
▪ Building on previous business interaction  
▪ Seeking assurances from high ranking executives in TSIC |

Figure 42. Goodwill trust-building actions to mitigate risks
Behavioural control actions

Due to the recent merger between Telia and Sonera and the decision to negotiate in secrecy TSIC were not able to verify aspects of operational processes and policies in all locations across Europe. Ericsson on the other hand did not have previous experience of acting as a telecom operator where immediate action is required. Neither TSIC nor Ericsson had experience of writing this type of service contract. The joint discovery process and Ericsson’s OBP supported the efforts in the negotiation to get the processes and policies as good as possible under the circumstances.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions TSIC</th>
<th>Risk mitigating actions Ericsson</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of decision making processes and accountability</td>
<td>Lack of policies and procedures Inappropriate policies and procedures Unclear roles and responsibilities</td>
<td>▪ Joint discovery process to access the knowledge of the supplier ▪ Advice from external consultant to increase understanding and knowledge</td>
<td>▪ Joint discovery process to access the knowledge of the outsourcer ▪ Ericsson OBP provides a framework for in support of the policies and procedures ▪ Advice from external consultant to increase understanding and knowledge</td>
</tr>
<tr>
<td>Hidden costs</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 43. Behavioural control actions to mitigate risks

Social control actions

The pressure on the TSIC team to complete a deal meant that this was the overriding goal. The concern for staff morale in TSIC was aimed at the staff that remained within TSIC rather than the staff that would transfer to Ericsson. There are limited indications that Ericsson made explicit plans for the social side such as understanding and considering the corporate culture of TSIC and how to meld the two cultures.
Unwanted events | Causes of the unwanted events | Risk mitigating actions | Risk mitigating actions
--- | --- | --- | ---
Loss of staff morale and cohesiveness | Lack of consultation among staff \nLack of communication \nPoorly handled transfer of staff and redundancies | ▪ Concern over reaction of TSIC staff but limited evidence of explicit actions to mitigate the risks | ▪ Concern over reaction of TSIC staff but limited evidence of explicit actions to mitigate the risks \n▪ OBP provides process limited support in areas of organizational culture and values of the outsourcer

Figure 44. Social control actions to mitigate risks

The notable character of the TSIC case is the decision to engage only with Ericsson in the formal negotiation process. As the Scoping & Search stage shows, the pressure from senior management in TeliaSonera was significant and the time scale to reduce costs was short.

A factor identified in the research is the OBP process at Ericsson. The OBP provides a step-wise structure that gradually increases the depth and quality of information on important aspects of the contract. Several check points are related to risk assessments of various aspects of the contract. Ericsson also spent considerable effort internally to ensure successful execution of the contract once it was signed including commitment at the highest executive level. TSIC on the other hand did not have a similar process to the OBP and had to develop the negotiation in “real time” whilst learning by doing: “We were negotiating through the night the last weeks. We did not have a direct deadline but we needed to have the implementation finished by end of 2003 so working backwards, we had to complete the agreement by end of July” (Director of Network and Maintenance). In general, this was a risky outsourcing decision by TSIC and reflected in the comment from the VP and Head of Networks: “I thought hard about this and even until the last minute when we were about to sign with Ericsson, I was thinking about other options. I could not find any, I could not see internally how we could fix this, it [field service operations] was not fixable” (VP and Head of Networks).

Most of the effort was focused on the “hard” side of the agreement such as output control, behavioural control, and competence trust-building. In contrast, more limited attention was placed on “softer” aspects of the relationship such as social control. What is also notable is the high level of goodwill trust building at the inter-organizational and intra-organizational level. Furthermore, the empirical material reveals the high level of interpersonal and team level trust.
that developed in and between the negotiating teams. Although this is not the focus of this dissertation there is little doubt that this was an important factor in the successful conclusion of the contract negotiation. The comment by the Director of Network at TSIC sums up the character of the relationship: “This type of contract can only be developed between two organizations that work together towards the same goal. What has been surprising is the personal nature this contract has taken. I have 700 contracts under my responsibility and none is like this one” (Director Networks Operation and Maintenance).

On 22nd July 2003 Ericsson issued a press release with the heading:

Ericsson signs Managed Service agreement with TeliaSonera International Carrier

Source: Ericsson press release. Document (TSIC 1)

This announcement started a fast paced set of actions to communicate and ensure stability within the TSIC organization, whilst Ericsson immediately took actions to take over the day-to-day operation of the field service operation. The official operational change over from TSIC to Ericsson was three weeks later on 18th August 2003. The next section describes the Transition stage or trial period as TSIC preferred to call it.

5.5 Managing risks in the Transition stage

As was identified in the Scoping & Search stage, the perception of risks associated with staff morale and loss of key personnel at TSIC was an important point in the decision of what should be outsourced and what should stay in-house. The size of the outsourcing contract for the whole field service activity ran into many SEK million’s and Ericsson informed the stock market at the same time as staff in TSIC was informed. On the 23rd of July an internal memo was circulated outlining the reasons for outsourcing field service, the benefits to TSIC and a broad timeframe for the transfer of the operation. Transfer of employees from one company to another requires adherence to employment laws and, in some cases, negotiations with union representatives. Full information on all aspects of job losses and transfers were therefore not possible to give immediately after the announcement. The risks related to staff and low morale should also be seen in the context of the overall situation at TSIC. Whilst the TSIC team negotiated the outsourcing contract with Ericsson for the field service operations, other parts of TSIC were
making large numbers of staff redundant. Altogether TSIC reduced its staff in the total operation from around 900 in 2002 to approx 450 people in 2003 of which a smaller part was part of the outsourcing agreement reported here. This was a difficult time for the TSIC management team as several unprofitable products and investments in unprofitable parts of the business were stopped resulting in a need to reduce staffing levels: “We were laying of 50% of the staff in the overall restructuring programme….I cut my department in half to meet the goals [for headcount]” (VP and Head of Networks).

After the initial announcement the VP and Head of Networks explained how many would get new jobs at Ericsson and how many would lose their jobs, however the individuals could not be named due to local employment laws. It took nearly 6 months to negotiate the transition of staff and employment contracts country by country. In the contract Ericsson agreed to take over parts of the operational team from TSIC and the remaining group of people were either made redundant or “placed” with other telecommunication organizations.

A characteristic of outsourcing is that the operational responsibility is transferred from the negotiating team to new teams of people in the Transition stage. The new team is an operational team supported with specialists in the transition process. Staffs from the outsourcer are informed of the outsourcing agreement, the consequences for jobs and organizational structure. This is a complex, stressful and important stage in the outsourcing contract. The analysis reflects the actions that actually took place and the extent it was planned for in the contract or developed in an emergent basis: “The change over from TSIC to Ericsson was 18th August. We had three weeks from announcing the deal to hand-over to Ericsson. This was an extremely short time. We were not ready, Ericsson was not ready” (Director Networks Operation and Maintenance).

The description of the Transition stage follows the same format as the Negotiation stage starting with the dimensions for managing Performance risks.

21 The actual numbers are not included for commercial reasons
5.5.1 Management of performance risks

The first section describes the perceived performance risks in the Transition stage from the perspective of the outsourcer.

Performance risks as seen by the outsourcer

Competence-building trust (high probability of success)

One of the main risks in the outsourcing decision was whether Ericsson would have the competence to take on the field service operation. “It is totally different to be a supplier of equipment than to be a telecom operator 24/7, we knew this was a risk and it turned out to be a problem in the beginning” (Director Networks Operation and Maintenance). As one of the main goals for TSIC was to reduce costs, for Ericsson to make a profit it would need to be more efficient and effective in running field service compared with TSIC. However, given that it is possible to run field service with less people, in the transition stage there is a steep learning curve for both parties.

The concern over Ericsson’s competence and experience led TSIC to retain key people with expertise and knowledge of field service operations. This decision was a double edged sword in that TSIC retained knowledge which would have been very useful for Ericsson in the transition stage: “[Ericsson] should have asked for more overall technical competence, people who could understand the full scope of the operations… they didn’t have the administrative and managerial knowledge, the understanding of the overall process and the overall picture of running the operation” (Vendor Implementation Manager). The TSIC management team was aware of Ericsson’s lack of experience in running field service operations yet the data suggests some of the problems in the Transition stage came as a surprise. There is limited evidence of TSIC adding extra resources in the Transition stage however, the transition period was extended from six months to nine months.

Output control (ability to measure outcomes in an objective way)

Some aspects of the contract such as the pricing were detailed and based on the existing costs less an agreed discount. The total cost was divided by the estimated number of call outs. This was a way of transferring risk to Ericsson from TSIC by converting a fixed cost to a variable cost. That is not to say that hard bargaining did not take place. “maybe I took advantage of the situation because I knew [Ericsson] wanted this work so badly. I put stringent requirements in the contract. I
think I had leverage in the [negotiation]. In the current negotiations for an extension of the contract I think [Ericsson] has more leverage” (VP and Head of Networks). This probably made perfect sense during the negotiations. However, the performance during the transition indicates that Ericsson could not meet the expected quality criteria. The outsourcing agreement required a different way of accounting for costs compared to the way costs where accounted for in TSIC: “Now it is a single point of contact, it’s all mechanised through the system. It’s more efficient”. However, it also meant that the full cost of each field service call became known and TSIC managers utilizing field services became cost aware and hence more careful and efficient in utilizing resources in the field. This caused resentment and sub-optimal operational decisions were sometimes taken based on less than full understanding of the cost comparison. Reducing costs, providing a single SLA, and a common way of working across all TSIC countries were prime objectives within the outsourcing decision and by applying a fixed cost to each service call TSIC was able to transfer a fixed cost to a variable cost. However, as the empirical data shows this was a too simplistic way of measuring and controlling (cost-) performance. There is limited evidence in the data that TSIC adjusted the measures to better align the output control to the actual operations during the transition stage.

Social control (establishment of common cultures and values)
The decision to outsource field service operations were not positively received among some of the TSIC staff: “There was a lot of resistance. In one country the Ops manager was threatening to leave with all his staff if we went through with the deal. In the end the manager did not leave.” (VP and Head of Networks). Negotiating with a small senior team made it difficult to engage with the broader TSIC organization. However, before signing the team consulted with an enlarged team on the operational side and once the deal was announced the whole organization was consulted. An added complication that affected communication was that staffs were in 18 different countries, all with different legal frameworks for labour laws. Each country was different in size of operation, history of business, and type of network operation. TSIC had limited managerial resources for the transition period and it had to be taken in a step-wise process with a few countries at a time. This inevitably resulted in many internal discussions and healthy debates, whilst from a contractual perspective Ericsson was operationally responsible for the performance of field maintenance operations. This was a difficult time for TSIC management and staff and the empirical material highlights the complexity and work load put on a few key individuals to implement the outsourcing agreement. It also indicates the high importance of a strong relationship with the supplier to solve all the unexpected difficulties and problems.
The transition stage was complex and demanding. The target set by the TeliaSonera executives for completed transition by end of 2003 put a lot of pressure on the TSIC team. Many operational decisions were taken to meet the target for cost reductions.

**Performance risks as seen by the supplier**

**Competence-building trust (high probability of success)**

There was a realization among the Ericsson managers involved in the TSIC outsourcing relationships that the performance risks were high. This was confirmed in the transition stage when the transition team took over TSIC’s field service operation. The main point is articulated by the Key account manager that negotiated the deal: “Ericsson is as all about organic growth. We don’t purchase companies and grow through acquisitions, we are not used to asking ‘what are the right organizational set up to deliver this type of services’”. And follows with “we are not a company that runs operations, we are not a services company…we don’t have the people used to working in operations.” In other words, Ericsson was reliant on the transferred TSIC staff to provide required expertise to deliver the service. Yet, to provide the service at 15% lower cost and deliver an acceptable level of profit implies significantly fewer people and lower costs. The Ericsson negotiation team were aware that lack of competence would be an issue during transition as well as that some of the sub-contractors may not be cooperative.

**Output control (ability to measure outcomes in an objective way)**

Ericsson measures performance in a fairly simplistic way where the goal is set as a gross margin and calculated according to internally standardised metrics: “we are going on a very bad margin, .. related to general knowledge [of field service operation] and the [low] volume.” (Director of Operations). One aspect of the fixed price costing model is that the price for a service call is the same irrespective of where it takes place. However, the actual cost varies quite significantly from a high cost country such as Germany compared with a low cost country such as Hungary. This makes forecasts of profitability very difficult and unpredictable. An additional complication is that each Ericsson market company that “host” the field service delivery has a requirement for gross margin for work done in the country. This caused difficulties in the transition stage where country managers, who had been supportive in the negotiation stage, realised that the actual gross margin for the contract was low in comparison with other products sold by Ericsson.
During the initial part of the transition much of the attention from Ericsson was on the cost side. Gradually the attention shifted to the quality of the service delivery. However, from the transition team’s perspective: “Transition was very much focused on cost and time. Quality was not part of the scope, so out of the transition project we had numerous issues related to the quality of service” (Director of Operations). The empirical data suggests that Ericsson struggled to manage the transition of the field service operation. The lack of operational experience seems to lead to an under-estimate of the type and amount of resources needed to provide a good level of service. “[we] were missing on quality on all accounts, and it took about 6-8 months to realise we have quality issues” (Director of Operations).

In addition to the challenge of managing the field service operation, Ericsson was dependent on several external sub-suppliers performance of services and flow of information. The contract did not include detailed descriptions and agreements on how these relationships should be managed. The low level of quality was due to the transfer of too few and competent resources, the tight deadline to complete before end of 2003, and a focus on reducing costs rather than running the operations. “It is business critical when we make a mistake…once and people notice, twice is not good, third time and you are out” (Director of Operations). In March 2004, TSIC sent a letter stating breach of contract to Ericsson citing poor level of service. This was a wake-up call for Ericsson. Gradually, the Ericsson team managed to recover the situation and at the time of interviews for the research, TSIC and Ericsson were engaged in discussions for adding further activities to the outsourcing contract.

Social control (establishment of common cultures and values)

The transition stage in the TSIC deal was not going well. The contract was signed 23rd July and as of 18th August Ericsson was formally responsible for the field maintenance operation. The main focus was on completing the transition by end of 2003, and on ensuring cost targets were met. A transition team from Ericsson took over the contract from the sales team and started to build a new organization and new processes to manage the daily operation. Sub-contracts for services were either cancelled or transferred to Ericsson, TSIC staff were gradually transferred to Ericsson country by country; it was a difficult and complex undertaking and the pressure on the Ericsson team was high.

A major difficulty which seems to have been under-estimated by both Ericsson and TSIC was the relationships with Skanova, IBM, HP, and Ericsson’s internal network operation. Skanova is
a subsidiary of TeliaSonera running the networks on behalf of TeliaSonera and they were not actively involved in the negotiations. Ericsson has its own global network which runs all its internal voice and data communication. IBM and HP run Ericsson’s IS and IT systems and software in an outsourcing contract. This is a technically complex and commercially sensitive set of relationships where each party has Service Level Agreements with different parties: “There are governance relationships between IBM and HP and EGOC (Ericsson Global Operations Centre) and Ericsson IS/IT, all involved in the TSIC deal one way or another “(Director of Operations). On top of this there were Ericsson market companies in each country that had to deal with taking on and delivering on the field service, some with no prior knowledge that this deal was being negotiated.

Very little in the contract addressed the complex set of relationships that where needed to deliver a quality service. The transition stage was primarily focused on contractual transfer of the operations and many of the key issues were emerging through difficulties and problems rather than pro-active planning and foresight.

5.5.2 Summary of performance risks

The data in figure 45, 46 and 47 shown below displays a summary of the risk mitigating actions taken by the outsourcer (TSIC) and the supplier (Ericsson) during the Transition stage.

Competence trust-building actions

TSIC was aware of the performance risks related to Ericsson’s competence as a field service supplier. The performance problems that emerged in the Transition stage did not come as a surprise and the Transition stage was extended from 6 to 9 months. The operational transition continued according to the contract until it became clear that Ericsson could not meet the performance levels agreed in the contract. In March 2004 TSIC issues a letter stating breach of contract.

Ericsson on the other hand had to build a new organization, learn how it operated and integrate it into the Ericsson market company organization. The empirical material indicates that both Ericsson and TSIC acknowledge that insufficient competence was transferred to Ericsson. At the same time, the staff retained at TSIC provided the possibility to use internal resources and “by-pass” Ericsson for the field work.
In the period after the Transition stage both TSIC and Ericsson began to address the problems through workshops and addition of resources.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions</th>
<th>Risk mitigating actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss of core competence</td>
<td>Lack of expertise</td>
<td></td>
<td>Ericsson was initially overwhelmed by the task and struggled to get on top of the operational tasks</td>
</tr>
<tr>
<td>Low adoption rate of new technology</td>
<td>Lack of experience Over promising</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Figure 45. Competence trust-building actions to mitigate risks**

**Output control actions**

A difficulty for Ericsson was the low margin on the contract in the first 12 months. The price was a fixed price per service call out. However, the volume of work was smaller than calculated during the negotiations. In the long-run this was not sustainable for Ericsson. From the TSIC point of view the contract had converted a fixed cost to a variable cost hence the risk had been transferred to Ericsson. The problem was the service quality, acknowledged by Ericsson to be below par and resulting in the breach letter. The transition stage was more difficult and took longer than anticipated and the empirical data suggests that the focus was transition rather than the operational performance. It was only after the official transition stage that discussion on the appropriateness of measures and costs were being addressed.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions</th>
<th>Risk mitigating actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not meeting contractual performance levels Hidden costs</td>
<td>Misligned budget planning Poorly designed SLAs Poor quality performance data</td>
<td></td>
<td>Ericsson</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Limited steps where taken to mitigate poor quality performance during the Transition stage</td>
</tr>
</tbody>
</table>

**Figure 46. Output control actions to mitigate risks**
Social control actions

The Transition stage was difficult for both TSIC and Ericsson. TSIC was still under pressure to reduce costs and manage a smaller but no less important part of TeliaSonera. Ericsson on the other hand was grappling with an operation that was outside of the traditional supply of equipment and systems. There is limited evidence that social control mechanism were high on the list of priorities during the Transition stage.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions TSIC</th>
<th>Risk mitigating actions Ericsson</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss of staff morale and cohesiveness</td>
<td>Unclear vision and purpose of the outsourcing decision Unclear goals broken down to operational sub-levels Lack of communication</td>
<td>• Many small and important decisions were taken during the period however, the empirical material suggests they were taken in a reactive manner rather than as deliberate risk mitigating actions</td>
<td>• Actions were gradually taken to address decision making processes with internal and external parties</td>
</tr>
</tbody>
</table>

5.5.3 Management of relational risks in the Transition stage

The character of the Transition stage is different to the Negotiations stage in several aspects. Firstly, it is now clear that agreement has been reached and the contractual details have been agreed. Secondly, the outsourcing contract is now known by all staff of the outsourcer. Thirdly, from a legal perspective the supplier is now operationally responsible for the performance of the operation based on the contract and the SLAs. There are often specific provisions in the contract only valid during the Transition stage such as the obligation by the outsourcer to act on behalf of the supplier in relation to employment contracts, and commercial contracts whilst these are legally transferred to the supplier. This process can often take several months and during this period the supplier is responsible but may not yet have formal control of all aspects of the operational activities.
Relational risks as seen by the outsourcer

Goodwill-building trust (one's good faith, good intentions, and integrity)

From the TSIC team’s perspective the same people that negotiated the deal continued in their positions as the transition process took place. The team had negotiated through the nights for the weeks leading up to the contract signing. The contract had been negotiated in an “open book” manner and much of the performance data and operational details were discovered jointly in the process. This created goodwill trust that to some degree carried over also in the transition stage.

A major risk identified in the Negotiation stage was the reaction of the TSIC staff: “We announced it to the organization and said we will make our best efforts to secure some, but not all, of the staff that are impacted” (VP and Head of Networks). All TSIC staff did not take the news positively. “It [transition] was quite turbulent…a number of staff were very worried about what was happening“. Despite the concern for the reaction of staff, TSIC had not prepared well for the announcement: ‘We did not appreciate the need for a ‘marketing’ plan to communicate and ‘sell’ the reasons and benefits of the outsourcing deal. We must understand this affects peoples life’s directly” (VP and Head of Networks).

However, the relationship included not only the contract between TSIC and Ericsson but also the critical sub-suppliers such as IBM and HP, Ericsson’s market companies, and other suppliers of network equipment. These relationships did not figure prominently in the contract and building goodwill-trust with the other parties was not high on the list of priorities in the Transition stage. An integral part to deliver the contract was the cooperation with the Ericsson market companies. “Once the deal was announced the communication within Ericsson was not as good as it could have been. The market company MDs may have said yes to the idea, but now the idea was reality and they had to deliver the SLAs” (VP and Head of Networks).

Once the contract was signed the operational responsibility was transferred to the operational team from TSIC: “when a new player comes into the picture there need to be a process where they can ‘internalize’ the contract and its processes“ (Director Networks Operation and Maintenance). In reality, establishing goodwill for the operational team took some time to build: “I sat down with [Ericsson] and said ‘OK, you must understand that we have to do this together” (Vendor Implementation Manager).
The TSIC case is a mixed picture of high level of trust in the Negotiating stage with a struggling Transition stage in terms of Goodwill trust-building. On the one hand, there was a degree of trust between TSIC and Ericsson however there were many other important relationships such as the sub-suppliers where no relationship had been established.

**Behaviour control (appropriateness of processes)**

Much time and effort in the Negotiation stage was spent on the contractual details written in a legalistic language. Once the contract was signed it had to be run from an operational perspective. “If you are not careful, it ends up a 50 page document. You can’t give that to an operator” (Director Networks Operation and Maintenance). “It’s been quite a rigid contract, it was too detailed…it should have been focused on the purpose [outcome] of the contract rather than the service specification” (Vendor Implementation Manager). The rigidity of the contract was not helpful in the early stages of the transition and “it has been an iterative process where we made small [improvement] steps all the time. Unfortunately, the way the contract has been written it has been hard to make the amendments.” (Vendor Implementation Manager).

“You must specify things to some level of details but from then on it’s the supplier’s responsibility to make it work” (Director Networks Operation and Maintenance). There were specific provisions for the transfer of sub-contracts and other services that Ericsson took responsibility for. In practice, this did not always work well “When Ericsson Purchasing department bought equipment, they bought the wrong stuff” (Director Networks Operation and Maintenance).

The decision to retain key staff in-house proved to have negative consequences in the Transition stages. As it was still possible to carry out aspects of the field service operation by TSIC themselves there was not a consistent way of operating which undermined the contractual procedures. The difficulties in the Transition stage were acknowledged by TSIC and the contractual transition period was extended from six to nine months.

Much effort was taken to agree the details of the contract during negotiation yet it turned out be too rigid and in places not possible to carry out as the procedures prescribed. Retention of key staff in-house created difficulties to ensure consistent processes and procedures. However, small and continous steps were taken to remedy the problems at an operational level and were gradually rolled out within the organization.
Social control (establishment of common cultures and values)

As the Transition stage progressed and both TSIC and Ericsson began to get to grips with the new way of operating the field service operation, common understandings increased: "We have lots of interactions with a lot of individuals; if we are happy with their performance we say so" (Vendor Implementation Manager). At the operational level the teams began to create informal communications channels and joint sense making to improve understanding and facilitate cooperation. "We have workshops at all levels, our fields ops meet together with their field ops". However these activities developed through the need to make the operations work rather than being agreed during the Negotiation stage. Specifically, what is emerging is the difference in attitudes when moving an operation from an in-house operations to an external supplier as the following comment suggests "you are being paid to do a job but then you see a lose hanging wire, you should call in an ask for a new ticket, be proactive and not so transactional" (VP and Head of Networks). It seems that TSIC were hoping for a proactive service rather than a contractual relationship.

Relational risks as seen by the supplier

Goodwill-building trust (one’s good faith, good intentions, and integrity)

Ericsson’s ability to successfully Transition the operation across was highly dependent on TSIC’s goodwill towards Ericsson. This translated into high dependence as a central characteristic in outsourcing. A complicating factor in outsourcing is the practice of the supplier’s sales team negotiating the contract with little or no involvement of the people that will run the contract. No contract can specify in detail the actions and information that are needed to perform the daily tasks and the acid test is the actions taken during difficulties. The empirical material suggests that goodwill-trust exists between Ericsson and TSIC and that Ericsson had a degree of faith in the integrity of TSIC’s actions, even in the face of a breach letter that was issued in March 2004: "We sit in meetings where [TSIC] is being very open with us, telling us their problem and asking us to help them." (Key Account Manager). An important aspect of this type of outsourcing is the knowledge and insights the supplier acquires of the outsourced activity: "The entirety of our staff is interfacing with the customer [and they depend on our performance]" (Key Account Manager).

In the case in hand Ericsson’s continued its efforts to get to grips with the operation and showed flexibility and willingness hence building goodwill trust in the long-term relationship.
Behaviour control (appropriateness of processes)

It becomes quite clear in the empirical material that many aspects in the contract were either not appropriate or not sufficiently flexible in the early months of the Transition stage. “Service governance has been done by the book however it has failed to identify new/emerging requirements” (Senior Consultant). The other issue that emerges is that Ericsson did not take over enough expertise and knowledge to be able to run the operation: “We took very few resources …that was a mistake from our side” (Key Account Manager). Compounding the lack of expertise is the lack of documented processes “TSIC did not have a process way of working, they did not have written down the way they work” (Director of Operations). Some of the quality problems during the Transition stage can be explained by the mismatch between contract and actual operational realities “We’re already going through the contract because we see that the contractual structure is not what we are actually delivering” (Key Account Manager).

An important element in the case is the relationships with other suppliers of essential services and interfaces. The contract has little detail on how these relationships and process are governed. “We had a workshop and asked TSIC that we wanted Skanova to also take part, however TSIC wanted to remain the interface with Skanova [although Ericsson is dependent of Skanova for its performance]” (Director of Operations).

It is clear that the processes and procedures in the contract did not match the reality on the ground. It seems it took quite some time before a) Ericsson realised their performance was poor and a breach of contract letter was written and b) a discussion on amendments and re-negotiation of the contract took place.

Social control (establishment of common cultures and values)

The focal point for the contract was the central TSIC team and the Ericsson account team based in Sweden. However, the field operation covered some 18 countries hence the same number of Ericsson market companies were involved in the delivery of the service. “We underestimated the difficulty of working in the Ericsson organization, establishing a multi-country agreement from a financial perspective” (Key Account Manager). The TSIC contract was one of many activities in an Ericsson market company. The challenge was to create attention and commitment across many countries.

22 Scanova is a separate subsidiary of TeliaSonera responsible for the network infrastructure. It directly interface with both TSIC and Ericsson
organizational units. Added to the challenge was the dependence on other external parties who may have had only indirect formal relationship with the outsourced activity.

It seems the cultural and geographical differences were never a point of discussion during the contract negotiations but became an issue in the operational stage: “The problems we encounter mostly have to do with relationship problems…with a global organization in different time zones, email becomes the common carrier of information and a common carrier of misunderstandings” (Director EGOC).

The empirical material highlights the embedding of the outsourced activity within the supplier yet its isolation as a specific contract with defined contractual obligations and service levels. These challenges are acknowledged in the empirical material but there are few concrete actions at the contractual or organizational level addressing the issues during the Transition stage.

5.5.4 Summary of relational risks
The data in figure 48, 49, and 50 below displays a summary of the risk mitigating actions taken by the outsourcer (TSIC) and the supplier (Ericsson) during the Transition stage.

Goodwill trust-building actions
The case data shows that relationships with external parties and sub-suppliers were underestimated by both TSIC and Ericsson. Outsourcing of business critical activities such as telecom field services requires cooperation and coordination by many parties. The empirical data suggests Ericsson made attempts to open up relationships with others but that TSIC was reluctant to let go of its role as “client” and control of information flow and decision making.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions TSIC</th>
<th>Risk mitigating actions Ericsson</th>
</tr>
</thead>
<tbody>
<tr>
<td>The other party not acting with good intentions (opportunism)</td>
<td>Not keeping promises, Leaking of information, Lying, cheating dishonesty</td>
<td>Limited actions where taken to mitigate risks related to internal and external parties important to the Transition stage</td>
<td>Showing flexibility and willingness to improve performance, Openness towards the outsourcer</td>
</tr>
</tbody>
</table>

Figure 48. Goodwill trust-building actions to mitigate risks
Behavioural control actions

The focus during the Transition stage was on the legal and organizational transfer of the outsourced activity. After the transition was completed it was acknowledged by both parties that the processes and policies in the contract did not match the reality on the ground. Limited actions were taken during the Transition stage to adjust the contract however the process was initiated some 12 months after the contract signing.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions</th>
<th>Risk mitigating actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of decision making processes and accountability</td>
<td>Lack of policies and procedures Inappropriate policies and procedures Unclear roles and responsibilities</td>
<td>TSIC Acknowledgment of inappropriate policies and procedures. Step-by-step process of operational improvements Extending the Transition stage from 6 to 9 months</td>
<td>Ericsson Seeking changes to procedures and contract Documenting processes as-is rather than as per the contract Seeking to involve all parties are involved in processes and discussions</td>
</tr>
</tbody>
</table>

**Figure 49.** Behavioural control actions to mitigate risks

Social control actions

In the latter part of the Transition stage both parties began to address social aspects of the relationship with joint problem solving meetings, and communication to a broad range of parties. This was a reaction to the reality on the ground and not planned activity as part of the Transition stage.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions</th>
<th>Risk mitigating actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss of staff morale and cohesiveness</td>
<td>Lack of consultation among staff Lack of communication Poorly handled transfer of staff and redundancies</td>
<td>TSIC Discussion and joint problem solving between outsourcer and supplier Efforts to communicate understanding and benefits of the new operational arrangements.</td>
<td>Ericsson Acknowledgement of a need to address internal and external dependencies but limited actions taken in the Transition stage.</td>
</tr>
</tbody>
</table>

**Figure 50.** Social control actions to mitigate risks
5.6 Summary of the TSIC – Ericsson case

The TSIC outsourcing case was a first in two respects. It was the first outsourcing of a pan-European field service operation in the telecom industry and it was the first pan-European field service contract for Ericsson Global Services. Both parties took significant operational, commercial and reputational risks in signing the outsourcing contract.

From TSIC’s perspective the drivers were primarily the need cost reduction and common ways of working across all the TSIC markets. But it was also driven by the need to overcome organizational and managerial difficulties by converting an internal organization to an external provider of services governed by a contract. From Ericsson’s perspective it was the opportunity to take a first strategic step towards becoming a full line provider of telecom services.

In the intersection of economic necessity and strategic opportunity two negotiating teams worked for several months towards a joint relationship that was complex, difficult, unpredictable but in the end had to work.

At the time of the case interviews both parties had overcome many of the difficulties the case describes, not always by design but by shear determination to solve problems with a joint destiny in mind. From the empirical material at hand the deal had been a success in that the field service operation eventually met its performance targets and both parties spoke of the other with mutual respect and understanding of the roles each played in reaching a common goal. What the material is not able to ascertain is the extent to which the contract has been a commercial success for either party. For Ericsson it seems that the costs of running the contract are higher than anticipated due in part to the lower volumes than anticipated. However, the strategic goal has been met and Ericsson is now capable of taking further field maintenance contracts with the potential to reap economies of scale.

In the TSIC case the deal has resulted in lower costs by converting a fixed cost to a variable cost whilst the volume of work is at a lower level than previous years. Without this conversion there is little doubt that TSIC would have suffered further losses in the years under investigation. Another target met is the reduction in headcount with the transfer of personnel to Ericsson. From an operational standpoint there are indications that Ericsson have streamlined operations
and put systems in place such as inventory maintenance control which in the long-term will benefit the quality and speed of response, as well as reduced costs. Outsourcing has shifted TSIC’s organization from hierarchy to a single-point relationship governed by a contract.

In short, the TSIC management team was able to meet their goals through outsourcing and in the time scale required by senior management whilst Ericsson have gained the experience and knowledge to offer field maintenance services to other telecom operators.

5.7 Epilogue of the TSIC case

In recent discussions with people from TSIC and Ericsson both parties claim to be very satisfied with the operational outcome of the contract. Ericsson was able to achieve operational control and deliver the required levels of service at an acceptable margin. TSIC was able to meet its goals for cost reduction and learnt much from the experience of negotiating outsourcing agreements. The Director of Network and Maintenance commented in January 2009 that “in retrospect, this is one of the best [operational] decisions we have taken”. Furthermore, the learning from this contract was applied in a subsequent outsourcing contract for the IS/IT infrastructure of TeliaSonera such as “one learning we took forward to the IS/IT deal is to involve the managers in the units that are affected during the negotiations. This improves the understanding of the actual operations and reduces the difficulties during Transition.” (Director Networks Operation and Maintenance).
6 THE HUTCHISON OUTSOURCING CASE

The second case in the study is the outsourcing agreement between Hutchison Australia and Ericsson announced in December 2002. It was a major outsourcing contract and the first contract of this kind in the telecom industry in Australia. The case describes the context and situation at the time and the description and analysis follows the 3-stage model adopted in this research. The empirical data is based on internal documents, documents in the public domain and interviews with the key decision makers in the outsourcing deal. The format is descriptive with quotations to illustrate the main points in the empirical material.

6.1 Introduction to Hutchison (Australia) Telecom

Hutchison – A historic review

The parent company to Hutchison (Australia) is Hutchison Whampoa, a Hong Kong-based multinational conglomerate with its origins dating back to the 1800s and is part of the Li Ka-shing group of companies. With over 220,000 employees worldwide, Hutchison Whampoa operates five core businesses: ports and related services; property and hotels; retail; energy, infrastructure, investments and others; and telecommunications. It is a prime force in the deployment of 3G telecommunication services in key global markets.
Hutchison Whampoa is a majority shareholder (52%) in Hutchison Australia, with Telecom New Zealand and Leanrose owning around 10% each and with 27% of the shares listed on the Australian stock exchange (Hutchison, 2007). Turnover in 2006 was Australian $925 million with an EBITDA of AU$ 30 million (Hutchison, 2007).

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>418</td>
<td>227</td>
<td>340</td>
<td>523</td>
<td>915</td>
<td>925</td>
</tr>
<tr>
<td>EBITDA</td>
<td>-113</td>
<td>-99</td>
<td>-285</td>
<td>-410</td>
<td>-180</td>
<td>30</td>
</tr>
</tbody>
</table>

**Figure 52.** Hutchison financials 2001-2006.

Source: Hutchison Australia Annual reports

Hutchison was founded by the Roberts-Thomson family in the 1980s as a paging network across Australia. The family sold the company to Hutchison and the family retain a small shareholding through Leanrose Pty, Ltd. Hutchison continued building the telecom infrastructure and invested and built a 2G (GSM) network in Australia under the brand name of Orange. In 2001, a major investment programme was undertaken to build a 3G network and Ericsson Australia was awarded the contract to build the infrastructure, including providing the first 12 months of operation before transferring it operationally to Hutchison. In March 2003 Hutchison introduced Australia’s first 3G network. The 3G network uses the global Wideband CDMA (W-CDMA) standard and was compatible with the Hutchison Whampoa networks in other parts of the world. As well as being more efficient than 2G, 3G enables the delivery of more than voice such as text services, live mobile TV and broadband access through mobile handsets. The user base has continued to grow and in 2005 the 2G subscriber base was gradually transferred to the 3G network. Today Hutchison Australia operates under the global brand name 3 and merged in Australia with Vodafone in February 2009.

However, “Hutchison-Whampoa was under huge pressure because 3G was costing them a lot more than they expected” (Director Outsourcing Engagements). During 2002 many of the ambitious investments in 3G technology and 3G licences saddled telecom operators such as Hutchison Whampoa with large debt and subsequent cash flow problems as the forecasts for growth in 3G services were

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23 6 million customers and combined total revenues of approximately A$4 bn. Source: (E72)
significantly reduced. Reducing investment costs and conserving cash became priorities in Hutchison Whampoa.

In December 2002, Hutchison announce a ground breaking outsourcing agreement with Ericsson Australia for managed services of network operations, engineering, and development. The Australian stock market responded with a 25% increase in the share price of Hutchison Australia.

“The increased technical challenges of 3G called for a new approach to managing service delivery. We already had a strong partnership with Ericsson – a world leader in network technology – so it made sense for us to build on that partnership. This initiative will deliver cost efficiencies, without sacrificing Hutchison control and intellectual property.”

Kevin Russell, CEO, Hutchison Telecoms, Australia

Source: Hutchison - Managed services. Document (E76)

6.2 Introduction to the Hutchison case

This section of the case analysis is a short introduction to the specific aspects of the case. This is followed by analysis of the Scoping & Search stage, the Negotiation stage, and the Transition stage.

The essence of this case begin in 2001 when Ericsson had just signed a multi-hundred million dollar contract to Hutchison (Australia) for the delivery and roll-out of a 3G mobile network. As with many other developments of new technologies there were technical problems and delays in the Hutchison contract. The technical difficulties was further affected by the delayed launch of 3G globally in the wake of the implosion of the dot com bubble and telecom operators were saddled with large debts from the purchase of licenses to run 3G networks. Hutchison had its own 2G operations already and as a consequence of the 3G contract, Ericsson worked side by side with the existing organisation. “What was actually happening was our operations and their operations were just fighting with each other constantly. we had to do something for both companies, it was just getting to a silly point”(Director Outsourcing Engagements). In the same period, the Whampoa Group was asserting more influence on the Australian organisation. Whampoa was taking over control and was
replacing parts of the management; a new CEO, Kevin Russell was appointed. One of the first instructions to Kevin Russell by the Hutchison Australia board was to align Australia to the global roll-out of 3G, for example using the LogicaCMG 3G messaging technology. Seen from a global perspective this was driven by the desire to ensure compatibility between Hutchison networks in the different countries. However, it meant Kevin Russell had to re-negotiate the Ericsson 3G contract accordingly and take out those parts where there was misalignment with Hutchison’s global technologies. With a signed contract in place Hutchison found themselves owing Ericsson a significant amount of money for the reduction in scope of the original 3G contract. As compensation Hutchison proposed, “come to us with a proposal to sell us something and we will make up the contractual difference in the 3G contract”. This was fine in principle with Ericsson but, as it would require actual money spent on ordering new equipment the process was slow. In early May 2002, the Chief Operating Officer (COO) from Hutchison Whampoa Limited (HWL) in Hong Kong visited Australia. During the visit the COO requested that Hutchison Australia get their 2G network EBITDA positive by end of 2002 and get the 3G roll-out cost under control. The new CEO Kevin Russell found himself with a new business driver and targets to sort out the operational problems and duplications in the 2G and 3G networks. During a meeting between Hutchison Whampoa and Ericsson the Hutchison Whampoa COO took the Ericsson Managing Director aside and said: “surely, you could run this operation cheaper and better, why don’t you bid for running the whole network?” (Director Outsourcing Engagements).

In response to the visit by the Hutchison Whampoa executive, the CEO replaced Hutchison Chief Technology Officer (CTO) and promote Michael Young. Michael Young has an IT background and was used to the concept of outsourcing. In June 2002 Ericsson was invited to Hutchison Whampoa in Hong Kong to give a presentation on Ericsson’s global capabilities in managed services. The VP of services from Sweden and the VP of services from Australia presented to the Hutchison Whampoa Board. In the meeting Ericsson decided to make a bold statement “we can run the network at a 20-25% cost saving to Hutchison.” This seems to have made an impact as “we’ve never been told exactly what happened there, but they [the CEO and CTO] came back from Hong Kong with a new business driver.. in business, it is all about timing and about the business drivers.” (Director Outsourcing Engagements). Anecdotally Michael Young and Kevin Russell were taken aside by the Whampoa board and given clear targets to reduce operational expenses in Australia.
The features of the Hutchison case are firstly; the pressure from the parent company Hutchison Whampoa on the CEO of Hutchison Australia to reduce costs and secondly; the requirements for decisions to be taken by the end of 2002. The case highlights the multiple levels of management involved in large outsourcing deals such as this. It is clear from the empirical material that the owner of Hutchison Australia was instrumental in setting the pace for selecting a supplier and the choice of supplier. The empirical data identifies failure to meet cost targets and an adversarial and inefficient situation within the 2G and 3G operations as major drivers and Hutchison Australia believed this could be resolved through outsourcing.

The empirical data suggests the driving forces for the Hutchison case can be summarised as 1) a strong need to reduce cost 2) gain operational cost control, and 3) a short time scale to implement cost savings.

The Hutchison CEO together with his new CTO spent two months after the meeting in Hong Kong weighing up the options available to meet the targets set by Hutchison Whampoa. The first decision was which supplier to approach and the second was how to set up the negotiation process.

Firstly, Hutchison had two options, either to start negotiations with 5 companies and slice up the operations or negotiate with one company for the whole piece. Negotiating with one supplier for the whole operation was the preference as it would give better cost savings and would be easier and less costly to manage. However, working with only Ericsson was a gamble for Hutchison; if no agreement was reached after some months of discussion, Hutchison would have difficulty finding another supplier to take Ericsson’s place and hence meeting its cost reduction targets by end of 2002. On the other hand it would be time consuming to negotiate with several separate suppliers. “it would have been costly for [Hutchison] in both time and effort to negotiate with multiple suppliers, and time was critical …” Time was of the essence, Hutchison needed to have a plan in place by the end of 2002.

Secondly, what was being outsourced was the network operation, design and service development. The outsourcing contract did not require a transfer of the physical network assets to Ericsson; the contract was entirely about the operational aspects of Hutchison 2G and 3G network operations. It was a clearly stated aim for Hutchison to retain what they term “the IP”
(Intellectual Property) of Hutchison. The decision to retain the network infrastructure suggests that Hutchison saw this as their IP and a core asset they would not outsource. As such the “assets” that were transferred were the employees running the network operation, engineering, and applications developments, a total of over 240 people.

The nature and size of the outsourcing contract required the Hutchison CEO to keep the plans for an outsourcing contract secret from the organization. A small team lead by the CTO Michael Young was tasked with selecting the suppliers, designing the negotiation process and securing the savings that had been indicated. However, there was much scepticism that outsourcing was the right approach in the Hutchison team. In one meeting some of the team members suggested that the probability of success was less than 10%.

In early August 2002 Michael Young approached Ericsson with the suggestion to engage in discussions for taking over Hutchison’s network operations by the 1st January 2003, a very aggressive time plan.

6.3 Managing risks in the Scoping & Search stage

The Scoping & Search stage covers the period from initial idea of outsourcing to the commencement of formal negotiations with potential suppliers. In this stage the boundaries of what should be outsourced and what should stay in-house are decided and also the approach taken to the negotiation process. It should be noted that although the perspective is seen from the outsourcer, there are informal discussions and soundings taking place in parallel with various outsourcing experts and external parties including suppliers that may be invited for formal negotiations.

The case description follows the analysis model identified in the theory chapter.

 Decisions on what should be outsourced and what should stay in-house
 The search and selection of suitable suppliers and the approach to the negotiation process (the search and negotiation design process)
This section analyses the decisions taken by Hutchison prior to engaging in formal negotiations with Ericsson. The perspective is seen from the outsourcer and the theoretical basis is transaction cost analysis as outlined in Chapter 2.

**What should be outsourced and what should stay in-house**

The decision on what parts of the network would be included in the negotiations centred on the perceived strategic importance and the perceived risks. It was concluded early on that the physical infrastructure was core to Hutchison. However, to operate the network efficiently an intimate relationship between the physical equipment and the network operations is required. Although Hutchison retained the physical assets on the balance sheet “the physical and application architecture sits with Ericsson on Hutchison’s behalf and the logical architecture sits with Hutch” (General Manager Development).

However, telecom networks are complicated systems and the end performance means that many adjacent and sub-system must work together: ”HP is responsible for the desktop environment, so all the PCs, all the applications, not all of them because IBM actually look after a number of applications as well. So that makes things really tricky… Then there was all the equipment suppliers such as Samsung, Siemens, Harris etc. in the mobile network” (Operations Director - Ericsson). One option had been to contract with a number of service providers for smaller parts of the total system. The problem with this solution was the time and effort to negotiate in parallel with different suppliers for different parts who are all interlinked and interdependent for good performance. The CTO of Hutchison came to the conclusion that Ericsson was the logical choice and that it would have to be a single-source negotiation. The question was how the negotiation could be set up such that both parties could get to grips with the complexity of the undertaking and meet the deadline of 1st January 2003.

Another aspect is what Hutchison calls its IP: “… the grand vision was that Hutchison would retain the kind of 12-18 month-2 year review of where the technology was going, and that they would get vendors in and get proof of concept, and get feasibility studies done” (General Manager Development).

Retaining technology knowledge and intellectual property (IP) was perceived as an area of importance. However, it was difficult for Hutchison to define what was considered IP and how to safeguard that Hutchison retained both ownership and knowledge sufficient to get value from IP. To safeguard IP Hutchison insisted on strict rules on information access and “Chinese
“walls” between the outsourced activity and Ericsson’s organization. Hutchison also retained control of purchases of new equipment.

The tight timescales for concluding an outsourcing contract required speed in the negotiation process. This implied a simple structure to negotiate around, with whole functions included which could be clearly identified as to their people, processes and performance measures. The downside to this approach was dependence on the supplier as all the vital aspects of the operation would be transferred to the supplier and limited knowledge and expertise in the departments would be retained in-house. In the deal that was on offer, Hutchison transferred complete functions and all staff required to run critical aspects of the network and engineering operations. Hutchison did however not transfer physical assets such as the network, switches and control room equipment.

The perceived need to negotiate the contract in secrecy added risks to the negotiations. One concern was potential unrest among staff before a deal was concluded. Another was the reduced knowledge in the negotiation team of the detailed network operation. It was acknowledged that the latter point could present difficulties if the details in the contract were inappropriate or possibly wrong. The solution to this problem was to apply an open book approach in the Negotiation design.

**The search process**

The goal of meeting the deadline of 1st January 2003 had to be balanced with the risks in the deal. The search and negotiation process was a gradual process of informal discussions, presentations to senior executives in the parent company of Hutchison Australia. Major network equipment suppliers such as Alcatel and Motorola were active in the Australian market, and therefore potential parties for an outsourcing negotiation. In fact, “the 2G network – no Ericsson equipment whatsoever, we had nothing to do with that network in terms of technology. It’s Samsung core and radio, and Siemens and Harris transmission”. Nevertheless, the supply market in Australia for telecom outsourcing at the time was limited as none of the equipment suppliers had taken on operations of this scale in an outsourcing contract. A complicating factor was the 3G contract which Ericsson had won and which had subsequently been reduced in scope. The relationship between Hutchison and the Ericsson team building the 3G network was strained and not going well. “It was a very complicated relationship developing, in fact the relationship was poisoning” (Director Outsourcing
Would a new supplier of the whole network be able to not only take over the 2G network but also work successfully with Ericsson in completing the 3G network? Furthermore, the parent company Hutchison Whampoa had been given indications by Ericsson of levels of cost reductions that Ericsson could offer. Could another supplier exceed the synergy benefits that Ericsson could achieve by combining the 2G and the 3G network operations? And finally, was there any supplier that could take on the network operation with its complex set-up and structure?

A focus for Hutchison was building the 3G network with a scheduled launch of March 2003. This meant that preventing any leakage of information about a potential outsourcing deal which may de-focus the organization and jeopardise the launch was important. The solution was to negotiate the deal with a small senior team from Hutchison and in secrecy from the organization.

There was awareness that the performance risks of poorly designed SLAs could be costly. Especially since 3G was a new technology and the level of acceptance by Hutchison’s customer was an unknown factor. The experience of outsourcing IS/IT by Hutchison’s CTO led to the view that information asymmetry between outsourcer and supplier could lead to poorly defined SLA’s. One of the main points for Michael Young was that long term relationships require the creation of trust and common goals to be successful. The short time scale requested by the parent company excluded parallel negotiations with several suppliers. The complexity of the network also suggested that having only one party to work with would be more efficient in the long-term.

At the end of the Scoping & Search stage Hutchison invited Ericsson for formal negotiations for an outsourcing contract in August 2002. The deadline that was set was 1 January 2003 and a small team of Hutchison executives began a rapid process of negotiations with a small team of Ericsson executives.

6.4 Managing risks in the Negotiation stage

In August 2002, a small team of senior executives from Hutchison and Ericsson began to explore what Hutchison wanted and what Ericsson wanted from entering into an outsourcing
contract. Part of this process was for the parties to clearly understand the business drivers and the financial return each organization was seeking from an outsourcing deal.

“… so we then set an extremely aggressive time plan knowing what we had to do over 4 months, because be [Hutchison CTO] said - “if we are going to do this, I want to start on January 1, 2003”.” (Director Outsourcing Engagements)

This time scale limited the options of a wide ranging approach to the negotiation process of the network operation. A series of workshops began in August 2002 where both companies identified why they were willing to do an outsourcing deal and what the prime drivers were from each company’s point of view. This was summarised into 3 points each: 3 points for Ericsson, 3 points for Hutchison and 3 points for why they would do it together.

<table>
<thead>
<tr>
<th>Hutchison</th>
<th>Ericsson</th>
<th>Jointly</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ability to support rapid change</td>
<td>Supports the Global push into Services</td>
<td>Scale to need</td>
</tr>
<tr>
<td>Cost control</td>
<td>Leverage existing infrastructure</td>
<td>Future benefits shared</td>
</tr>
<tr>
<td>Protection of Hutchison IP</td>
<td>Re-usable model</td>
<td>New culture</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 53. Joint objectives between Hutchison and Ericsson.

Source: Michael_Young_Hutch_HK_Nov04.ppt. Document (E84)

Central to the approach by Hutchison was the balance between trust and control: “the last thing [Michael Young] wanted us to do was to come to them with a standard model of what he classed as an IBM model, where we would go in very cheap to start with and then all variations [to the contract] would be phenomenally expensive” (Director Outsourcing Engagements). This approach, however, was not an easy one to implement. Whilst the negotiations on the outsourcing contract took place, Ericsson continued to build the 3G network and meet its contractual obligations. The 3G contract was a “traditional” supply contract: “Hutchison as a company go back to their heritage... So if there’s a clause they can screw a supplier into the ground on, they will do it. On our 3G contract that’s what they do every day. So they tried to take a different approach with the [outsourcing] contract, so within their own company there are some conflicts about how they do that because it goes against their normal [purchasing behaviour]” (Director outsourcing engagement).
There were risks in the deal for Ericsson regarding the legal status of the networks. The 2G network was owned by a different subsidiary than the 3G network. “one of our concerns was what happens if they decide to sell one of the networks? How does that impact us?” How do we consider what happens if 3G is not a success? What do we do then? So we actually had to have it flexible enough that we could downsize as well as upsize and still make it profitable” (Director Outsourcing Engagements)

“The biggest risks for us were [if we did not]) understand [the operation]. When I say open book, we never actually got there.. there aren’t physical edges to the organization anymore, but there was still a covertness in a little way about how much of their cost information they share with us..[for example] Hutchison had 5 offices.. one whole office was going to transfer into Ericsson’s organisation.. and that was a million dollars a year saving.. They turned around and said “No, we have to exclude that from our costs because we were going to do that anyway”, that type of approach.. They wouldn’t actually tell us what the rental was, we got that through the back door.” (Director Outsourcing Engagements).

In the early days of the negotiations Hutchison had not decided it wouldn’t go to somebody else. “It could have gone to Samsung or any other supplier”. In the end, Hutchison did not go out to tender and in the last months of 2002 Ericsson was negotiating the details of the contract with Hutchison. The fact that Ericsson was building the 3G network and the 3G contract stipulated that Ericsson would run the network for the first 12 months suggests that the option for Hutchison to award an outsourcing contract to another supplier may not have been altogether realistic.

Negotiating with Ericsson only was a potentially risky decision if no agreement could be reached. However, the strategy of the CTO to create a trusting relationship provided the basis for an inclusive approach to the negotiations. There was also a view that outsourcing such a business critical activity as the operation of the network required a different approach to the long-term relationship.

The case description of the Negotiation and Transition stages applies the analysis structure as outlined in Chapter 2 where the focus is how the outsourcer and supplier manage Performance and Relational risks. It is applies the analysis separately for the outsourcer and the supplier followed with a section that compares and contrasts the perspectives on risks between outsourcer and supplier.
6.4.1 Management of performance risks

This section presents the case data related to management of performance risks first for the outsourcer followed by data from the supplier. A table summarises the mitigating actions the outsourcer and suppliers took in relation to the identified risks.

Performance risks as seen by the outsourcer

Competence trust-building (high probability of success)

The empirical material shows that Hutchison understood that Ericsson had limited experience of running networks of the Hutchison’s type. Ericsson had a reference contract in Holland and some build-operate-transfer contracts as evidence that they had the competence to take over the network operation: “we said [at the time] that a lot of the areas that we are now managing, we had no confidence in because they were outside the standard Ericsson portfolio, and we said up front we’re not going to tell you we can do this better than you, we had to take your staff and they have to become Ericsson people, and then deliver back the same service“(Director Outsourcing Engagements). What mitigated the lack of experience on the part of Ericsson was that the whole network operation would be transferred from Hutchison to Ericsson. In principle, all the required knowledge would therefore be available to Ericsson. The problem would emerge if the staff decided not to transfer to Ericsson in large numbers or if some of the operationally critical individuals would not transfer across.

Both Hutchison and Ericsson were concerned with the reaction of the staff to the outsourcing deal. There were two principal reasons why the negotiations were kept secret to the Hutchison organization: firstly, because of the size and significance of the contract the stock market could only be informed when the contract had been signed; secondly, it was felt that it would be disruptive and focus people’s attention away from their daily tasks if the negotiations were common knowledge before a contract was signed. It would also cause disruption and unrest should the negotiations break down and no contract signed be signed with Ericsson. Negotiation in secrecy prevented unrest before contract signing and the shock tactic of giving the staff only four weeks to decide if they would transfer their employment to Ericsson worked in the short term but did have negative effects as we will see in the Transition stage.
Output control (ability to measure outcomes in an objective way)

The contract covers the complete network operation and therefore the output measures for the contract are relatively simple in view of the complexity of the undertaking. It covers operational measures such as network availability, call drop-out rates, and time to fix faults etc. “However, because of the timeframes that we had, the two uncertainties were around the true costs and service level agreements”. During the negotiations the Ericsson team asked to get inside the Hutchison organization. Care had to be taken not to alert the Hutchison staff so the reason given was a business audit as part of the 3G contract. The team reported back to Hutchison’s CTO: “At the end of that week we presented back to the management team how we saw they operated, where we saw immediate duplications within their own organisation. One of the things that actually surprised them, because they’re a fast growing company, they didn’t actually know how many people they employed” (Director Outsourcing Engagements). The empirical data shows that Hutchison did not have complete records or an overview of the total network operation. The audit report indicates the operational performance levels that were discussed in the negotiations were uncertain as to their level of accuracy and the way they were measured. The CTO wanted an “open book” approach to the negotiations to minimise incorrect understanding of the operations and incorrectly set performance measures. This approach was not initially supported within his own team.

The empirical material suggests that there was incomplete information and knowledge of the detail of the network operations and the secrecy approach limited the possibility to search for information within the Hutchison organization; the short time scale made in-depth investigations impossible. There was awareness of these shortcomings in the Hutchison team however, the practical reality prevented these risks being mitigated and risk reduction to mitigate inadequate performance measures and control was medium/low.

In the contract discussions there was a concern for the retention by Hutchison of intellectual property (IP). However intellectual property of a telecom network is not easy to describe, monitor and regulate. In the negotiations the Hutchison CTO Michael Young described the relationship as Jing and Yang as both parties had to manage the conflicting interests for the common good of the outsourced operation. Figure 54 below describes Michael Young’s description of the relationship.

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24 Hutchison contract SLA (EPA/H 0961-0073/201) Rev M Nov 2004 Source: Document (E78)
“If we bring in intellectual property that has already been developed by Ericsson in another organisation, say from Japan, Holland wherever, that remains Ericsson’s intellectual property. But if we develop something specific and then share with Hutchison it's Hutchison’s intellectual property. There are actually pages on the intellectual property side” (Director Outsourcing Engagements). The difficulty for the negotiation was how to determine what IP was and what was not. “We’re using a fairly broad category of core, about creation and protection of intellectual property. So it was core if it created or protected intellectual property. It was really left up to [Hutchison] to make a decision [on what was core]“ (Director Outsourcing Engagements).

Although IP was deemed to be very important to Hutchison the difficulty of describing and managing this asset remains. The empirical data suggests that very limited risk mitigating actions that could be taken due to lack of information within Hutchison and the short timeframe to conclude the contract.

**Social control (establishment of common cultures and values)**

The fast track approach to the negotiations was used by the CTO Michael Young to instil urgency and engagement in his team. “[M Young] said if we are going to do this, I want to start on January 1. Initially we were like, do what on January 1? He goes ‘if we’re going to outsource anything we would do it by then’, and we’re thinking that’s not that long. His managers were the same, pretty blown away” (Director Outsourcing Engagements).
The CTO himself was under pressure to deliver the cost savings and at some point after the
meeting in June 2002 in Hong Kong he made his mind up about what to do and how to go
about it. There seems to have been a broader agenda by the CTO of changing the organizational
culture at Hutchison towards better cost and implementation control: “Michael [Young] knew that if
it was left to Hutch and we were trying to manage our own workforce we probably wouldn’t control it very well and
actually end up having 3 or 4 times the amount of people they required” (General Manager Operations). What
the Hutchison CTO wanted was… “whether we could get to the culture of Ericsson not the other way
around. By transferring the whole networks operation it had a good chance of success” (Engineering Manager).

Although there were important goals in the mind of the Hutchison CTO in respect of cultural
and social values the outsourcing contract is an operational contract dealing with SLAs and
performance measures. There is limited evidence that the cultural aspect was defined and
described, let alone identified as an important goal or reason for taking the outsourcing decision.

Performance risks as seen by the supplier

For Ericsson the contract negotiation with Hutchison followed the strategic direction of growing
in Telecom outsourcing. Although this was not the first outsourcing contract for Ericsson, at the
time it was among the largest and the broadest scope.

Competence trust-building (high probability of success)
There were two aspects of the outsourcing deal with respect of the probability of success. Firstly,
the 2G network which had been in operation for many years but did not contain any Ericsson
equipment. Secondly, the 3G network was nearing completion but had suffered technical delays
and was commercially difficult both for Ericsson and Hutchison. Could Ericsson run the 2G
network and would it be preferable for Ericsson to take on the running of the 3G network or
extract itself once the 12 months running of the network was completed accordance with the
contract?

Hutchison had knowledge and experience of Ericsson as a supplier from the 3G contract. In the
first meeting of the negotiating teams the CTO asked for an up-front declaration of the driving
forces for Ericsson, but also offered the same for Hutchison: “[M Young] said - I’ve got to be open up
Two technical aspects relate to the assessment of risk mitigating actions. On the one hand, Ericsson has an Australian network centre where it runs 12 small and medium size networks for customers, hence there was experience and expertise available. On the other hand the 2G network is a large, national network that is much more complex to run. For the 3G network it may have been advantageous to shift the contractual interface from Hutchison to an internal outsourcing unit. The relationship with Hutchison was strained and commercially fraught hence outsourcing may have lessened the risks and difficulties in delivering the 3G network to the contract specifications. The short time scale for the negotiations and secrecy prevented Ericsson from doing a thorough due diligence before signing the contract.

However, Ericsson would take over the whole network operation including its entire staff. This in principle would reduce the lack of in-house competence in Ericsson including the expertise in running the 2G network. The critical point would be the risk of key staff not transferring across from Hutchison.

**Output control (ability to measure outcomes in an objective way)**

Ericsson had serious concerns with the quality and reliability of the data that underpinned the SLAs and performance targets. The internal audit carried out during negotiations demonstrated that Hutchison did not have complete control of its own operations hence there were concern about the reliability of the operational performance data and procedures.

The contract structure and the type of SLAs included were in principle acceptable however, there was limited opportunity for due diligence and benchmarking of the data. The quality and reliability of output control was a major risk for Ericsson. The SLAs had penalties attached and it was not possibly to verify these performance targets prior to signing the contract. Some efforts were made to write contingencies into the contract but this would only provide low level of risk mitigation.
Social control (establishment of common cultures and values)

Although the importance of organizational culture and social processes was understood by the Ericsson team, there is limited empirical evidence that this was actively addressed beyond working with the HR team from Hutchison to “design” the day of the announcement, comparing the employment conditions etc. It seems the view was that once the decision was announced it was up to the line managers at Hutchison (now Ericsson) to deal with any issues that may occur.

6.4.2 Summary of performance risks

The data in figure 55, 56, and 57 displays a summary of the risk mitigating actions taken by the outsourcer (Hutchison) and the supplier (Ericsson) during the Negotiation stage.

Competence trust-building actions

Running, developing and maintaining a telecom network is a complex undertaking. In addition, the build and launch of 3G network technology required integration of IS/IT systems. Ericsson as an equipment supplier made clear that they did not have the experience in all aspects of the outsourced activity. Hutchison on the other hand did not have complete control of its fast growing organization. The solution to some of these challenges was to outsource whole functions and departments to one supplier rather than to split up the contract among several suppliers.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions Hutchison</th>
<th>Risk mitigating actions Ericsson</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss of core competence</td>
<td>Lack of expertise</td>
<td>▪ Transfer of the whole network operation and functions</td>
<td>▪ Transfer of the whole network operation and functions</td>
</tr>
<tr>
<td>Loss of expertise</td>
<td>Lack of experience</td>
<td>▪ Reference visits to other contracts</td>
<td>▪ Secure experienced staff to transfer from Hutchison</td>
</tr>
<tr>
<td>Dependence on the other party</td>
<td>Over promising</td>
<td>▪ Ericsson being honest about its lack of experience in some parts of the operation</td>
<td>▪ Applying the OBP process to the letter</td>
</tr>
<tr>
<td>Low adoption rate of new technology</td>
<td></td>
<td>▪ Rules for how the IP could be used by Ericsson</td>
<td></td>
</tr>
</tbody>
</table>

Figure 55. Competence trust-building actions to mitigate risks
Output control actions

The belief by the Hutchison CTO was that this type of complete system outsourcing could only deliver performance if there was trust and alignment between the outsourcer and supplier. This applied especially to the retention of IP for Hutchison. The approach led to an “open book” approach to the negotiations. Ericsson on the other hand had first hand experience of the Hutchison approach to supplier management through the work on the 3G contract. The intent of the Hutchison CTO was evident, however negotiating in secrecy did not provide Ericsson the opportunity to verify the operational and performance data in the contract. There was limited opportunity to uncover any hidden costs.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions Hutchison</th>
<th>Risk mitigating actions Ericsson</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not meeting the contractual performance levels</td>
<td>Mismatched budget planning Poorly designed SLAs Poor quality performance data</td>
<td>▪ Joint data discovery process. ▪ “Open book” negotiations ▪ Joint design of SLA’s parts of the operation ▪ Rules for how the IP could be used by Ericsson</td>
<td>▪ Due to negotiation in secrecy there was limited possibility to mitigate risks through verifying performance data</td>
</tr>
<tr>
<td>Hidden costs</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Figure 56. Output control actions to mitigate risks

Social control actions

The contract was negotiated in a short space of time and covered a large number of staff. Although the HR departments of Hutchison and Ericsson were involved in the latter part of the negotiations the focus seems to have been on the legal aspects of the contract rather than considering the organizational culture aspects of the deal. Although not explicit in the empirical material it seems that Hutchison opted for a take-it or leave-it approach to ensuring that the staff would take up the option of transferring their employment to Ericsson. The main concern of Hutchison was to not lose the focus on delivering the launch of the 3G network in March 2003.
<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions</th>
<th>Risk mitigating actions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Loss of staff morale and cohesiveness</td>
<td>Hutchison</td>
<td>Ericsson</td>
</tr>
<tr>
<td></td>
<td>Unclear vision and purpose of the outsourcing decision</td>
<td>▪ Limited evidence of specific social control actions that could reduce relational risks.</td>
<td>▪ Limited evidence of specific social control actions that could reduce performance risks.</td>
</tr>
<tr>
<td></td>
<td>Unclear goals broken down to operational sub-levels</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Figure 57.** Social control actions to mitigate risks

### 6.4.3 Management of relational risks

Relational risks in outsourcing can be seen from several perspectives. First and foremost, the organizational relationship between outsourcer and supplier is critical for the performance of the outsourced operation. However, there are also other important stakeholders where relational risks are relevant. One such stakeholder is the Hutchison staff, both those who will transfer across, those that will lose their jobs, but also those that will remain with Hutchison in some capacity important for the outsourced operation. The case data shows that this is a critical aspect of the success of outsourcing. Another important stakeholder group is the sub-suppliers of telecom equipment, many of whom are competitors of Ericsson, and other areas of the business that interface with the outsourced operation. Again, as the empirical material shows, these latter relationships are of very high importance but are not covered in the research as the focus is on the contractual relationship between Hutchison and Ericsson.

We should remind ourselves of the unit of analysis in the thesis. The unit of analysis is the organizational relationship between outsourcer and supplier. In the Negotiation stage there is a personal relationship developing between the negotiation teams however, the analysis focus as its attention on the decisions and processes that are put in place to secure the relationship in the whole organization and over the lifetime of the contract.
Relational risks as seen by the outsourcer

Goodwill trust-building (one’s good faith, good intentions, and integrity)

The negotiation stage in the Hutchison case was very short in duration and there was limited time and possibility to investigate the degree of good intentions by the supplier, Ericsson in this case. It is noteworthy that the relationship in the on-going 3G project was described as ‘poisoning’ and was not going well. "Michael [Young] actually said to us in a meeting, ‘as far as I’m concerned this is like sitting down with your worst enemy, asking them to share a glass of wine and hoping they haven’t poisoned it’. So both companies from a senior level have to actually take that leap of faith that the other company at a senior management level is serious about doing this type of work together.” (Director Outsourcing Engagements).

The CTO had previous experience of large scale IT outsourcing and had a clear view of the best way to create successful outsourcing relationships. He also challenged his own team in the negotiation meetings by a) putting pressure on his own team to follow his lead and b) demonstrate good intentions and the type of relationship he was seeking. “we then presented back from that what the potential scope of works would be, Michael actually then challenged both us and his management team and said “why, that’s way too narrow, why?” He turned around to his billing manager, “why is your billing critical to my intellectual property? Because ….. No, that’s rubbish, why is it? Don’t you think …” and he then challenged both us and pushed us and his own people. He didn’t force people to give up areas, but tried to logically reason through, and a lot of thinking out loud”(Director Outsourcing Engagements).

The empirical material shows that the CTO was seeking an open and trusting relationship between Hutchison and Ericsson, and there is some evidence that he achieved this. What is less clear is the extent this could be transferred to the organization more broadly, especially since the negotiations were carried out in secrecy.

Behaviour control (appropriateness of processes)

The contract is comprehensive and detailed in specifying the SLAs and other important aspects such as the intellectual property of Hutchison. The contractual documents and SLAs are clear about the performance measures and obligations in the relationship between Hutchison and Ericsson. Hutchison was trying to get control over both operational and development processes by creating a customer-supplier interface in the organization. “By forcing alternative managed services
to come in to do those works from an engineering perspective, it meant that each one had to be put to Hutchison as a business case and then approved“ (Engineering Manager).

In the Hutchison case much effort was spent on behavioural control and safeguards for IP and technology development such as “Chinese walls” to protect from information leakage. However, business critical outsourcing contracts such as the one between Hutchison and Ericsson have many important dependencies with adjacent parties and systems. In outsourcing of the whole network operations the cooperation of other suppliers with equipment or services important for the functioning of the network is critical. If these relationships do not work well poor performance of the outsourcing contract can follow. What was less clear in the negotiations was the relationship with other parties outside of Hutchison. In the contract several of the sub-suppliers contracts were assumed to carry on and transferred to Ericsson yet none of them could be contacted before contract signing to verify their positive approval. This is partly a technology issue but mostly a relational issue.

Social control (establishment of common cultures and values)

The relational risks relating to the social control dimension can be viewed from several perspectives. On the one hand taking the perspective of the relationship risk in the on-going outsourcing contract, on the other hand, one could consider the relationship within the negotiating team in terms of social control. As the focus of this dissertation is of the on-going outsourcing relationships the case description takes an organizational perspective.

The importance of this aspect seemed clear to both Hutchison and to Ericsson. However, there is little evidence that either party articulated what this aspect could mean for the long-term relationship and the perception of risks. The HR department of Hutchison was involved in the latter part of the negotiations, both as this is required by Australian law but also with expertise on how to handle the transfer of the staff. What is evident from the empirical material is the difficulty (i) to offer consultation with staff when negotiating in secrecy, and (ii) that Hutchison has little influence over social control aspects once the contract is signed. People’s skills and expertise were critical for success however, in practice there were limited possibilities for Hutchison to secure buy-in from key staff prior to signing the contract.
Relational risks as seen by the supplier

Based on the research into outsourcing and the empirical material this author would argue that the relational risks are significant for the supplier. The reason is that activities and resources transferred to the supplier in business critical outsourcing are intimately dependent on cooperation by the outsourcer for the performance of the contract. Should the supplier apply its knowledge and processes in operating the activities, they could then be appropriated by the outsourcer at the end of the contract, or worse, be transferred to another competing supplier of outsourcing services.

Goodwill trust-building (one’s good faith, good intentions, and integrity)

Ericsson had to assess two contradictory experiences in the negotiation with Hutchison. On the one hand, the expressions of a relational and partnership approach by the CTO were confirmed with the actions taken in the negotiation meetings. On the other hand, the approach taken by Hutchison in the 3G contract work was a purely commercial and transactional approach to the relationship. The question was: would the outsourcing contract be a transactional contract based relationship or a genuine partnership? It seems that the CTO was clear in his views of how this type of outsourcing relationship must work for it to be successful. There was genuine concern among the Ericsson team how far this could be transferred to other parts of the Hutchison organization.

Behaviour control (appropriateness of processes)

Negotiating in secrecy and in a few short months did not provide detailed understanding of the Hutchison operation and how details of the contract would ensure good processes and rules of engagement. In this respect the cards were stacked against Ericsson understanding and securing the appropriateness of the contract details. The internal audit by Ericsson during the negotiations demonstrated that Hutchison did not have full control of all aspects of their operations. The empirical material indicates that the team followed the Ericsson OBP process in the negotiations and that risk was assessed as the negotiations were progressing. Negotiating in secrecy reduces the possibility to qualify the appropriateness of the procedures.
Social control (establishment of common cultures and values)

With no or limited possibility of interaction and discussion with staff in Hutchison the Ericsson team was dependent on Hutchison’s HR department for information about staff and how things worked in Hutchison. Ericsson had well developed processes and decision making structures for the outsourcing negotiation. What is less evident in the empirical material is the “softer” side of organizations such as values and common organizational culture.

6.4.4 Summary of relational risks

The data in figure 58, 59, and 60 below displays a summary of the risk mitigating actions taken by the outsourcer (Hutchison) and the supplier (Ericsson) during the Negotiation stage.

**Goodwill trust-building actions**

The Hutchison CTO was championing a relational approach by acting in an even handed way to both Hutchison and Ericsson. The negotiation process started with joint declaration of what each party wished to achieve with the outsourcing contract. The “open book” approach by Hutchison was tempered with evidence of keeping information back by members of the Hutchison negotiating team. Negotiating in secrecy did not provide Ericsson with full insight into all aspects of the Hutchison organization hence it was reliant on Hutchison’s goodwill and relational intent.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions Hutchison</th>
<th>Risk mitigating actions Ericsson</th>
</tr>
</thead>
<tbody>
<tr>
<td>The other party not acting with good intentions (opportunism)</td>
<td>Not keeping promises, Leaking of information, Lying, cheating dishonesty</td>
<td>• Seeking to understand the strategic importance for both parties</td>
<td>• Seeking to understand the strategic importance for both parties</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Hutchison CTO’s actions demonstrations goodwill intent</td>
<td></td>
</tr>
</tbody>
</table>

*Figure 58. Goodwill trust-building actions to mitigate risks*

**Behavioural control actions**

The open book approach to the negotiations was supportive of providing appropriate policies and process for the outsourced operation. Retaining IP was strategically important for Hutchison and efforts were made to document this in the contract. Negotiating in secrecy did not provide...
Ericsson with the possibility to verify the SLAs hence Ericsson relied on the OBP process to evaluate risks and the operating procedures.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions Hutchison</th>
<th>Risk mitigating actions Ericsson</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of decision making processes and accountability</td>
<td>Lack of policies and procedures</td>
<td>Policies and procedures well documented but did not include relationships with other external parties</td>
<td>Joint discovery process to improve understanding of the network operation.</td>
</tr>
<tr>
<td>Information leakage</td>
<td>Inappropriate policies and procedures</td>
<td>Much effort on securing IP and “Chinese walls” within Ericsson</td>
<td>Ericsson OBP provides a framework in support of the policies and procedures</td>
</tr>
<tr>
<td>Loss of staff morale and cohesiveness</td>
<td>Lack of consultation among staff</td>
<td>Concern over staff reaction but limited evidence of explicit actions to mitigate the risks</td>
<td>Concern over staff reaction but limited evidence of explicit actions to mitigate the risks</td>
</tr>
<tr>
<td></td>
<td>Lack of communication</td>
<td></td>
<td>OBP provides process limited support in areas of organizational culture and values</td>
</tr>
<tr>
<td></td>
<td>Poorly handled transfer of staff and redundancies</td>
<td></td>
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**Figure 59. Behavioural control actions to mitigate risks**

**Social control actions**

Ericsson had the possibility to assess the culture of Hutchison through the 3G project. This however, seemed to be at odds with the relational approach advocated by the Hutchison CTO. There was concern over the staff reaction but the very short time to complete the negotiations did not seem to allow any focus on social control aspects such as engaging with the staff to assess their willingness to join Ericsson. The HR teams were involved at the end of the negotiations but seemed mostly focused on the legal aspects of the employment transfer.

**Figure 60. Social control actions to mitigate risks**

The planning for the transfer of staff was primarily driven by legal requirements whilst it was acknowledged that keeping “business as usual” would be critical, especially with the imminent
launch of the 3G network. The notable character of the Hutchison case is the decision to engage only with Ericsson in the formal negotiation process. As the Scoping & Search stage shows, the pressure from senior management in Hutchison Whampoa was significant and the time scale to reduce costs was short. The Negotiation stage of a large and complex outsourcing contract was completed in less than 4 months.

On 2 December 2002 the contract was signed, it was announced that Ericsson would take over 240 people and the network operation of both the 2G and 3G network as of 1 January 2003. The contract was announced to the stock market and the share price of Hutchison Australia jumped by 25%.

### 6.5 Managing risks in the Transition stage

Although the commencement of the contract was 1 January 2003, the signature and information to the Hutchison organization took place in early December 2002. At the same time, the CTO made abundantly clear that the priority was to not lose focus on completing and launching the 3G network by March 2003.

The process of informing all the staff was a challenge as nearly 500 people, of which over 240 would move to Ericsson, would be informed in three cities across Australia at the same time. The message was “some people would be exited, made redundant or their contract not renewed but we still want you to all be focused on launching this 3G network. So it was actually a lot of turmoil to say the least. Hutchison [managers] sat down and talked to all the individuals who were going to be affected.”

The news came as a surprise to most people. “[w]e had a big presentation from Ericsson with a whole bunch of people sat down in a room still not really knowing what was going on. Mostly people were very shocked, mostly people didn’t want to go to work for Ericsson, that was the initial reaction, quite quickly followed by people saying this is actually quite good, this will be great, we’ll get better opportunities within Ericsson” (General Manager Development)

All staff affected were given two letters; one letter of acceptance of the offer of employment on the same terms with Ericsson, and one letter of resignation from Hutchison; the staff had 4 weeks to make their mind up. There was no consultation, only to choose between two options.
Staff from the HR departments of both Hutchison and Ericsson were at hand to speak individually with everyone directly affected: “There were a few that were very angry, but they were angry about the way they thought they were being treated”.

A new unit within Ericsson was established and is known as Hutchison Managed Services (HMS) and all but one person signed the employment letter and became employees of Ericsson Australia.

A new manager was appointed to HMS. He was from outside Ericsson and Hutchison and did not participate in the Negotiation stage. It was thought that HMS should operate as a separate unit within Ericsson. It is a sizeable unit with over 300 staff and multi-million $ profit and loss responsibility. The new manager ran the unit with the contract as the basis however, very soon there were internal disputes with Hutchison and also between Ericsson and HMS. The manager was replaced after 7 months by Bradley Mead from Ericsson. Bradley had been working on the 3G contract and earned the respect of the Hutchison managers. “Brad has been instrumental to navigating the relationship between HMS and Hutchison” (Engineering Manager). Bradley Mead’s role had ultimate responsibility for the operational performance of the network “They’ve given us the keys to the house, where we run their whole business end to end, technically… unless we’re seen as if we are Hutchison, if it’s a purely adversarial customer/supplier relationship, it won’t work” (General Manager HMS). However, HMS is also a strategic partner to Hutchison. This is recognised by the CEO and CTO. “If we fail, Michael[Young] and his small team fail as well. That’s what led me to be invited into the Executive management team at Hutchison.” (General Manager HMS). In other words, an Ericsson employee and supplier to Hutchison sit on the Executive board of Hutchison.

On the contractual side there were also problems that needed resolving during the first year. There were large penalties imposed for not meeting the SLAs and performance measures. Due to the speed of negotiation and that Ericsson did not have access to the organization for a thorough due diligence the HMS team found that many of the performance measures were not possible to achieve. “when you have an alarm on a base station often there is a service level agreement that says that first level fault must be restored or repaired in one hour, so that’s ok we’ll do that. But then you find out it actually takes you 3 hours to drive to the site to find out what’s wrong with it”. The contract gives specific targets and it took the HMS team much effort to find out how the network actually worked rather than how Hutchison thought it worked. “when we actually took over [we found that] all the service
levels were pure slideware, they were what the company wanted, not what they actually did, so then we spent the first 12 months sorting out those SLAs” (Director Outsourcing Engagements).

The person setting the tone of the relationship during the Transition stage was the Hutchison CTO: “Since we signed we do a service level reporting every month, but we don’t talk about penalties anymore because Michael’s [Young] argument now is “if we’re actually doing that then we’re no longer having the relationship we want. If we do then we’ve gone back to a contractual relationship only” (Director Outsourcing Engagements).

The Transition stage started with shell shocked staff who were now working for Ericsson and a visionary Hutchison CTO that believed that it would only work if a positive relationship between outsourcer and supplier could be established. It took many months of hard work from both parties to transition the operation from Hutchison to Ericsson. Several senior people had to leave as they could not mentally make the transition. The time period for the Transition stage was specified in the contract however in practice it was not adhered to. The focus has been on the relationship rather than the contract.

6.5.1 Management of performance risks

The Transition stage applies the same analysis structure the Negotiation stage and the focus is how the outsourcer and supplier manage Performance and Relational risks. It applies the description separately for the outsourcer and the supplier followed with a section that contrast and compares the perspectives on risks between outsourcer and supplier.

Performance risks as seen by the outsourcer

Competence-building trust (high probability of success)

The technological challenge in 3G is integration of the telecom infrastructure with the IT infrastructure. This was recognised by Hutchison. A major driver for the outsourcing deal was to put both technologies under one hat. The critical point was if Ericsson could manage this integration better than Hutchison could themselves: “Virtually the only single organisation which has a complete end to end view of 3G operations,[and] it must be end to end, is Ericsson HMS”. The empirical material demonstrates that HMS and Hutchison spent much time and effort in the Transition stage adjusting the SLAs and KPIs to reality: “Hutchison said we understand the 3G network is not
Ericsson was stating upfront that there were areas (such as IT) where they did not have expertise and track record. The critical factor was change management in the transfer of staff with the required expertise from Hutchison to Ericsson. The dilemma in competence-building is that the objectives are of a technical nature (i.e. operational performance) however, poor performance could come from HMS/Ericsson not managing organizational change well.

Output control (ability to measure outcomes in an objective way) 
Once the network operations were transferred and measured according to the contract SLAs it appeared that Ericsson was not meeting the expected performance criteria. The source of these problems could be traced to unrealistic performance measures in the SLAs and insufficient resources with Ericsson. It is not known the extent to which Hutchison knew that many of the SLAs and agreed performance measures were unrealistic to achieve but significant efforts were made to adjust the SLAs and cost calculations. There were a number of factors that contributed to the network problems: “some of them were Hutchison’s, the additional work they were trying to put on us, but I think the main part of it is that Ericsson had clearly under dimensioned the resources to deliver” (General Manager HMS). The response by Hutchison to this problem was to add additional resources during the Transition stage at Hutchison’s cost. A decision was taken to apply an open-book approach to the profit level of HMS. “We agreed on what was an acceptable margin, and we agreed on all the costs that it takes… it was open book, they knew that we were getting 17% margin” (General Manager HMS).

Hutchison and HMS were able to work through the problems and risks in the contractual agreement to a large extent hence were able to stabilise the relationship and performance of the network. This was done through mutual adjustments and learning-by-doing.

Social control (establishment of common cultures and values) 
The Hutchison CTO identified organizational values and culture as important aspects for the long-term performance success in the relationship. The empirical material speaks of many workshops and discussions between HMS and functions within Hutchison such as sales and
marketing, billing etc. The purpose of these meetings was to create mutual understanding of how the interface would work and the business drivers for each side.

An area that was not addressed directly in the Negotiation stage was the interface to other suppliers and organizations that provided essential equipment and services to the network operation. Some of them were direct competitors of Ericsson. Efforts were made to engage with the other parties with mixed success. The contractual relationships with the other parties were with Hutchison however, the operational responsibility for the relationship was with the Ericsson. This in part caused confusion over who, Hutchison or Ericsson, was taking the lead in the discussions leading to confusion among some of the suppliers and other external organizations. A few of the suppliers threatened legal actions but these were later withdrawn.

Hutchison made efforts to instil understanding of each side’s goals and processes. Many of these processes had never been formalised when the network was part of Hutchison. Although there were issues with some of the external parties it seems that this process was relatively successful.

**Performance risks as seen by the supplier**

Signing the Hutchison outsourcing contract was an important deal for Ericsson. It followed the global strategy of entering the telecom outsourcing market and it had the potential to resolve some of the disputes that made the 3G contract a drain on resources and “poisoning” the relationship with Hutchison. The short negotiating time scale had made it difficult to check facts and information given by Hutchison and limited time was afforded to due diligence before the contract was signed. From the signing of the contract in December 2002 Ericsson had operational responsibility as of 1st January 2003.

**Competence-building trust (high probability of success)**

There are two ways of looking at the competence of Ericsson in running network operations. On the one hand Ericsson is a network equipment supplier and although it has experience of running networks, this is not seen as its core competence. In this perspective there was considerable risk of poor performance. On the other hand, this is an outsourcing contract which would transfer the staff and expertise in running the network to Ericsson. In this way of looking at the risks of poor performance the risk is not in expertise in running network but in expertise
in change management and the process of transferring people and skills from one organization

to another. “typically in a lot of [outsourcing negotiations] Ericsson budget that only 80% will accept. There’s

no guideline to that, but that’s what we were trying to work on at the time. So what that meant was potentially we

have to find contingencies to get another 20% of the workforce” (Director Outsourcing Engagements). In the

event, Ericsson lost only a few people during the Transition stage. In the OBP process there are

policies and steps identified in the Transition stage such as the appointment of a Transition

manager with experience of outsourcing. “We appointed a transition manager who came in November, a

month before we signed the contract. One of the lessons we learned is that person should probably come in much

earlier”.

Although most of the staff transferred across to Ericsson, it became clear that Ericsson had

underestimated the resources required to manage the Transition stage. Although whole functions

and departments were outsourced the interface between departments in the daily work had

moved from an internal and informal decision process to a contractual relationship. A managerial

level where competence building was needed in the transition stage was senior and middle

management from Hutchison “[the] process of having a series of workshops at senior level to open up our

knowledge of both companies has certainly helped that balance”. The responsibility for establishing the new

working procedure of this new interface was the responsibility of the middle managers that

moved across to Ericsson. This job had to be done on top of the day job and Ericsson did not

have sufficient resources in place in support of this work. Ericsson gradually added additional

resources but also received resources from Hutchison to improve and speed up the process.

Another characteristic of telecom outsourcing is that the outsourcer will take on responsibility

for running other companies equipment and networks. In this case it meant that Ericsson could

not make an informed judgment of their own ability to run and manage others equipment. To do

this well there was a strong need to secure co-operation from all the other suppliers on the

network however, the contracts with the other suppliers remained with Hutchison and Ericsson

had limited powers to enforce the contracts.

The empirical material indicates that Ericsson took some actions to mitigate the risks associated

with its competence in running network but struggled in many areas through lack of resources.

Some actions in relation to sub-suppliers were taken but building these relationships would

always be fraught with difficulties.
Output control (ability to measure outcomes in an objective way)

Assessing and negotiating the SLAs and output control was a challenging task for Ericsson. The fast negotiating process, the secrecy surrounding the process, the lack of due diligence before signing the contract all added to the difficulty. It turned out that many of the KPIs and SLAs were far from realistic and impossible to achieve within the frame of the contract.

The empirical material demonstrates several approaches to resolve issues around output control. The approach of applying the contract to the letter by the initial manager for HMS did not work in a circumstance where there were significant gaps between contract and reality. Replacing the initial manager with Bradley Mead was by all accounts a key decision in resolving the problems. The other is the willingness by both parties to focus on the purpose of the agreement, that of running a successful telecom network. An important factor was the pricing of the contract. It was a fixed margin contract rather than a fixed price contract. Brad Mead also insisted that the HMS unit would run with an “open book” process. This allowed Hutchison to see all costs and resources actually required to meet the SLAs and KPIs. The Hutchison CTO decided to increase the resources short-term to get on top of technical and capacity problems to stabilize the network. The SLAs and KPIs were gradually re-negotiated and adjusted to meet actual demand and realities such that by the end of the Transition stage both parties felt they had good and appropriate measures of output.

The KPIs and SLAs were poorly aligned with reality and the contract could easily have been terminated within the first year if the measures of performance were not re-aligned. During the Transition stage both parties worked hard on aligning the contract through building trust and openness between the organizations and key individuals. Ericsson applied flexibility and openness to such degree that it reduced the risks in output measures to a high degree.

Social control (establishment of common cultures and values)

A critical aspect of performance risks that emerges from the empirical material is how the supplier transfers knowledge and understanding between the sales team and the transition team. In commercial organizations more generally there is often a separation between sales and operations, so also at Ericsson. This could be explained by the difference in skills and expertise required to negotiate an outsourcing contract compared to the change management expertise required to successfully transition large groups of people from one organization to another.
There was some recognition of this within Ericsson: "... my role was changed from lead sales to contract commercial manager, and then I became part of the governance. So I continued... there shouldn’t be clean breaks [between the negotiation team and the transition team]" (Director Outsourcing Engagements). This action contributed to continuity in the understanding of the purpose and spirit of the contractual agreement. However, this action did not address the reaction among the people at Hutchison who were asked to transfer to Ericsson. "[Hutchison staff] their option was - come across or be unemployed, but then you need in some ways to be that hard-nosed because they couldn’t have that option of hanging around the company". The issue here was the performance risk if large groups of demotivated staff did not accept the change. It became clear that the approach taken in the Hutchison case was to move very fast: "we had to tell over 500 people in 3 cities at the same time. We didn’t want to tell Sydney and then having them all ring their colleagues in Melbourne“. This shock tactic did work well to the extent that almost all staff decided to transfer to Ericsson however, "One of the things we couldn’t have control over is how they [Hutchison staff] were told because that was Hutchison’s responsibility". It seems that the change management process was thought of as a mechanistic process primarily driven by the legal requirements: "what I didn’t like from Hutch is that they told everyone this is what’s happening, now you’re getting two letters. One is your resignation letter from Hutchison and one’s your acceptance letter from Ericsson. You either sign the Ericsson acceptance or you resign from Hutchison. There was no other consultation" (Director Outsourcing Engagements).

For the individual, they were doing exactly the same job as they did before the announcement hence in the short-term it seems that the new unit (HMS) continued to operate the network in the same way as when it was with Hutchison: "in a lot of ways to the credit of most of the staff, there was very little slackening of their pace or focus. Initially their cultural displacement took a while to recognise, it wasn’t until after the launch [of 3G] that it became an issue...at this point it was now Ericsson’s responsibility.

Some months into the Transition stage the impact of the transfer of staff became apparent. "unfortunately there’s probably been a small group of people that have never really got over the fact that Hutch did this to them... we’ve chosen to exit them because they’re actually continuing to damage the relationship with the customer, but they’re also damaging the culture and the morale within the team" (General Manage HMS).

At the commercial level Ericsson was able to retain good understanding of the contractual agreement and the spirit of the relationship by transferring the sales lead manager to the transition team. This reduced the performance risks to some degree. Giving Hutchison staff 4
weeks to make up their minds whether they agreed to transfer to Ericsson was a device to “shock” people into accepting the formal transfer. However, from a practical point of view, the job of actually managing the change process rested with the senior and departmental managers in Hutchison that transferred to Ericsson. These managers had less than a week’s notice of the change yet had the responsibility to explain the purpose and benefits of the outsourcing deal for their staff. Comments among these managers reveal the challenge this posed and the loss of effectiveness and efficiency it actually caused in the operations once the first shock of the transfer had sunk in for the staff. There were significant risks that the performance of the network would suffer materially and Ericsson was only able to take actions that mitigate the risk to a medium degree.

“Hewlett Packard [an IT equipment supplier] actually had lots of trouble really understanding the concept of what we wanted with a key relationship. We had to de-scope their involvement in the contract” (Director Outsourcing Engagements). Samsung, another supplier to Hutchison, went straight to their lawyers with their own contract with Hutchison in an attempt to stop Ericsson from working with the equipment and network supplied by Samsung. The Samsung situation was only partially resolved two years after the signing of the agreement.

### 6.5.2 Summary of performance risks

The data in figure 61, 62 and 63 below displays a summary of the risk mitigating actions taken by the outsourcer (Hutchison) and the supplier (Ericsson) during the Transition stage.

**Competence trust-building**

Ericsson had been open with the fact that they did not have expertise in all areas of the outsourced operation and although whole functions had been transferred performance was suffered in the Transition stage. The solution from Hutchison was to add short term resources. Ericsson did their best to secure key staff in the transition process in what was a fast paced transfer of staff from Hutchison to Ericsson.
Unwanted events | Causes of the unwanted events | Risk mitigating actions | Risk mitigating actions |
--- | --- | --- | --- |
Hutchison | Ericsson |
Loss of core competence | Lack of expertise | Fast paced transfer of the staff from Hutchison to HMS | Securing key staff in the employment transfer process |
Low adoption rate of new technology | Lack of competence | Adding additional short-term resources in response to poor performance of the supplier | Workshops to increase internal understanding of Ericsson |
Dependence on the other party | Over promising | |

Figure 61. Competence trust-building actions to mitigate risks

Output control actions

A major issue in the Transition stage was the poor alignment between the SLAs and KPIs in the contract. Both Hutchison and Ericsson showed willingness to adjust the SLAs and other contractual obligations. The approach of open book accounting provided Hutchison with insight into the financial consequences of the contract and any adjustments.

Unwanted events | Causes of the unwanted events | Risk mitigating actions | Risk mitigating actions |
--- | --- | --- | --- |
Hutchison | Ericsson |
Not meeting contractual performance levels | Misaligned budget planning | Adjustments of KPIs and SLAs to the reality of the situation | Acknowledgment that the contract KPIs did not correspond to reality |
Hidden costs | Poorly designed SLAs | “Open book” approach | “open book” accounting to ensure transparency and remove hidden profit motives |
Poor quality performance data | | Mutual flexibility to accommodate changes | Focus on achieving good network operation rather than contractual agreements |

Figure 62. Output control actions to mitigate risks

Social control actions

At the end of the Transition stage both parties began to address some of the organizational cultural aspects such as re-alignment of individual score cards and goals. This was however a slow process and those staff who found it difficult to adjust gradually left the organization.
Unwanted events | Causes of the unwanted events | Risk mitigating actions | Risk mitigating actions
--- | --- | --- | ---
Loss of staff morale and cohesiveness | Unclear vision and purpose of the outsourcing decision | Workshops to understand goals and objectives | Keeping key individuals from the sales team to transfer into the operational team after contract signing
 | Unclear goals broken down to operational sub-levels | Meetings and discussions establish performance criteria and processes | Short and decisive process to achieve high acceptance of transfer employment to Ericsson
 | Lack of communication | | Removal of staff who could not adapt to the new situation |  

Figure 63. **Social control actions to mitigate risks**

The big challenge for settling in the new organization was laid at the door of the functional and departmental managers who transferred across from Hutchison. They had to quickly assimilate the Ericsson way of working and implement the changes needed. On the Ericsson side the initial GM for the HMS unit did not work out and the decision to replace him had an important impact on developments during the Transition stage.

### 6.5.3 Management of relational risks

Words such as trust and relationship were used by all parties and individuals in the Hutchison case. It seems that the vision of the Hutchison CTO was successful in keeping this spirit over the first 2 years of the contractual relationship. However, it was not always plain sailing and the first 7 months were difficult until a new manager took over management of HMS. The analysis of how the parties managed the relational risks is illustrated with quotations and description of events.

**Relational risks as seen by the outsourcer**

*Goodwill-building trust (one’s good faith, good intentions, and integrity)*

[The transition] “we did rush it very fast. That was a drawback because a lot of things were not clearly identified up front when people were moved into the new organisation. People didn’t know fully what their roles were, people didn’t know what their responsibility was to Ericsson vis-à-vis Hutchison” (Engineering Manager).

For the individuals in the new HMS unit their jobs were at stake. Ericsson would need to reduce overall costs to deliver the costs savings they had promised Hutchison. There was also the issue
of duplication between the 2G and 3G networks: “A lot of political lobbying, a lot of backbiting, that sort of stuff, they had to because they were fighting for their future [jobs], of course”. The issue of trust was critical. “On their side Michael [Young] actually at one stage went overboard to try and give extra benefits to Ericsson to promote that trust, and what he expected back in return… Bradley Mead on the other hand went overboard backwards to do things as well” (Engineering Manager). Many times what the contract said and the financial consequences were put aside by both parties in an attempt to create trust and to focus on the operational success as a means to manage the relationship. After the initial period and a change in manager at HMS the relationship recovered and a more trusting relationship developed.

The unit of analysis is the organizational relationship and actions such as not referring to the contract at all times built a level of organizational trust and goodwill. The behaviour of Hutchison’s CTO and reciprocated by the new HMS manager Bradley Mead seemed to contribute to reduced risk of bad faith and untrusting acts.

**Behaviour control (appropriateness of processes)**

Two aspects of processes in the Transition stage can be identified. One is the period just after the outsourcing deal was announced and another is the on-going management of the relationship. The negotiations had drawn up who would go with Ericsson, who would stay with Hutchison and who would be made redundant. “there were some people that had staff working for them that weren’t part of either or any of those, and they handed out letters to distribute to their people all on the same day”. Many people continued to struggle with the ideas and reasons for outsourcing during the Transition stage. Managers in HMS spend a lot of time with individuals and teams to align interests and understanding of the job at hand. One estimate was that HMS was only 30% effective the first 12 months after the deal. Gradually, as the new organization settled in there has been progress on aligning both the internal goals and the goals with external parties. “We aligned our scorecards to their scorecards, so there has been a fair bit of time and the data results show that we have improved on the staff of where their goals are, where they’re heading to, how they align their goals with the success of Ericsson” (Engineering Manager).

The second aspect was the governance process of the contract: “There is two levels of governance, a formal governance meeting that’s held one a week or once every two weeks as required. That just puts the issues that are occurring between the two companies on the table and tries to reach a resolution, puts the action points in
place”. In practice there were daily contacts, discussions and resolution of problems and unforeseen issues. At the corporate level the relationship has developed an informal decision making system in parallel with the formal governance system.

“it’s [decisions and disputes] really decided outside the formal meetings, the formal meetings are just to formalise things and document things basically.” (Engineering Manager). In practice, many decisions were taken informally between Bradley Mead from HMS and the CTO and CEO at Hutchison. The decisions were then ratified at the governance meetings.

Time and effort was spent negotiating the contract down to detailed level of procedures and performance measures. However, the reality turned out to be different. It seems that a lot of the detail in the procedures and SLAs were either not understood by the negotiating parties, or it was not possible to assess them in the short negotiating process. The pragmatic approach taken during Transition was to be flexible, to trust the other party and to adjust when that made sense.

Social control (establishment of common cultures and values) “we all sat in a room, all the managers that were involved, and we sort of had a telling day where Shane and Russell Gill and a couple of others all stood in front of us and explained what the process was going to be and what the end organisation transition to organisation was going to look like (General Manager Operations).

A telecom network is a 24/7 operation requiring fast decision making in operational situations: “in this particular environment it was a matter of establishing HMS with staff that were from the [Hutchison] organisation. Normally you bring the suppliers staff in and it takes a long time for you to get the culture of the carrier” (Engineering Manager).

In the negotiation there was consideration of organizational culture and process during the announcement of the outsourcing deal: “the idea was that [people] shouldn’t feel much different because you’re still doing the same job and you’re still in the same area and the only difference is you get a paycheque with the word Ericsson written on it” (General Manager Operations). However, this underestimates people’s reaction to being pushed to change employer. In some cases, the person at the next desk is changed from a colleague to a customer overnight “In reality it was a totally different environment. The people that were Hutchison now treated you differently, they treated you as some external organisation that had to deliver” (Engineering Manager). Asking individual staff it seemed the jury was out on the merit of the
outsourcing deal for them personally: “There seem to be a lot of people in the HMS group are still unsure whether it is a good thing or bad thing after two years, only time will tell” (General Manager Operations). Although culture and trust was an area of importance the empirical material suggests that the reaction among staff was underestimated, certainly the time it takes to settle down and integrate people into a new organization.

**Relational risks as seen by the supplier**

Goodwill-building trust (one’s good faith, good intentions, and integrity)
The CTO of Hutchison had been very clear that he wanted close collaboration and a partnership relationship between Hutchison and the HMS unit. His actions during the negotiation stage gave Ericsson confirmation of the sincerity in the approach. The challenge during the transition stage was how the spirit of goodwill and trust could be transferred to the rest of the organization and what Ericsson could do to facilitate the process.

Building goodwill and trust takes place at different organizational levels and at internal and external interfaces. The empirical data shows that mutual adjustment was used to build goodwill and trust: “when Hutchison changed their CTO, Ericsson changed the HMS manager at the same time, a quid pro quo for the two companies to get rid of the two people” (Director Outsourcing Engagements). The initial appointment of the HMS manager was agreed by both Hutchison and Ericsson. The principle applied was to appoint a person from the outside, someone who would be independent and run the HMS unit as a separate entity. This approach turned out not to work well. “He came in to a 300+ organisation, multi million P+L. He was the CEO if you like of one of our major companies in Australia, because of the size, and he ran it as if it was his own company, with no regard for Ericsson or Hutchison. He had no linkage back into either company” (Director Outsourcing Engagements).

After seven months Ericsson appointed a new HMS manager. With the relationship not going in the right direction, a new start was required: “I have to instil in my team whilst we’re Ericsson, we’re providing a managed service, we have to demonstrate that we’re managing Ericsson as a vendor appropriately, like we have to manage Alcatel, Logica, CMG, we manage all the support agreements and the supplier agreements on Hutch’s behalf and my view is we have to demonstrate that especially well towards Ericsson” (General Manager HMS). An important interface for HMS was with the suppliers of equipment in the network. Their co-operation was required for technical support and services of their equipment. The legal
contract with the sub-suppliers were with Hutchison but HMS was the operational party, and to carry out that role HMS needed detailed technical and performance data from what were effectively the main competitors of Ericsson: “Under no circumstances are we to disclose anything internally within Ericsson about [Hutchison’s] architecture of their content and apps, or the strategy for what’s coming with new content, and how we practically do it” (General Manager HMS).

At the corporate and senior management level it seems that Ericsson have taken actions to build goodwill trust. This should be balanced with the way the outsourcing deal was announced to the staff and the process of communicating and engaging staff in the process. The empirical material makes clear that Ericsson had limited means to build goodwill relationships with the sub-suppliers.

**Behaviour control (appropriateness of processes)**

Much focus in the negotiation was on the KPIs and SLAs. Time was also spent designing the governance process. In this respect the Ericsson OBP process had specific requirements regarding governance in the transition and operational stages of an outsourcing agreement.

A feature of large outsourcing relationships is that what was once an internal interface managed through the hierarchy is transformed to a customer-supplier relationship. This is a substantive change yet there is no visible sign of the change. “It took a little while for some of those managers to understand what outsourcing had done. Some of the interfaces are exactly the same people, and they’re sitting in exactly be same seats, they didn’t change, but their ownership changed.” What was critical was that new procedures and policies had to be worked out and agreed among middle managers that had not been involved in the contracts negotiations. Different people reacted differently to challenge. “Initially some other managers in Hutchison switched, well you are no longer my colleague you are now my supplier and they approached them differently. It is very funny psychologically how they did that, so we had to help them reverse that.” (Director Outsourcing Engagements).

At the contractual level there were many things that were not specified in detail: “I was then converted to the contracts and governance manager and Hutchison had another person in there called Bill Miller. Bill was the governance manager from Hutchison. Initially we clashed a lot, however, we fought through it… We both recognised the importance of the relationship...we were actually fighting over what was particularly important to our companies” (Director Outsourcing Engagements).
At the senior level the new HMS manager changed the approach to governance and the relationship. The role of the General Manager for the HMS unit is challenging: “I've got lots of masters and that's probably one of the interesting and challenging parts of the role. First it is Kevin Russell who's the Hutchison Australia's CEO, I sit on his weekly management team meetings, so I'm part of his team. We also have a governance process for the managed service which has a mini board that I have to report to and have representatives from both sides” (General Manager HMS).

The outsourcing contract has created a strong operational dependence between Hutchison and Ericsson. The GM of the HMS unit personified this aspect of the relationship: “I talk to him (CEO of Hutch) almost, probably not daily, but 4-5 times a week. Often he won't ring me in real time when the outage is going, he'll ring me afterwards” (General Manager HMS).

It seems clear from the empirical material that many policies and procedures where either lacking or not defined in the contract. The roles of managers transferring to HMS were unclear and they had to resolve issues and design procedures themselves to make the relationship work. The Ericsson global transition team is most likely very experienced however it came as a surprise how the transition process would be handled. However, at the individual level key managers in Ericsson and HMS were instrumental in working through the first 12 months of the contract. The views from both Ericsson and Hutchison suggest the outcome of the transition has been successful.

Social control (establishment of common cultures and values)

From one day to the next 240 people changed their employment from Hutchison to Ericsson. The question it raises is the extent to which Ericsson took corporate culture into account and the actions taken to mitigate the relational risk through social control. Firstly, the culture of each organization was different: “We definitely had a difference in culture between the ways both companies operate” (Director Outsourcing Engagements). Hutchison is a relatively young company in a fast growing industry, a company with strong entrepreneurial spirit. Ericsson has a long history with a strong emphasis on process and procedures. The initial GM for HMS was from outside Hutchison and Ericsson and struggled with the relationship and the cultural difference. The approach was to create a new and independent organization: “During the transition phase we did, again a learning we did, we let cultural conversion slip a bit, and that was partly because we had the New GM coming in as the head, who tried to move the organisation as a separate entity from either of the two companies…"
that confused a few people, because culture is really led from the top person” (Director Outsourcing Engagements). Once Brad Mead replaced the initial GM a set of workshops where arranged to begin to address the issues that the transition raised about policies and procedures but also relationships and organizational culture: “A learning is that we left that a little late.”

For Hutchison the stages in an outsourcing relationship came somewhat as a surprise. “I had been working day and night with their guys for months [on the contract], and suddenly there’s a new team of people [in the transition]. The way it was seen is that we had the two teams interfacing each other, then suddenly there’s this new group and we were the people they had dealt with and developed the trust and relationship with…we didn’t explain to the customer properly what this transition phase was, how we’re really going to manage it” (Director Outsourcing Engagements). Ericsson had a global team of experienced transition managers that ran the transition stage: “we completed the transition phase and the transition manager moved on. Again, then suddenly, as far as Hutchison were concerned, this person was gone. So this transition team came and went” (Director Outsourcing Engagements).

Ultimately, HMS is an Ericsson unit and management control was gradually achieved, “There was a conscious programme at the time where Ericsson staff were moved in and for 2 years now I think probably of all the senior managers, most of the senior managers bar one has been replaced.” (Engineering Manager).

However, the GM of HMS summarizes the importance of the relationship. “They’ve given us the keys to the house, where we run their whole business end to end, technically. We have to have interfaces into sales and marketing, finance, unless we’re seen as if we are Hutchison, if it’s a purely adversarial customer/supplier relationship, it won’t work” (General Manager HMS).

The initial choice of selecting a GM for HMS from outside of both Hutchison and Ericsson seems to have been the wrong strategy. There was recognition that the cultures of the two companies were different but there is limited evidence that this was initially taken into account. With the new GM of HMS this is gradually being addressed. Replacing key managers is one way of achieving an Ericsson like organizational culture and after the first 12 months the situation was improving after a shaky start.
6.5.4 Summary of relational risks

The data in figure 64, 65, and 66, shown below displays a summary of the risk mitigating actions taken by the outsourcer (Hutchison) and the supplier (Ericsson) during the Transition stage.

Goodwill trust-building actions

The performance in the Transition stage was initially not going well. Relationships with Hutchison were strained but also between HMS and Ericsson. The response by Ericsson was to replace the GM with a manager that had the respect of Hutchison. Hutchison on the other hand added resources and did not insist on the contractual terms when SLAs where not met. As goodwill building action but also to ensure strategic alignment between HMS and Hutchison the new GM was invited to join the Hutchison executive team.

<table>
<thead>
<tr>
<th>Unwanted events</th>
<th>Causes of the unwanted events</th>
<th>Risk mitigating actions</th>
<th>Risk mitigating actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>The other party not acting with good intentions</td>
<td>Not keeping promises</td>
<td>▪ CTO offers support to Ericsson on and above</td>
<td>▪ Replaces initial GM of HMS unit</td>
</tr>
<tr>
<td>opportunism</td>
<td>Leaking of information</td>
<td>contractual obligations</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Lying, cheating dishonesty</td>
<td>▪ Additional short-term resources added by Hutchison.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Invites GM of HMS to management team of Hutchison.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>▪ Open book approach to costs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>▪ Change people that do not fit with the new set-up</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>and strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>▪ Reciprocal actions</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>▪ Creation of separate unit to safeguard important</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>information</td>
</tr>
</tbody>
</table>

**Figure 64. Goodwill trust-building actions to mitigate risks**

Behavioural control actions

Led by the Hutchison CTO, many policies and procedures were changed at the end of the Transition stage through mutual adjustment. One action which supported a transfer of understanding from the Negotiation- to the Transition stage was the role for sales lead that continued as contracts manager. In general, the change in staff on the Ericsson side from sales though the transition teams and finally the operational team was disruptive but some actions were taken to reduce this problem.
Unwanted events | Causes of the unwanted events | Risk mitigating actions Hutchison | Risk mitigating actions Ericsson
---|---|---|---
Lack of decision processes and accountability | Lack of policies and procedures | • Willingness to change and alter policies and procedures that were not effective | • Sales lead manager continued as contracts manager during transition • Workshops with managers that transferred from Hutchison
Information leakage | Inappropriate policies and procedures | Unclear roles and responsibilities | |

**Figure 65.** Behavioural control actions to mitigate risks

**Social control actions**

Eventually, actions to create understanding of the goals and strategies for the new HMS unit took place. But there is general acknowledgement this was reactive rather than planned actions. Gradually, Ericsson replaced managers to align the culture of a service organization with strong interdependencies with Hutchison.

Unwanted events | Causes of the unwanted events | Risk mitigating actions Hutchison | Risk mitigating actions Ericsson
---|---|---|---
Loss of staff morale and cohesiveness | Lack of consultation among staff | • Replace individuals whose behaviour does not build trust and goodwill. • Continued communication, especially at the lower level of the organization | • Workshops among managers to discuss the reasons for outsourcing • Gradually replacing key managers with Ericsson managers
Lack of communication | Poorly handled transfer of staff and redundancies | |

**Figure 66.** Social control actions to mitigate risks

The announcement and subsequent shock to the Hutchison staff may have been necessary for legal reasons. However it took time and was a gradual process to win the hearts and minds of many of the employees. The credit for any success must go the individual manager’s leadership and resilience in managing a very complex and difficult situation.
6.6 Summary of the Hutchison – Ericsson case

Although this was not the first outsourcing contract in the Telecom industry it was one of the first where the whole network operation, engineering and development were outsourced, and outsourced to an equipment supplier at that. Such a decision is of high strategic significance since the network is core to the operator and importantly, it is critical for the innovation and delivery of new services and products. Whilst it is strategic and business critical the operator may take the view that it is not its core business to run the network but to offer innovative and competitive services to its customers. This is the fundamental decision underpinning this case. Once this decision is reached the question becomes who can run the network in the most efficient and cost effective way, Hutchison or an external service provider? With the general pressure on costs from the parent company Hutchison Whampoa the stage was set for an outsourcing decision.

On initial inspection the decision to outsource the running of the network seems bold and the risks substantial, however, on further inspection it seems that provided a few fundamental pre-requisites are adhered to, the benefits may exceed the risks. It has not been possible to verify the financial savings as the network is continually growing with a cost plus price for the resources needed to deliver the quality and performance. One aspect that stands out in the Hutchison case is the decision to outsource the whole network to one supplier. This is in contrast to research by Lacity et al (1996) and Cox et al (2002) who suggest that short multi-vendor contracts are the preferred choice in outsourcing. Another aspect that stands out is the strong emphasis on a collaborative approach in the negotiation stage leading to the willingness to show flexibility and joint problem solving in the Transition stage. The empirical material indicates this approach was driven by the experience and philosophy of the Hutchison CTO and the evidence suggests that this was the right approach and ensured that the contract survived past the transition stage despite many and difficult problems to overcome. In a very similar tone to the TSIC case it is notable that the mutual respect the parties refer to the relationship that governs the actual working of the contract.
Part 3  Analysis, discussion and conclusions

Part 3 of the thesis is divided into three sections. Chapter 7 is a cross case analysis and discussion of the cases followed by Chapter 8 which discusses findings and propositions linked to the purpose and research questions in Chapter 1. Chapter 9 brings together insights and learnings from the thesis and discusses additional findings from the research on and above the specific research questions. The final part in the chapter discusses implications for practice and suggestions for future research.
7 CROSS CASE ANALYSIS AND DISCUSSION

The purpose of the cross case analysis is to compare and contrast how the outsourcers and suppliers perceive and endeavour to mitigate risks in the TSIC and Hutchison cases. The analysis follows the structure of the analysis model and the discussion highlights the actions taken in the three stages covered in the research. The first part discusses the Scoping & Search stage from the perspective of the outsourcer and the second part discusses the Negotiation and Transition stages from the perspective of both outsourcer and supplier.

7.1 Cross case analysis of the Scoping & Search stage

The cross case analysis of the Scoping & Search stage discusses the decisions the outsourcer takes to mitigate risks in preparation for the formal negotiation with suppliers for an outsourcing contract. The section follows the analysis model and is divided into two sections: (i) what activities should be outsourced and what should stay in-house (the scope); (ii) the search process.

7.1.1 What should be outsourced and what should stay in-house

The scope of an outsourcing deal is strategic in nature as it creates a new boundary with the external environment and there is a need to ensure effective and efficient interfaces between the outsourcer and the supplier. On the one hand, to ensure high performance of the outsourced activity sufficient knowledge and skills must be transferred to the supplier. On the other hand, retention of sufficient knowledge of and control over the outsourced activity to reduce dependence and the possibility of opportunism by the supplier (McIvor, 2003).

Physical and Human Asset specificity

The Scoping & Search stage displays a concern for opportunism and asset specificity in the TSIC and the Hutchison cases. In both cases the network infrastructure was excluded from the outsourcing deal because it was considered core to the business and displayed high physical asset specificity. This suggests a decision that follows transaction costs logic (Williamson, 1975, 1985). The argument is that the physical network assets have higher specificity and hence transaction costs compared with the estimated cost savings from outsourcing the physical network. On this point it should be noted that owning the network infrastructure is not an absolute requirement.
for a telecom operator. The comments by the VP and Head of Networks at TSIC “we use the same [cable] trench and site masts [as our competitors] and these assets are becoming a commodity” highlights that asset specificity is not constant but changes over time. In other words the competitive landscape is shifting also for the physical network assets in the cases. A trend in recent years has been the development of mobile virtual network operators (MVNOs). These operators buy wholesale telecom capacity and offer it directly to end-users, often through companies with strong brands such as Virgin Mobile and Tesco Mobile. This trend coincides with the comments made by the Operations Director at Telfort Mobile: “the network is core to our business, but it is not our core business. Marketing and development of mobile services is our core business” (ibid). It seems there is a shift in the value adding activities in the value chain in the telecom industry and different players take different strategic positions in the value chain. Nevertheless, at the time of the research, the perspective taken in the two cases and the pilot case was that the network had high asset specificity and the risk mitigating action was to not outsource the network.

However, there appears to be a difference in perception of asset specificity with reference to human asset specificity. In both the TSIC and Hutchison cases it was primarily people rather than physical assets that were transferred in the outsourcing deal. The pattern that emerges in the cases is that managers seem to make a distinction between physical assets that have legal ownership attached and human assets who are free to decide if they want to stay with the supplier after the outsourcing contract is signed or to leave and move to another employer, possibly a competitor. It seems that physical and human assets have important asset specificity properties in business critical outsourcing but differ in the outsourcer’s perspective on the transaction costs associated with asset specificity. In fact it could be argued that human asset specificity is even more troublesome in its uniqueness and idiosyncrasy than physical assets. Physical assets can be described and valued in the balance sheet whereas human asset specificity is not only about competence, knowledge, experience and learning-by-doing (Williamson, 1991) but also about routines and processes (Nelson, 1995). The latter can conceivably be codified and detached from the individual member of staff but not the former. In the contractual documents of the two cases, there is no evidence that this type of human assets is either described or the ownership of processes and routines regulated. The risk mitigating actions are summarised in the figure 67 below.

26 Virgin Mobile is a UK division of the Virgin Group, owned by Richard Branson
27 Tesco is the UK’s largest food retailer
<table>
<thead>
<tr>
<th>Transaction cost drivers</th>
<th>Physical assets</th>
<th>Human assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk mitigation TSIC</td>
<td>Keep network infrastructure in-house</td>
<td>Transfer staff to the supplier but keep key people in-house to: 1. Retain knowledge and expertise 2. Monitor the performance of the supplier</td>
</tr>
<tr>
<td>Risk mitigation Hutchison</td>
<td>Keep network infrastructure in-house</td>
<td>Outsource whole functions and department</td>
</tr>
</tbody>
</table>

**Figure 67. Transaction cost drivers – physical and human assets**

The analysis shows that TSIC and Hutchison took the same decision regarding the physical network assets but a different decision regarding the human assets. The decisions suggest that TSIC put emphasis on dependence and opportunism to mitigate risks whereas Hutchison considered the high degree of complexity and business criticality in the activity and transferred whole functions and departments to ensure high performance of the outsourced activity.

**Asset specificity and opportunism**

Business critical outsourcing by its nature results in outsourcing activities which includes people and competences with human asset specificity. The approach taken by TSIC was to retain key staff in-house, partly to retain knowledge and expertise but also to monitor the performance of Ericsson and safeguard for opportunism at the end of the contract period. Ericsson has a long historical relationship with TSIC and TSIC is a large and important customer for Ericsson’s future sales in the Nordic region, and the TSIC managers make reference to the fact that the business relationship is important for both parties.

Hutchison on the other hand transferred whole departments and functions and had little remaining expertise in-house that could run the network. With no contractual agreement on how to regulate the return of specific expertise and knowledge there seems to be opportunities for hold-up situations at the end of the contract (Lonsdale, 2001). There is no description in the empirical material on how expertise and key employees are regulated in the contract and limited evidence of risk mitigating actions taken by Hutchison to reduce the transaction costs related to human assets and opportunism. It seems that the approach by the Hutchison CTO was to use organizational trust as a means to manage and reduce the risk of opportunism rather than contractual obligations. Only time will tell whether this is a sustainable approach.
As part of retaining the network in-house Hutchison retained the decision power for purchases of any new equipment for the network operation, short-term resources etc. Hutchison was seeking to regulate the information flow between the outsourced operation and the supplier, the creation of “Chinese walls” and ring fencing of the outsourced operation.

<table>
<thead>
<tr>
<th>Transaction cost drivers</th>
<th>Asset specificity and opportunism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk mitigation TSIC</td>
<td>• Keeping competing supplier for small part of the outsourced activity</td>
</tr>
<tr>
<td></td>
<td>• Short contract periods with break clauses</td>
</tr>
<tr>
<td></td>
<td>• TSIC is a major customer of Ericsson with long-term potential for future sales</td>
</tr>
<tr>
<td>Risk mitigation Hutchison</td>
<td>• Retaining the responsibility for the decisions regarding purchase of new equipment.</td>
</tr>
<tr>
<td></td>
<td>• Policy and rules for information transfer between Hutchison and Ericsson, and Ericsson internal organization</td>
</tr>
</tbody>
</table>

Figure 68. Transaction cost drivers – assets specificity and opportunism

Asset specificity and dependence

Also in this aspect the two cases differ in the approach to risk mitigation. TSIC’s managers had concerns with the loss of in-house knowledge and expertise and decided not to transfer all the staff involved in the outsourced activity to reduce dependence. Retaining a competing firm for a small part of the field service operation was one another way to reduce dependence of the supplier. On the other hand, the VP and Head of Networks at TSIC acknowledged that over time the supplier would have more knowledge and possibly at some point dependence could be the result. The contract was structured in short periods with break clauses which provided a “get-out” clause after a short time. However, in the TSIC case Ericsson was charged with the responsibility for creating an information and data handling process that captured all the costs of the field service activities. This system is specific to this contract and to the knowledge of this researcher the ownership is not specified hence a potential asset is being created which could make TSIC dependent on Ericsson.

In the case of Hutchison the termination of the contract is described but does not describe how human assets should be treated. With limited in-house knowledge and expertise the result could be dependence on Ericsson for vital parts of the delivery of mobile services and products at the end of the contract period. Today, Ericsson runs the technical infrastructure end-to-end for Hutchison and it is difficult to see how this can be taken back without impact on the level of service and quality of the network. The approach of Hutchison to the dilemma of transferring
knowledge was to insist on the retention of current and future intellectual property of the network operation.

<table>
<thead>
<tr>
<th>Transaction cost drivers</th>
<th>Asset specificity and dependence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk mitigation TSIC</td>
<td>• Keeping competing supplier for small part of the outsourced activity</td>
</tr>
<tr>
<td></td>
<td>• Short contract periods with break clauses</td>
</tr>
<tr>
<td>Risk mitigation Hutchison</td>
<td>• Retention of IP related to the network operation</td>
</tr>
</tbody>
</table>

**Figure 69. Transaction cost drivers – asset specificity and dependence**

This research has not been able to establish the reason for the difference in treatment of human assets but possible explanations in the Hutchison case could be that the Hutchison case had a higher degree of complexity compared with TSIC.

**Technological uncertainty**

Technological uncertainty is analysed in terms of the risks of loss of future technological requirements, technology diffusion, and appropriation.

TSIC took actions to secure that an outsourcing deal would not jeopardise future technological requirements. One action was to keep in-house expertise. Another was to select an equipment supplier rather than a “traditional” field service supplier where the argument is that equipment suppliers by their nature are at the forefront of technology. Field service companies are good at fixing equipment rather than developing the next generation of kit.

In the case of Hutchison it seems that one goal with outsourcing was to secure leading edge knowledge within a fast moving and complex technological environment. A technological shift was taking place with the development of 3G technology and Ericsson was at the forefront of this development. The scale and financial resources to stay at the technological forefront may not in the long-term be viable for a mid-sized telecom operator such as Hutchison. Therefore it is notable that Hutchison emphasised the retention of IP in the contract negotiations. The dilemma this exposes is the recognition that losing control of the technological development could be detrimental in the long run whilst economies of scales and sheer scale of development

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28 Further evidence of this point is the merger of Vodafone and Hutchison Australia in 2009
resources means only the largest telecom operators can keep all the technological knowledge in-house.

**Technology diffusion**

In this respect it seems the risks of technology diffusion is relatively low for TSIC. Field service operations may be business critical but are not by themselves high technology operations. The knowledge that is transferred is probably not a major risk should it leak to competitors of TSIC.

For Hutchison technology diffusion may turn out to be a future issue should the technological insights be diffused within Ericsson and applied to competitors of Hutchison. The approach to mitigating the risk of technology diffusion was to regulate transfer and ownership of IP in the contract. However, technological insights in this research are intimately connected to people. Therefore, there is every possibility that Hutchison may not have access anymore to many of the critical people and resources to run the network at the end of the contract. In the same way as the staff were asked to transfer to Ericsson with no guarantee that anyone would take the offer, the same situation applies if Hutchison decides to take back the network operation in-house. The legal position would require the cancellation of the outsourcing contract which does not stipulate that certain people should transfer their employment to Hutchison or to another supplier who may take over the contract. In fact, the situation could be even more difficult should the contract be transferred to another supplier, and competitor of Ericsson. Why would Ericsson willingly let go of valuable competence and resources that may have productive use elsewhere within Ericsson? It should be said however, that there are very clear rules for confidentiality of information between the Hutchison Managed Service unit (HMS) and the rest of the Ericsson organization. What such an agreement cannot regulate is the knowledge and competence that resides in people.

The combination of human asset specificity, dependence and technology diffusion creates transaction costs and the question this raises is how difficult and costly it would be for Hutchison to take back the running of the network from Ericsson at the end of the contract. The dependence this creates raise the question, is this an outsourcing contract or a sale of the network operation (Bleeke and Ernst, 1995)?
Appropriation risks

It is notable that in both bases the price level was communicated before formal negotiations commenced. This means that competitive bidding was not the process used to established the lowest price, however, it meant that both parties had the opportunity to make a first assessment of the likelihood that a deal could be reached. Once the price level had been assessed the appropriation risk was down to the pricing mechanism used to regulate the cost of the outsourced activity and how risk was shared between outsourcer and supplier.

The TSIC contract stipulated a cost per field service call out based on a predicted volume. This transferred the volume risks to Ericsson whilst offering a conversion from fixed to variable costs for TSIC. Should the volumes be high Ericsson would make more profit whereas TSIC would not benefit from the volume effect. On the other hand Ericsson would lose profitability in the case of low volumes, which in fact was the case in the early part of the contract. The contract provides low risk/low return for TSIC and higher risk/higher return for Ericsson. This seems a fair and equitable split of the rents and reflects the difference in risks for each party. Should either party not be satisfied with the profits and benefits received there is the possibility to give notice to terminate the contract. The TSIC contract structure in three steps, 6 months transition (trial), 2 year operation, 1 year extension provides the option to break away from the deal relatively easy.

In the Hutchison case the contract was a fixed margin contract hence Ericsson received an agreed margin on the resources and costs of running the network. The contract is a 5 year contract plus 2 year optional extension with a shared incentive scheme for improvements in efficiency and service levels\(^{29}\). The contract was run on an open book basis where Hutchison had full visibility of the underlying costs. The cost with a mark-up was passed on to Hutchison hence Hutchison stood the risks of higher relative costs in case of lower volumes. In the event of higher volumes it would be exposed to the time lag to increase resources to a new level of network capacity in a similar way as if the network was run by Hutchison. In the Hutchison case the risks were born primarily by Hutchison and limited risks born by Ericsson.

\(^{29}\) Hutchison contract Rev M. Source: Document (E78)
Figure 70.  Transaction cost drivers – technological uncertainty

### 7.1.2 The search process

The empirical data shows similar actions in the search process by the management teams in TSIC and Hutchison meet the goals of cost reductions by the stipulated deadline. The data suggests that the risk of not delivering a cost reduction plan by the deadline set by the company executives frames the perspective on risks. The parent company executives did not specify that outsourcing was the solution but that cost reduction targets had to be met. The analysis and discussion of the search process applies the analysis model as described in chapter 2.9.2. Based on the empirical data the figure 71 below summarises the risk mitigating action taken by TSIC and Hutchison.

The management teams in TSIC and Hutchison faced the same dilemma. On the one hand parent company management had set clear goals for cost savings and a deadline to meet them. On the other hand engaging with several potential suppliers in formal negotiations would be costly and take time, probably longer time than the deadline set by parent company management.

The analysis shows that TSIC and Hutchison took the same actions to meet the goals set. The most fundamental decision was to not issue a formal RfP to several potential suppliers but to consider engaging in single-source negotiations. This decision was underpinned by clarifying the cost savings before starting formal negotiations. In the TSIC case they stipulated the minimum cost savings to Ericsson and in the Hutchison case Ericsson offered a level of cost savings to

<table>
<thead>
<tr>
<th>Transaction cost drivers</th>
<th>Risk mitigation TSIC</th>
<th>Risk mitigation Hutchison</th>
</tr>
</thead>
<tbody>
<tr>
<td>Future technology</td>
<td>Select a supplier</td>
<td>Outsourcing to a supplier offered access to expertise at the technology frontier, especially important in the context of technology shifts</td>
</tr>
<tr>
<td>Technology requirements</td>
<td>category which</td>
<td></td>
</tr>
<tr>
<td></td>
<td>operates at the technology forefront (e.g. equipment suppliers)</td>
<td></td>
</tr>
<tr>
<td>Technology diffusion</td>
<td>There is limited risk for TSIC associated with technology diffusion</td>
<td>Ownership of IP regulated in the contract, primarily processes and routines, but not human asset specificity</td>
</tr>
<tr>
<td>Appropriation</td>
<td>Price communicated by TSIC prior to formal negotiations</td>
<td>Price level communicated by Ericsson prior to formal negotiations</td>
</tr>
<tr>
<td></td>
<td>Fair and equitable distribution of risk and reward</td>
<td>Hutchison bears the financial risk with limited risk for Ericsson</td>
</tr>
</tbody>
</table>
entice Hutchison to engage in negotiations. Given a decision for single-source negotiation and an indication of cost reductions the question was if the chosen supplier had the competence and commitment to conclude and successfully deliver on an outsourcing deal. Prior ties and seeking commitments from senior executives in the supplier organization was used to assess the perceived risk. However, this does not mean that that the actual risk was reduced.

An additional area of risk that occupied the management teams was the possible reaction of staff in the outsourcer’s organization. In the case of Hutchison there was a need to keep the information restricted due to stock market regulations however, in the case of TSIC this was not a requirement. On the one hand the management teams in the outsourcer needed access to a range of information in the negotiations, and on the other hand there was a concern that there would be unrest and disruption among staff if the idea of outsourcing had been made public before a deal was concluded. In both cases the outsourcer opted for negotiations in secrecy in preference to wide access to information and knowledge from within the organization.

The risk mitigating actions taken in the cases are summarised below where *the unwanted event* is transaction costs through a set of *causes of the unwanted event*.
<table>
<thead>
<tr>
<th>The unwanted event</th>
<th>The causes of the unwanted event</th>
<th>Risk mitigating actions by TSIC</th>
<th>Risk mitigating actions by Hutchison</th>
</tr>
</thead>
</table>
| Transaction costs (sunk costs) associated with not concluding the negotiations once they have commenced | Not agreeing the desired cost reduction with a supplier | • Stipulating minimum cost savings to the supplier before the start of negotiations  
• Making savings conditional in contract | • Initial estimate by Ericsson of cost savings before commencement of the Negotiation stage.  
• Declare some cost savings out of scope |
| Short time scales for completion of negotiations       | Not writing large formal RfP  
• Negotiation with only one supplier  
• Negotiating with a small team of senior managers | • Not writing large formal RfP  
• Negotiation with only one supplier  
• Negotiating with a small team of senior managers  
• Including whole functions to reduce complexity in negotiations | |
| Commitment of supplier                                 | Identifying outsourcing as the strategic direction for the supplier  
• Informal soundings before commencing formal negotiations  
• Meetings with Senior executives from supplier | • Outsourcing as the strategic direction for the supplier  
• Meetings with Senior executives from supplier | |
| Information Leakage                                    | Keeping a small negotiating team  
• Fast negotiation process  
• Negotiating only with one potential supplier to limit information flows | • Keeping a small negotiating team  
• Fast negotiation process  
• Negotiating only with one potential supplier to limit information flows | |

Figure 71. Transaction costs – not concluding negotiations

A feature of the TSIC and Hutchison cases is the limited supply market for outsourcing services of the type they were seeking. There was no supplier with a proven track record of outsourcing of field service or network operations that fitted perfectly with the requirements. The perceived reputation of the supplier was important as in both cases it was primarily people that were being outsourced; people that were essential for the performance of the outsourced operations.
A major risk for both TSIC and Hutchison’s managers was the decision to focus their negotiations on one supplier. It may turn out that the supplier had major deficiencies and was not suitable and by the time this was discovered it is likely that time would have run out to engage in negotiations with another potential supplier. It seems that the time scales set by parent company executives forced a trade-off between on the one hand a more time consuming multi-party negotiation and on the other hand a fast track negotiation with one supplier, with the risk being that the supplier in the end would be found not to be suitable.

<table>
<thead>
<tr>
<th>The unwanted event</th>
<th>The causes of the unwanted event</th>
<th>Risk mitigating actions TSIC</th>
<th>Risk mitigating actions Hutchison</th>
</tr>
</thead>
<tbody>
<tr>
<td>The transaction costs (sunk cost) associated with not finding a suitable supplier in the search process</td>
<td>Lack of competence by suppliers</td>
<td>▪ Select suppliers with good relationships with other vendors</td>
<td>▪ Transfer of whole operational functions and departments</td>
</tr>
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<td></td>
<td></td>
<td>▪ Size of suppliers installed base of equipment in the network</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Limited previous experience with the suppliers</td>
<td>▪ References</td>
<td>▪ References</td>
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<td></td>
<td></td>
<td>▪ Commitment from senior executives of the supplier</td>
<td>▪ Commitment from senior executives of the supplier</td>
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<td></td>
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<td>▪ Informal soundings</td>
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<td></td>
<td>Poor reputation of suppliers</td>
<td>▪ Check experience with the supplier to verify reputation</td>
<td>▪ Check experience with the supplier to verify reputation</td>
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<tr>
<td></td>
<td></td>
<td>▪ Internal soundings before inviting suppliers for negotiations</td>
<td>▪ References from other outsourcing contracts</td>
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<td></td>
<td></td>
<td></td>
<td>▪ Informal soundings on suppliers capabilities</td>
</tr>
<tr>
<td></td>
<td>Limited number of suppliers</td>
<td>▪ Seek information from 3&lt;sup&gt;rd&lt;/sup&gt; party observers</td>
<td>▪ Seek information from 3&lt;sup&gt;rd&lt;/sup&gt; party observers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Wide search for possible suppliers</td>
<td></td>
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</tbody>
</table>

**Figure 72. Transaction costs – not finding suitable supplier**

With the limited supply market of knowledgeable and proven suppliers in both cases, TSIC and Hutchison approached the problem in different ways. Hutchison took the decision to outsource whole functions and departments to ensure that the supplier had all the requisite knowledge and
expertise to run the operation. In contrast, TSIC chose to retain key staff with expertise to oversee and monitor the performance of Ericsson. This however reduced Ericsson’s ability to perform the service effectively. This action allowed TSIC sufficient in-house capability to take back the operation in case of poor performance, a risk mitigating action and defensive move in other words. As the analysis in the transition stage shows, the approach by TSIC resulted in a lack of competence at Ericsson and subsequent poor operational performance. In contrast, there is no evidence of poor performance in the Hutchison case due to lack of competent resources. What this analysis indicates is that there is a trade-off between dependence on the supplier and sufficient competence transferred to the supplier and that different outsourcers approach this trade-off differently. It seems that for business critical outsourcing choosing to include whole activities, “to go the whole way”, is preferable to holding resources back.

**Bounded rationality**

A feature in the two cases is the similarity in approach to the negotiation process. Transaction costs theory would hold that the choice of market rather than hierarchy implies an arm’s length negotiation with multiple suppliers to achieve maximum cost advantage relative to the transaction costs. This is not what took place in these cases. Instead the outsourcer quickly went straight into formal negotiations with only one supplier, with the cost savings stipulated up-front. Not only did the outsourcer opt for single-source negotiations but also decided to approach the negotiations in what they themselves term “open book” negotiations. This approach is in contrast to much of advice in prior research (Cross, 1995; Willocoks et al, 1996; Lonsdale and Lonsdale, 1997; Lonsdale, 2001). In the TSIC case the management team was aware of shortcomings in the underlying performance and operational data going into the negotiations. In the Hutchison case the view of the CTO was that this type of outsourcing requires trust-building and joint data discovery to overcome information asymmetry. Although for slightly different underlying reasons the “open book” approach and joint data discovery suggests recognition of bounded rationality and information asymmetry on part of both the outsourcer and the supplier.

Taking a transaction costs analysis perspective would on the one hand identify several transaction costs in single source negotiation such as opportunism, loss of negotiation power, dependence on the supplier, limited comparisons to assess the offer from a technical and commercial point of view (Williamson, 1975, 1985, 1991). On the other hand there are benefits such as a faster and lower cost process. TCA could be used to explain the choice made
where the transaction costs and risks were lower than the benefits of a fast and lower cost process. What TCA does not help us explain so readily is the choice of an “open book” and evolving negotiation process. This is where bounded rationality helps us appreciate the rationale for the “open book” approach.

The Scoping & Search stage focuses its attention on the decision of what should be included in a potential outsourcing deal, the selection of potential suppliers and the most appropriate negotiation process. Once formal negotiations commenced the analysis focuses its attention on how both the outsourcer and the supplier perceive and manage risks in the Negotiation and Transition stages.

**7.2 Cross case analysis of the Negotiation stage**

The next two sections compare and contrast the risk mitigating actions in the Negotiation and Transition stages in the two cases and begin with an analysis of the Negotiation stage.

The Negotiation stage should be seen in conjunction with the decisions taken by the outsourcer in the Scoping & Search stage. It is worth noting that a prerequisite for business critical outsourcing is that there is at least one willing and capable supplier that would be prepared to take on an outsourcing contract at a given price level. In this research the expected price level was communicated at the starting point of the Negotiation stage. It suggests that the first decision by the supplier is to decide if and under what circumstances it is willing to invest the time and money required to negotiate a deal. The empirical material points to a systematic and structured approach taken by the supplier of outsourcing services in an effort to reduce their own transaction costs and risks. The Ericsson OBP process is comprehensive, detailed and has clear decision points for go no-go decisions based on a calculation of the return relative to the risks. Estimates by Ericsson suggest the cost of bidding for outsourcing contracts can range from $0.2 to $2.5 million. Entering into negotiations requires an early assessment of significant opportunities to reduce costs through economies of scale and an assessment of the opportunity costs in negotiating one deal in favour of another potential outsourcing deal. Once the decision is taken to enter into negotiations the focus shifts to keeping the production costs low and the price offered high enough to meet the supplier’s internal targets set for profits and risks.
What is outside the control and influence of the supplier are the decisions taken by the outsourcer in the Scoping & Search stage regarding what is included in the potential outsourcing contract and the design of the outsourcing process. The empirical material suggests that business critical outsourcing favours single-source negotiations, negotiations in secrecy, and that there is recognition of information asymmetry between outsourcer and supplier. The main risk mitigating action that the outsourcer offers the supplier is to approach the negotiations in a cooperative manner to reduce both performance and relational risks, especially through goodwill trust-building.

7.2.1 Performance risk mitigation

Performance risk in outsourcing (Das and Teng, 1999) is the risk that the outsourced activity will not meet the operational and financial goals sought by outsourcer and supplier. The purpose of the Negotiation stage is to establish if there is a supplier that is able and willing to commit to delivering the operational and financial performance required by the outsourcer. Given that a contract is signed, the conclusion must be that the perceived performance risk is sufficiently low relative to costs savings and the transaction costs for both parties. The focus therefore in the cross case analysis is to establish the risk mitigating actions taken in the two cases.

Risk mitigation through competence trust-building

Complex activities such as telecom network operations and field service require a high level of competence, as they are time critical and have a direct impact on the financial results of the telecom operator. It can be assumed that the competence of the potential suppliers is of great importance. Likewise it can further be assumed that the performance risk to the supplier of taking over such a complex and business critical activity is high. The outsourcing literature have suggests factors related to competence risk such as loss of competence (Sullivan and Ngwenyama, 2005; Gonzales et al, 2005; Earl, 1996) and dependence on the supplier (Gonzales, 2005; Bahl and Rivard, 2003; McIvor, 2003; Lonsdale and Cox, 1997). Das and Teng (2001) propose that building competence trust in the other party reduces performance risks.

In the case of Hutchison it was clearly stated by Ericsson that there were areas of the network operation that they did not have demonstrated expertise and experience. The solution to this was to outsource the whole network operation including the entire staff, knowledge and expertise. This action reduced the competence risk considerably. On the one hand, Hutchison “handed the
As the GM of HMS put it, but on the other hand it gave Ericsson the competence to run the network in its entirety.

TSIC on the other hand retained key staff in-house which did not serve to effectively mitigate risk through trust-building in the dimension of trust-building.

The analysis demonstrates two very different mechanisms for reducing competence risks: one focused on retaining in-house competence and the other focused on ensuring the supplier had the required competence. The consequence of this difference is discussed in the cross case analysis of the Transition stage.

Das and Teng (2001) argue that competence trust-building reduces performance risks, however the decision to carry out the negotiations in secrecy reduces the ability of both parties to safeguard that the output measures are relevant and that the service levels stipulated in the SLAs are appropriate. The research identifies a dilemma facing outsourcing of business critical and complex activities and the case demonstrates a perceived need to conduct the negotiations in secrecy for both formal and business management reasons. Outsourcing of business critical outsourcing requires full and detailed understanding of the activity however this is difficult to obtain if only a select few senior executives are involved in the contract negotiation. The research shows that the way TSIC and Hutchison tried to manage this dilemma was through a cooperative and ‘open’ approach to the negotiations.

Furthermore, negotiating in secret is less of a problem for the outsourcer than the supplier when it comes to competence risk. On the one hand the TSIC negotiation team were able to meet and discuss the outsourcing contract with people inside Ericsson and develop confidence in Ericsson’s capability and commitment. Ericsson on the other hand had limited possibilities to reduce the competence risk as no access to the TSIC operational team was possible.

Finally, the most important action to mitigate competence risks was assurances from parent company executives who committed their organization to providing the necessary resources and competence to ensure success. TSIC had verbal commitments from the CFO of Ericsson and visited company executives in the locations where services would take place. Ericsson has specific decision points in the OBP process where written commitments such as Memoranda of
Understanding established the overall scope and commitment behind the decision to outsource. In other words, competence trust is built from executives who have the formal power to commit the organization.

Risk mitigation through output control
Formal control in outsourcing is suggested as essential (Das and Teng, 2001) and much of the Negotiation stage is centred on agreeing the description of output measures and level of performance. The two cases support findings of previous research that focus and effort is expended on negotiating the output measures (Arino and Reuer, 2004; Arino et al, 2005). The contract in both cases give detailed descriptions of measures of performance such as specific response times to resolve technical problems, maximum down-time of the network, dropped call rates etc. According to Das and Teng (2001), output control is most effective if two task characteristics are present: (i) one’s knowledge of the [outsourced activity] is limited and (ii) output measures are precise. Both cases were negotiated in secrecy and in practice it was difficult for outsourcer and supplier to verify and secure the necessary information required for appropriate Service Level Agreements and performance measures. From Ericsson’s perspective this mean a risk that the requested performance levels and SLAs were difficult to achieve or factually incorrect. Das and Teng (2004) argues that subjective trust is the mirror image of risk and what emerges from the cases is that the perceived risk in the quality of output measures was mitigated through trust-building.

However, a reduction in the perceived risk in the output measures through trust-building does not mean an actual reduction in the output measures due the limitations imposed by negotiating in secrecy. By implication, the supplier can only compensate for the risk of poorly designed SLAs through the price offered for taking over the outsourced activity. It therefore falls on the outsourcer to offer mechanisms and procedures that build confidence in the trustworthiness of the data that is offered to the supplier. The empirical material indicates three types of risk reducing mechanisms that the outsourcer could apply in the Negotiation stage:

- An open book negotiation and cooperative approach
- External and independent advice
- Joint design of the contract
Both cases indicate that simplistic metrics such as percentage cost savings and headcount were the basis for initiating the principal decision by parent company executives to outsource (see Nordigård (2007) for similar findings), and then left to the operational management team to work out how to deliver the savings whilst minimizing the level of risk of failure. The approach of stipulating the price before commencing formal negotiations created a negotiating environment that focused attention on reducing performance risks to the benefit of both parties. The pressure on the managers negotiating the deals was evident in the empirical material and the word failure used in the previous sentence has two very different meanings. Failure means to not delivering the plan for cost savings by the deadline given but failure also means poor performance of the outsourced operation once it has been outsourced.

A major difference in the two cases is the importance to Hutchison of intellectual property (IP). Much effort was expended in the contracts negotiations to establish and describe the IP that belonged to Hutchison vs. the IP that belonged to Ericsson, and how this could be defined in the contract. The empirical material indicates that although there are attempts to describe IP there is no objective means to control the output of IP. In this situation neither of the conditions for output control referred to by Das and Teng (2001) are met. This presents a performance risk that may prove costly in the future and there seem to be limited possibilities for either party to reduce this type of risk fully.

Furthermore, there were no contacts or discussions with sub-suppliers and other parties whose cooperation would be essential for the performance of the outsourced activity. In fact, it was explicitly stated in the TSIC case that Ericsson was responsible for costs related to third party relationships beyond the initial cancellation period of any contract in place with TSIC. The analysis in the Transition stage shows that the omission of other parties, whether internal or external to the outsourcer and supplier, increases the performance risk. It seems that neither this was ignored or the parties did not feel able to apply confidence trust-building beyond the narrow circle of people involved in the direct negotiations.

Risk mitigation through Social control

The research finds that the decision to negotiate in secrecy resulted in attempts by the outsourcer to reduce performance risks through trust building. Das & Teng propose that: *A firm’s goodwill trust in its partner will reduce its perceived relational risk in an alliance, but not the performance risk*” (Das and
Teng, 2001, p257). However, the research in this dissertation does not support this proposition. In the two cases both the outsourcer and supplier applied goodwill trust actions in the Negotiation stage to mitigate performance risks, in addition to relational risks, in the dimensions of output control and competence trust. This supports the findings by Sengun and Wasti (2007).

Social control is referred to as a socialization and consensus making process and that risk mitigating actions are highly applicable in outsourcing relationships (Das and Teng 2001). The analysis highlights the limited attention placed on the social nature of decision processes (Das and Teng, 2002), engagement of staff impacted by the outsourcing decision in the negotiation, and understanding of organizational cultures as a means to reduce the Performance risks. The empirical material shows that the contracts make limited references to social control mechanisms and that it seem not to have been major points of discussion during the Negotiation stage. It seems the outsourcer is trading off the costs and risks associated with organizational unrest and diversion of attention among staff in their daily activities if the possibility of outsourcing was known, with the reduced possibility of applying social control to mitigate performance risks. In a similar way the supplier is not able to build competence trust in the outsourcer’s organization through verifying its skills and knowledge to run the proposed outsourced activity during the Negotiation stage.

The functional and departmental managers that would be instrumental in explaining the rational and benefits of the outsourcing contract were not involved in the Negotiation stage. In the case of Ericsson the contract was negotiated by the Ericsson sales team and it was only after signing the contract that the operational team from Ericsson got involved hence limited transfer of social control mechanisms were applied prior to contract signing.

7.2.2 Relational risk mitigation

Relational risk is defined as the probability and consequences of not having satisfactory cooperation by the partner (Das and Teng, 1996). The literature review found calls for more research into relational aspects of outsourcing (Kern and Willcocks, 2000) and the management of the outsourcing relationship (Ahlstrom and Nordin, 2006). Das and Teng suggest that relational risks are distinctive aspects of strategic alliances such as outsourcing. “Thus, relational risk is an unavoidable – and quite problematic – element of strategic alliances” (Das and Teng, 1999, p51). This risk is specific to outsourcing as it requires transfer of assets and operational responsibility
to a third party hence the outsourcer is dependent on the appropriate behaviour, goodwill and commitment to achieve common goals of the supplier. Equally, as the business critical activity is linked to and partly embedded within the outsourcer organization, the supplier is dependent on the outsourcer’s appropriate behaviour, goodwill and commitment to achieve common goals to mitigate relational risks. Given the costly consequences of failure we could expect that much emphasis is put into reducing relational risks in business critical outsourcing.

What we find in the empirical research is that both outsourcer and supplier actively apply risk mitigating actions to reduce relational risks, but also that there are conditions which reduce the possibility to fully apply the types of risk mitigating actions suggested by the theoretical model of Das and Teng (2001).

**Risk mitigation through goodwill trust-building**

Goodwill trust-building is extensively used by all parties to mitigate relational risks in the cases reported here and hence supports the proposition that goodwill trust-building reduces relational risk (Das and Teng, 2001, p257). The main risk mitigating actions used were:

- Establishing mutual interest by assessing the commitment at the most senior level in both the outsourcer and the supplier where motivation is viewed as a source of trust.
- Joint dispute resolution through the use of an open book approach and joint writing of the contract details and SLAs.

The empirical material demonstrates the emphasis placed on and the effort made by TSIC to satisfy themselves that Ericsson was committed to making the outsourcing deal work, despite Ericsson having limited experience of running field maintenance of a pan-European network. Two aspects stand out. Firstly, the negotiations were actively supported at the highest executive level at Ericsson and at TSIC and secondly, that TSIC became convinced that it was of strategic importance for Ericsson to build its capabilities in field service of networks whereas Ericsson had information that suggested TSIC needed to reduce costs and that an outsourcing deal would support this goal. Relying on commitment of senior executives for goodwill trust-building to reduce relational risks supports Langfield-Smith’s (2008) findings. Prior ties and long standing business relationships supported the ability to make judgments on the other party’s trustworthiness and good intention (Gulati, 1995).
In the case of Hutchison the fast paced negotiation provided limited possibility for either party to take action and provide evidence that built goodwill trust at an organizational level. Ericsson had evidence that parent company executives in Hutchison Whampoa wanted the cost savings that an outsourcing deal could offer. Supported by the Hutchison CEO, the individual who drove the trust-building dimension was the Hutchison CTO, not only in words but in actions during the Negotiation stage. However, this in the end was a fragile bridge on which to build trust when changes in strategic direction or the removal of a key individual can break this bridge in a manner of minutes. The empirical material shows that there was scepticism and concern over the risks among the managers negotiating the contract. This scepticism should also be seen in the context of a problematic and difficult relationship with the Ericsson team that were building the 3G network for Hutchison whilst the negotiations were taking place. For Ericsson, actions taken by the Hutchison team in some aspects of the contract negotiations gave an indication of a lower willingness to build goodwill trust than the rhetoric of the Hutchison CTO. We have to keep separate goodwill trust at the organizational level and at the individual level (Zaheer et al, 1998). The open book approach in the two cases had an impact on the goodwill trust but does not extend to reducing the relational risk more generally as it affects the trust within the negotiation team rather than the whole organization. As the Director of Network at TSIC pointed out “in the end, this contract is between organizations, and not individuals”.

The empirical material shows support for proposition 9 in Das and Teng (2001, p266) that goodwill trust and competence trust will enhance risk reduction in all control modes but raises a question. The findings support the proposition that goodwill trust-building is used to overcome the difficulty for the supplier and outsourcer in assessing the risks related output- and behavioural control as well as social control under conditions of secrecy in the negotiations. However, in the research it becomes clear that goodwill trust is a pre-requisite for developing competence trust rather than an independent dimension together with competence trust. This is especially the case for the supplier who is dependent on the outsourcer for information and data with which to make an assessment of performance and relational risks.

The empirical material also shows that there is is a particular sequence of events that has an impact on the performance- and relational risks as the outsourcing process proceeds. The impetus to the initial decision in the two cases has come from the company parent management,
which is a level higher than the managers that negotiates and makes decision on development of the outsourcing relationship.

In both cases the company parent executives are important and decisive in generating goodwill trust and competence trust. The goodwill trust is generated by parent company executives in both the outsourcer and supplier through an understanding of the motivation and driving forces behind a decision to outsource a business critical activity. Statements such as “we will make this deal work” by the CFO of Ericsson are evidence that money and effort would ensure resources and competence to deliver or the public statement by the CEO of TeliaSonera AB to the stock market that profitability in TSIC would be restored by 2003. These risk mitigating actions are directional and flows from the upper level of management down to the teams that negotiates the deal.

Risk mitigation through Behavioural control
The approach taken in relation to behavioural control is similar in the two cases. The contract negotiations specify in detail the formal policies, procedures and processes that governed the operational relationship. The empirical material shows that the contracts attempt to convert operational procedures into legally binding statements of what should be done and by whom. The factors that puts limits to this approach are negotiation in secrecy and the complexity in the activity the contract seeks to describe. A device applied in both cases was to apply a joint discovery process of the operation and to use an external consultant as a means to reduce the risk of poorly conceived policies and procedures.

In the case of the Hutchison case the whole network operation and support function were outsourced hence many of the operational procedures and details that were required in the TSIC were not required to the same extent in the Hutchison case.

The empirical material makes little reference to policies and procedures to reduce behavioural risks related to external parties. In the TSIC case there were nearly 400 sub-contractors across Europe that were affected by the outsourcing contract and in the Hutchison case the equipment in the 2G network was all from competitors of Ericsson. To run the 2G network all the operational descriptions, policies and procedures would have to be handed to Ericsson and the equipment given support in cases of technical problems. From Ericsson’s perspective the
performance of the contract was highly dependent on positive and efficient cooperation with parties that had no part in the negotiations and these type of risks where not addressed in the Negotiation stage.

Risk mitigation through Social control

The two outsourcing cases in the research are essentially outsourcing of human assets, some with asset specificity (Williamson, 1991). The TSIC management team had real concerns that an outsourcing deal would cause discontent among staff. This was one of the reasons that the negotiations were carried out in secrecy. In the case of Hutchison concerns for staff were voiced but it seemed more concerned with loss of competence rather than motivation and discontent. Although the issue of staff motivation and behaviour was a factor in the decision to outsource there is limited evidence that particular actions were taken to mitigate or reduce those risks. In fact, with negotiations in secrecy, Ericsson had very limited possibilities to verify how staff would react to the prospect of leaving their employment and join Ericsson. This was a calculated risk by Ericsson and the policy document in the Ericsson OBP process had contingency in the cost calculations that up to 20% of staff may decide not to join hence new staff would have to be recruited. Decision making in both cases was top down and the choice for staff was “join Ericsson or find yourself a new job”.

The assessment in the two cases of low and low/medium risk reduction in the social control dimension is not to say that this dimension was not considered important but that it seems the negotiating parties did not include specific process and activities directed towards social control as a means to manage relational risks. This includes the staff that would be transferred but also other parties, both in the outsourcer and thirds parties, that were affected by the decision to outsource.

The cross case analysis of the two cases show that some dimensions of performance- and relational risks were addressed but that others were largely ignored or the parties where not able to implement risk mitigating actions.

In the case of TSIC the problem of competence trust was addressed by retaining key staff in-house but proved to have negative consequences in the Transition stage. In the case of
Hutchison the solution was to transfer all the necessary skills and knowledge to the supplier, but this may have consequences for technological insights in the future.

Much of the attention in the contract negotiations focused on output- and behavioural control such as SLAs, incentives, penalties, and operational details. Yet it is clear from the empirical material that both outsourcer and supplier were unable to reduce the performance and relational risks substantially. Effort was expended in developing goodwill trust and an “open book” approach to the negotiations. This was important for Ericsson’s assessment of risks. With limited possibility for due diligence Ericsson had to take much of the operational information given by TSIC and Hutchison and developing a trusting relationship and the goodwill of the outsourcer reduced the perceived risk in taking on the outsourced activity.

Where neither party applied risk mitigation is in the dimension of social control. This fact exposes a discrepancy between theory and practice in outsourcing negotiations. Social control has impact on both performance- and relational risks but the decision process of outsourcing by its nature may not provide a basis for social control for three reasons. Firstly, if the outsourcing deal is large and of material importance, then legal frameworks such as stock market rules may prevent an open and transparent outsourcing process. Secondly, as was demonstrated in the two cases, there may be genuine concerns for staff morale if the possibility of an outsourcing deal was discussed in the open and with all parts of the organization. Thirdly, it may not be advisable to alert sub-suppliers and other third parties of the possibility of the activity being outsourced, in particular with those third parties that would be negatively affected such as through loss of business. The dilemma is that in a situation where social control can not be applied, the performance- and relational risks remain unmitigated in this dimension.

More generally, the decision to negotiate in secrecy reduced the possibility for risk mitigation in all the other dimensions hence the dilemma exposed in the research is that conducting outsourcing negotiations in secrecy limits the possibility for performance and relational risk mitigation. This was the situation leading into the Transition stage.
7.3 Cross case analysis of the Transition stage

The cross case analysis of the Transition stage follows the same format as the analysis of the Negotiation stage. The first observation is that the Transition stage shows similar performance outcomes in TSIC and Hutchison in the Transition stage. The situation in the TSIC case is demonstrated by Ericsson struggling to get to grips with the operational aspects of the field service operation. The result was a breach letter for poor performance issued by TSIC nine months after the signing of the contract. In the case of Hutchison the situation was complicated by the parallel work on the launch of the 3G network which was scheduled for three months after the outsourcing contract had commenced. However, it soon became clear that there were discrepancies between the contractual description of SLAs and procedures compared with the actual workings of the network operation.

The case description gives a sense of the shock and upheaval among staff to the decision to outsourcer such core and business critical activities as network operations and field services. The empirical material bears out the significant time and effort required among senior and middle manager to transition hundreds of staff from one organization to another whilst maintaining the service and performance of the day-to-day activities. As the Director of Network at TSIC sums up comments from many of the interviews:

“The biggest cost has been the human effort to make it all work.”

7.3.1 Performance risk mitigation

In the Transition stage the supplier has been chosen and the deal has been publicly announced. The specific performance levels and SLAs have been agreed in the contract and the supplier is now running the outsourced activity and is responsible for meeting the agreed SLAs.

Risk mitigation through competence trust-building

The views on the other party’s competence and ability to carry out the contractual obligations have now shifted from the view of those managers that negotiated the deal to the two organizations as a whole. Das and Teng argue that “competence trust in its partner reduces the perceived performance risk, but not its relational risk” (Das and Teng, 2001, p258). The two cases allow us to
contrast the approaches by TSIC and Hutchison in the competence trust-building dimension. TSIC retained staff and therefore had the competence to carry out a mixed strategy (Nordigarden, 2007) and hence parallel provision of the field service activities. In the case of Hutchison whole departments and activities had been transferred hence there were no practical means to carry out a mixed strategy. The result in the TSIC case is the initial response by TSIC staff not to trust the Ericsson team and initially use the internal resources wherever possible. As a consequence Ericsson was missing out on some potential revenue but more importantly, did not gain the knowledge and expertise fast enough to build competence in its ability to deliver on the contract. In the Hutchison case the competence and resources had been transferred to Ericsson and competence risk was not a major issue during Transition. It seems that in business critical outsourcing that it is important to transfer all the needed competence to the supplier to ensure reduced competence risk affecting performance of the activity.

Although the two cases approached competence trust-building differently TSIC and Hutchison were both in difficulty at the end of the Transition stage. The response by Hutchison was to add resources and competence to Ericsson in the Transition stage at Hutchison’s expense whilst TSIC did not take this approach. In the Hutchison case Ericsson replaced the initial General Manager of HMS in a response to address the struggling performance in the Transition stage. Both Hutchison’s and Ericsson’s responses were effective in building competence trust and also built goodwill trust between the organizations.

The empirical data indicates that a flexible and cooperative approach in the transition stage is an effective means to mitigate competence risks.

**Risk mitigation though Output control**

When Ericsson took over the TSIC field service operation they were thrown into the deep end. Ericsson as an organization is by its own omission a project based organization, whereas operating telecom systems is a continuous operation where service mindedness and responsiveness is the imperative for success. In the TSIC case it gradually became clear that Ericsson did not have sufficient skills and resources for running the field service organization and the performance fell below the levels agreed in the contract. This was partly due to TSIC’s decision to keep resources in-house as backup and contingency but also Ericsson’s acceptance of this as it provided a lower cost operation for Ericsson. Sengun and Wasti (2007) found support
for the hypothesis that a focus on output control undermines goodwill and competence trust in buyer-seller relationships. It seems that the reverse may also be possible, such that insufficient resources (competence) and low goodwill trust-building actions increase the risks of poor performance in business critical outsourcing as measured by output control.

In the Hutchison case the performance became problematic soon after signing of the contract. The specifications and policies in the contract and SLAs were in many cases not practical or could not be measured as intended. The cause of these problems was negotiating in secrecy with limited possibilities for Ericsson to verify the output measures agreed in the contract but also that Hutchison did not have complete control of their own operation and performance measures prior to the outsourcing deal. The response to poor performance by Hutchison differed from the response by TSIC. Through significant efforts and investments in time and resources by both Ericsson and Hutchison, the contract details and performance measures where painstakingly renegotiated to match the reality of the network operation. The empirical data suggests that in a situation of poor output performance actions in the competence areas and goodwill trust-building support re-writing of the SLAs and other adjustments in the contractual relationship.

What we don’t know however, is how the cost in underperformance of the SLAs and the additional investments to adjust the contract cost compare to the estimated savings from outsourcing. This is an ex-post transaction cost (Williamson, 1975, 1985) which both TSIC and Hutchison were seeking to mitigate through the cooperative approach in the Negotiation stage but were not fully successful. In the Hutchison case with a seven year contract this sum may be small relative to the overall cost savings but for TSIC the time to recover any extra costs is shorter. This is dilemma between opting for a short contract period and more frequent renegotiations and the costs of adjustments during the Transition stage (see Cross, 1995; Bahli and Rivard, 2004; Lacity et al, 1996). In the IS/IT industry the trend is towards shorter contract periods but this leads to a need for higher margins for the supplier\(^{30}\) to recover the initial costs to manage the Transition stage and hence less saving for the outsourcer.

Another finding in the research is the importance of other parties not included in the contract negotiations and not part of the contract or SLAs. This is an additional factor that has an impact

\(^{30}\) Discussion with Sales Director at CSC Australia
on the performance in the Transition stage. The contract is clear that the responsibility for the performance of the outsourced activity but many of the contractual relationships with sub-suppliers or other parties continue with the outsourcer until such time as the contractual relationships have been transferred. The risk is that the sub-supplier will not accept a transfer of their undertakings and withdraws their support to the supplier, as was the case with Hutchison.

Risk mitigation through social control

Das and Teng (2001) argue that when decision-making processes to reduce performance risks are participatory and informal “…as a result, more honest and open communication will take place” (Das and Teng, 2001, p276).

Risk mitigating actions in the social control dimension were low in the Negotiating stage in both cases due to negotiating in secrecy. A complicating factor in both cases were the significant geographical distances between staff in different network centres and countries. In the case of TSIC the organization was dispersed in nearly 20 countries across Europe, and in the Hutchison case in three main locations in Sydney, Melbourne and Perth, all more than 1000km from each other. The local situation and legal implications of the transfer of staff differed in the different national locations in the TSIC case and difficult relations with staff representatives did not provide a good start for the new ventures. This study finds that social control is an important dimension that can be used for performance risk mitigation. However, it also seems that practical reality in large scale outsourcing deals spanning geography and cultural borders makes it a difficult and slow process to achieve.

The Transition stage in Hutchison can be divided into two phases. A first stage which had a General Manager of the HMS unit that ran the relationship according to the contract. A second stage with a new GM that approached the relationship with a collaborative stance. The outsourcer, personified by the Hutchison CTO, emphasised the need for a collaborative approach however, the empirical material shows that a champion of collaboration is necessary but there are limits to one persons reach within a large and dispersed organization. An observation in the case of outsourcing of business critical activities is the embeddedness of the outsourced activity within the outsourcer. The consequence of this is that two people sitting next to each other that previously were colleagues, now have a buyer-supplier relationship regulated by a formal contract. Ericsson actively managed the socialising process by gradually replacing
managers who had difficulties adjusting to the new organizational configuration and gradually the performance improved, but this took effort and time. Comments among the interviewees indicate that social control is difficult to achieve as on the one hand the new outsourced unit is not part of Hutchison but also an isolated part of Ericsson, partly due to its specific operational nature, partly because the people are embedded in the Hutchison organization, but also due to the requirement to isolate the activity from the broader Ericsson organization to safeguard IP and commercial information.

The Ericsson team discovered in both cases that there were important external parties such as Scanova in the TSIC case that had an impact on the performance but had not been involved in the negotiations. This is another example where theory proposes that social control has power to mitigate risks. However, the practical reality of applying social control with external parties whether in the Negotiation or Transition stage is difficult. Das and Teng (2001) suggest that the applicability of social control is high to moderate whereas in practice the use of social control may have limited power to reduce performance risk related to other parties.

7.3.2 Relational risk mitigation

With the contract signed and the outsourcing formally transferred to the supplier the relational risk is now activated. There is strong dependence between outsourcer and supplier and the success of the Transition stage depends on how each party deals with the implementation of the contract and agreed performance levels in the SLAs. Relational risk depends on the partner’s willingness to cooperate (Das and Teng 2001).

Risk mitigation through goodwill trust-building

According to Das and Teng (2001) goodwill trust can be established through – “establishing mutual interest, individual and team [organizational] trust, and joint dispute resolution” (Das and Teng, 2001, p272).

What stands out in the empirical material is the collaborative and relational approach by the Hutchison CTO. This was reciprocated by the new General Manager at HMS who “was bending over backwards” to build goodwill and a give-and-take attitude to improve the performance of the outsourced activity.
Sengun and Wasti (2007) found support for the hypothesis that goodwill trust and competence trust increased the use of social control and the empirical material in the Hutchison supports this finding. Sengun and Wasti (2007) did not find support that goodwill and competence trust reduced the use of output control. However, the empirical data in the Hutchison case suggests that in the Transitions stage both outsourcer and supplier apply competence and goodwill trust building and a switch to social control processes to manage performance risks reduces the reliance of output control to manage performance risks. An example of goodwill-trust building is to invite the GM of HMS to join the executive board of Hutchison.

In Hutchison an issue facing the new HMS organization was the relationship with external parties such as Samsung, HP and the relationships with internal Ericsson and Hutchison units that were essential to the network operation. The general manager initially appointed was recruited from the outside and did not have an anchor in either Ericsson or Hutchison. The empirical material does not shed light on the directives given to the manager but it seems his strategy was to run HMS as an independent and separate unit to both Ericsson and Hutchison, in time this resulted in major fractures in the relationships. Some seven months into the contract this was realised by both parties and the manager was replaced. This action provided the opportunity to rescue the relationship through a cooperative and flexible stance rather than following the contract to the letter.

In the TSIC case Ericsson was struggling to manage the Transition stage and was willing to show flexibility, adding resources and made efforts to build goodwill trust. The operational team in TSIC on the other hand were trying to run the relationship as per the contract at the same time as pockets of staff within TSIC where resisting the outsourcing deal. An important source of goodwill to begin tackling the issues was the goodwill that had built up during the negotiations and carried through into the Transition stage. However, it took some time before both parties realised that there were quality problems in the performance. The relationships with other parties such as the Scanova network centre in the TSIC case impacted Ericsson’s ability to deliver the service yet Scanova were not invited by TSIC to engage with Ericsson to resolve performance issues.

The findings in the research make a strong case that goodwill trust-building is a powerful dimension to reduce not only relational risks but also performance risks. Both outsourcer and
supplier are using goodwill trust extensively through establishing mutual interest, and joint dispute resolution to overcome deficiencies and problems.

Risk mitigation though behavioural control

Das and Teng (2001) suggest that behavioural control includes policies and procedures, reporting structure, and staffing and training. In the Hutchison case it soon became apparent that the contract and the SLAs did not match the reality of the network operation. Both parties were prepared to tear up aspects of the contract and establish new procedures and reporting structure. The fact that the GM of HMS was invited to join the executive board of Hutchison is an example of how the two organizations recognized that the HMS unit should be represented at the highest level in Hutchison.

In the TSIC case no major re-writing of the policies and procedures took place until the issuing of the breach letter. Up and until that point both parties were trying to make the operation work by applying the contractual description. From the empirical material it seems that the breach letter was a turning point for taking a more flexible approach and to focus on the way the operation worked rather than what the contract suggested. Gradually amendments and changes were incorporated into the daily routines and the relationship began to recover.

The decision by TSIC to retain key staff in-house provided the possibility to continue some of the activities within the TSIC organization and hence did not follow the policy and procedures laid down in the contract. As a consequence the operators were reluctant to use Ericsson for services as firstly, there was still an internal resource available, and secondly, Ericsson was perceived to be expensive compared to the internal charges levied before outsourcing.

The research has identified the root cause to be poor alignment of behavioural control in the Transitions stage in the secrecy approach in the Negotiation stage. Secrecy in combination with outsourcing of complex activities with external parties closely linked to the outsourced activity made behavioural control a weak dimension in reducing relational risks.

Risk mitigation through social control

For staff in TSIC and Hutchison the announcement of the outsourcing contract came as a surprise and shock. Outsourcing such business critical activities and to do it with a supplier with
no previous experience of running telecom operations of the operations created concerns. Resistance among pockets of staff made the Transition stage difficult and slow.

Also in the case of Ericsson the internal organization was not as willing and ready once the contract was signed as the initial discussion would have suggested. Although the TSIC contract in its totality was significant, when broken down to each of the 18 market companies where the field service where carried out, it turned out that it was a relatively small business for each market company. Because Ericsson had limited experience as a provider of telecom field services it was time consuming and a slow process to implement the contract across Europe.

With the transfer of whole departments the situation was somewhat different in the Hutchison case. The main issues that affected decision-making were the relationship with external suppliers and other parties in Ericsson and Hutchison that were essential for the outsourced activity. Credit for managing this difficult situation must go to the line managers who had less than a week to first personally get to grips with the fact they were going to be Ericsson employees and then take responsibility for implementing the transition of staff and operations. The empirical material bears out the stress, pressure and uncertainty felt when they navigated uncharted waters whilst keeping the ship afloat.

The approach in the Negotiation stage was broadly similar in the two cases. However, the response in the Transition stage shows differences. In particular in the Hutchison case both Ericsson and Hutchison made significant efforts and showed flexibility to adjust contractual procedures and policies during the Transition stage. This reduced both the performance and relational risks to the benefit of both parties. The empirical material shows that the cooperative approach advocated by the Hutchison CTO transferred into the Transition stage and reduced performance and relational risk.

In the TSIC case the two parties worked through the Transition stage largely with the contractual agreement in the front seat. The lack of competence and skills transferred to Ericsson reduced the possibility for high performance and undermined the competence trust-building effort. At the end of the Transition period some of these problems where acknowledged and some efforts were made to improve goodwill trust-building and social control. The time limit for the Transition stage was extended in the both cases and at the time of the interviews the TSIC team
were in discussions with Ericsson for an extension of the scope of the contract. There was no certainty that this extension would be given to Ericsson based on the performance during the Transition period. In the Hutchison case the situation had begun to turn for the better but there were still many issues to resolve.

The two cases may have the same supplier in common but are two separate cases with different people involved, in different countries and in a different context. However the driving forces on the teams in both TSIC and Hutchison during the Negotiation stage were similar; under pressure to do the deal, under time pressure to meet tight dead lines, and facing decisions with incomplete data and understanding. There is therefore little surprise that both contracts were in difficulty at the end of the Transition stage. Chapter 8 will reflect the findings in the research and discuss the implications for successful outsourcing of business critical activities.
8 FINDINGS AND PROPOSITIONS

This chapter presents the findings and propositions linked to the research questions. The structure is the same as the analysis model starting with the Scoping & Search stage followed by the Negotiation and Transition stages.

To understand the findings of how outsourcers and suppliers manage risks we begin by going to the origin of the idea that outsourcing can solve some specific business problems, and that the risks associated with outsourcing must be less than the difference between cost savings and the transaction costs for an outsourcing contract to be signed. Relating the purpose to the empirical material raises the question; were the risks lower than the difference between cost savings and transaction costs? Could the management teams of TSIC and Hutchison have met the goals set by parent company management through other means than outsourcing? We will never know but in both cases the decision to outsource was taken. There is a view in both the outsourcer and the supplier that cost efficiencies can be obtained through outsourcing hence confirming the general view that the decision to outsource is driven by cost savings considerations (Clegg et al, 2005). There is also the question of how the cost savings offered in the two cases were calculated. Why did TSIC opt for a 15% cost reduction and why did Ericsson propose they could run the network at a cost saving of 20-25%? The empirical data suggests that fairly rough and standardized calculations were used to determine the costs of running various aspects of a telecom network and that the estimated savings could only be indicative rather than accurate and absolute figures (Willcocks et al, 1996; Earl, 1996).

What the findings in the research report on are the risks in business critical outsourcing and the risk mitigating actions that were taken at the time of the research. This neither means that all potential risks were considered nor that every conceivable risk mitigating action was taken. On the contrary, the empirical material demonstrates mistakes and learning by all parties and also that the decisions taken in one stage have consequences for the performance and decisions in subsequent stages. But first, let us consider the perceived risks in the Scoping & Search stage.
8.1 Findings in the Scoping & Search stage

In the Scoping & Search stage the analysis is only concerned with the outsourcer’s perception of risks in the internal discussions on the merits and risks in a potential outsourcing decision. The research question in the Scoping & Search is:

RQ1  How does the outsourcer perceive and manage risks in the Scope & Search stage before entering into formal negotiations for an outsourcing contract of a business critical activity?

The findings will discuss the decisions related to (i) which activities should be outsourced and which should stay in-house, (ii) the search for and selection of suitable suppliers.

8.1.1 What should be outsourced and what should stay in-house

The decision of what should be outsourced and what should stay in-house is a fundamental decision as it sets a broad frame for the scope of business critical outsourcing and is analysed through the lens of TCA. The following discusses the decision, from the outsourcer’s perspective, based on the transaction cost theoretical considerations outlined in chapter 2.

Asset specificity and its impact on outsourcing decisions

Asset specificity plays a central role in transaction costs analysis. A network in a telecom operation has high degree of physical and dedicated asset specificity and in neither case was the network infrastructure outsourced hence follows transaction costs logic. However, if skills, knowledge and expertise were viewed as asset specific then the empirical case material is less obviously consistent with transaction costs logic. Research into transaction costs often ascribes asset specificity a general nature rather than being specific about the type of asset specificity referred to in the research (Williamson, 2002). In this research there is a need to treat physical and dedicated asset specificity separately from human asset specificity. In the case of telecom networks the physical assets are of high specificity as they are specific to the functioning of the network, the location of switches, communications masts, software for managing the voice and data traffic, billing systems etc. Although staff can be assigned asset specificity according to Williamson (1985) human assets are of a different character compared to physical assets. One
difference is that physical assets, in many circumstances, have cost accounting values attached and are recorded in company records. With few exceptions, human assets do not have accounting values attached (Williamson, 2002), and although recorded in company records, the organization does not own their human assets. The empirical data suggests that physical and human assets are treated differently in the decision to outsource and the discussion that follows aims to explore how this difference manifests itself in business critical outsourcing.

Williamson (2002) discusses the human asset specificity from the perspective of the contract and identifies four alternative modes of governance:

| Node A | Unassisted markets | ▪ Absence of dependency  
▪ Governance through market price  
▪ Disputes solved in court |
|--------|--------------------|-------------------------|
| Node B | Unrelieved hazard  | ▪ Specialized investments with no contractual safeguards  
▪ Risks are priced into the contract price |
| Node C | Credible contracting | ▪ Interfirm contractual safeguards in place  
▪ If costly breakdowns occur it may be converted to hierarchical governance mode  
▪ May be costly to integrate into hierarchy hence seen as governance of last resort |
| Node D | Hierarchy | ▪ Integrated into the firm |

*Figure 73. Modes of governance.*  
Adapted from Williamson (2002)

Analysing the four contracting nodes in Williamson (2002) identifies node C as describing business critical outsourcing. It is notable that Williamson comments that this node can be costly to reverse which certainly applies in business critical outsourcing.

Williamson (2002, p 183) argues “Try markets, try hybrids, and have recourse to the firm when all else fails”.

Williamson (2002) continues by suggesting that labour has a differential treatment in the discussion on asset specificity “Because a firm can not own its labour, hierarchy is irrelevant and the

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31 Professional football players are contractually bound, the player can be traded and there is a market value to the player. A club can and does assign asset values to the individual player which is recorded in their balance sheet.
comparison [of governance mode] is down to the remaining three” (p185). On the basis of the latter statement it could be argued that human assets in the two cases have no (nil) asset specificity. On the one hand it explains why staff that performed a business critical activity were outsourced. On the other hand, if none of the staff had accepted the offer of transfer the consequences would be detrimental for the outsourcer. Management of the network would stop, faults would not be rectified and operation of the network would eventually grind to a halt. It would take time and significant costs to replace hundreds of staff and importantly, the knowledge and specific expertise would be lost and take time, possibly years, to be re-established. It seems therefore that:

- staff do have asset specificity,
- at the individual level there are some staffs that are more critical than others, and
- it is depending on the proportion of staff that transfer across to the supplier.32

From a contracting perspective Williamson (2002) further asserts that labour can be skilled and knowledgeable but can nonetheless lack firm specificity hence assessing the degree of human asset specificity is not a trivial undertaking. One aspect of this is that negotiating contracts that regulate knowledge and expertise would be costly to write since it need:

- information of and description in the contract of the asset specificity of the competences
- to define penalties and payments if key people leave.

The discussion above indicates that in outsourcing of business critical operations it is complex and difficult to assess the degree of asset specificity of the staff. In the research cases the actions of the TSIC and Hutchison teams suggest two alternative explanations to the treatment of human asset specificity. One is that the outsourcer considered human asset specificity to be low or nil, the transaction cost is therefore low, and outsourcing human assets not problematic. Alternatively, although acknowledging that staff has a degree of asset specificity it is considered too costly and difficult to regulate this in a contract. Therefore no attempt is made to put in place contractual safeguards. The latter alternative moves the governance mode in respect of human asset specificity from credible contracting (node C) to unrelieved hazard (node B) in the Williamson (2002) model hence:

32 Ericsson OBP business case calculations apply cost projections that 20% of staff will not transfer across and be recruited
P1. If human assets are outsourced then contractual safeguards are not available which increase the risks in business critical outsourcing.

The discussion above highlights the difficulty in assessing human asset specificity and perception of risks in business critical outsourcing decisions. In addition to asset specificity of human resources, managers have to take into account on the one hand the loss of knowledge and insights when knowledge and expertise is transferred to the supplier, and on the other hand the need for sufficient resources to be transferred to the supplier for successful performance of the outsourced activity.

**Technological uncertainty and business critical outsourcing**

Transaction cost theory predicts that under conditions of high technological uncertainty the decision would be to retain the activity in-house (Williamson, 1975) whereas Walker and Weber (1994) did not find support for transaction costs associated with technological uncertainty.

In the case of Hutchison the technological uncertainty resulted in concern over loss of technological insights and future competitive positioning rather than uncertainty over technological developments itself. Efforts were made in the contractual writing to clarify and safeguard intellectual property rights. The complexity in network development and management is such that Hutchison chose to transfer whole functions and departments to ensure the proper functioning of the transferred activities. As a consequence there was only very limited knowledge and expertise retained in-house with Hutchison. Although specified in the contract it seems likely that much if not all of the knowledge and expertise in the future will reside with Ericsson hence Hutchison may suffer loss of technological insights over the course of the contract period.

In the case of TSIC the risks were less connected with the future competitive positioning but rather with the loss of knowledge which could make a transfer back of the outsourced operation should the supplier not perform satisfactorily. To mitigate this risk TSIC retained key experts in-house instead of transferring them to the supplier. However, as the analysis of the Transition stage shows the lack of knowledge transferred to the supplier had a significant and adverse effect on the operational performance after outsourcing.
The two cases identify two alternative approaches to technological uncertainty. One alternative is to retain expertise in-house as a safeguard against poor performance but this can backfire by being the cause of poor operational performance by the supplier (the TSIC case). An alternative approach is to transfer whole functions and departments to ensure high performance of the outsourced activity (the Hutchison case) but this can cause loss of insights and future competitive advantage in the market place. The figure 74 shows graphically the position of the two cases.

![Figure 74. Transfer vs. Loss matrix](image)

On the one hand, if the risk of opportunism and dependence was perceived to be high it seems the logical choice would be to retain expertise in-house, but may result in poor performance by the supplier. If on the other hand the risk of opportunism and dependence is perceived to be low then whole functions and departments would be outsourced to ensure high operational performance, but may risk the loss of future technological insights.

Whist the decision on what should be outsourced is important, of equal importance is whether there is a capable and willing supplier that could take over the activities. This is discussed in the next section.

### 8.1.2 The search process

In the analysis model the risks in the search process is defined as: (i) not concluding the negotiation once it has commenced and (ii) not finding a suitable supplier. A finding in the research is how the deadline and pressures from company senior management for cost reduction framed the perception of risks and the approach to the negotiation process. In both cases the time scales to carry out the negotiation were short, there were only a few potential suppliers that could take on the proposed outsourcing deal and there was a perceived need to negotiate in
secrecy. The combination of these aspects generated a set of decisions for the negotiation process.

<table>
<thead>
<tr>
<th>Decisions on the negotiation process</th>
<th>Impact on transaction costs</th>
<th>Consequences</th>
</tr>
</thead>
</table>
| Quickly moving into single-party negotiations with one supplier | Lower cost process compared with multiparty negotiations | ▪ Not achieving lowest possible cost  
▪ Not receiving best technological solutions |
| Communicate the required cost savings at the start of negotiations | Setting a ceiling on the potential cost savings | ▪ Not achieving lowest possible cost |
| A fast track process involving only a small group of senior managers | Low cost process | ▪ Lack of detailed understanding of the activity under consideration for outsourcing |

**Figure 75. Decisions regarding the negotiation process – single-source negotiation**

Single-source negotiation offers the benefits of a fast and low costs negotiation, meeting the time schedule requested by senior company management. Single-source negotiations also mean risks such as: limited possibility to verify data, no comparison with other supplier’s offers, weak negotiating position possibly leading to higher prices.

The downside of the approach in the cases is that there is no comparison with other offers as to cost savings and how the outsourced activity could be run. With this in mind the approach of stipulating the expected cost savings up-front can be explained as it gave indications to the supplier that a deal could be reached at the cost level communicated up-front. If the expected price levels were not attractive to the supplier they would not engage in negotiations and the outsourcer would quickly get important feedback for the decision to pursue an outsourcing deal or not. It is notable that in the case of TSIC the cost target was communicated by TSIC and in the Hutchison case by Ericsson.

A further aspect of the findings in the empirical case material is the perceived need to conduct the negotiations in secrecy from the rest of the organization.
Decisions on the negotiation process | Impact on transaction costs | Consequences
--- | --- | ---
Negotiation in secrecy | Lower cost negotiation process Reduced potential disruption in the organisation during negotiations | - Increased risk for poorly written contract and inappropriate SLAs - Potentially higher costs if poor understanding causes operational problems and costs in the operational stage

**Figure 76.** Decisions regarding the negotiation process – negotiating in secrecy

A feature of business critical outsourcing is the limited supplier market available to the outsourcer. In such situations, transaction cost economics would suggest that the activity is not outsourced and kept in-house due to dependence and opportunism. However, as the empirical material show, the outsourcer seems willing to take the risks associated with dependence and opportunism in single-source negotiations. The actions taken by both TSIC and Hutchison to mitigate the risk were a cooperative and an open book approach to the negotiations. It seems the nature of business critical outsourcing is such that both parties recognise the importance of the activity and therefore the negotiations are carried out in an atmosphere of collaboration and joint responsibility for a successful relationship.

P2. If single-source negotiations in secrecy is selected, an open book and cooperative stance in the negotiations is applied to reduce risk in business critical outsourcing

![Diagram of negotiation process](image)

**Figure 77.** Negotiation process in single-source negotiation
The empirical data suggests that although transaction costs are central, the higher the complexity of the outsourced operation the more important a cooperative stance becomes. Cooperation and relationship management in this context includes the approach to the negotiation process as well as trust-building actions taken by both parties. Relationship management has a sequential character in that decisions taken in one stage can increase or reduce costs as well as increase or reduce risks in a subsequent stage (Malmgren, 2005).

Once the approach to the negotiations had been decided the next step was to approach suitable suppliers.

The search and selection of suitable suppliers

A complicating factor in the outsourcing decision is the complexity of the undertaking and the limited supply market (Vining and Globerman, 1999). In the two cases the activity is highly complex and there is a limited supply market which suggests higher transaction costs compared with outsourcing of less complex activities. This brings us back to the model of outsourcing that was introduced in chapter 1.

It may seem from the case data the outsourcer from one day to the next decided to negotiate with only one supplier, in this case Ericsson. What the case bears out is that for business critical outsourcing the starting point is for an initial and informal inquiry by the outsourcer to assess the possibility and probability that an outsourcing deal could be struck with a credible supplier. This implies good knowledge of the supplier base by the outsourcer, and that the potential suppliers have an ongoing and extensive connection with the outsourcer on operational matters as well as discussions on new and further purchases of equipment and services. Research on strategic alliances has identified prior ties as important criteria for success on alliances (Gulati, 1995, Child and Faulkner, 1998). It appears the same approach applies for outsourcing of business critical activities. It seems unlikely that a completely unknown supplier without an ongoing relationship would venture into such complex and involved relationships as business critical outsourcing. This would be risky not only for the outsourcer but also for the supplier.
P3. If there are previous ties with potential suppliers it is more likely the outsourcer will engage in negotiations to outsource a business critical activity.

The figure 78 below illustrates some of the iterations that took place in the TSIC-Ericsson case. A similar pattern was evident in the Hutchison case. The empirical material in both cases finds that outsourcing is dynamic in nature and that TCA with its perspective of outsourcing as a make-or-buy decision has limited explanatory power. This thesis finds that business critical outsourcing is not a choice of market but a hybrid located close to a hierarchical governance mode.

**Figure 78. Interaction process during outsourcing risk mitigation**

Please note that figure 78 should be seen as an illustration only and is of course a gross simplification of a frequent and complex process.

8.1.3 Conclusions in the Scoping & Search stage

The literature review identified transaction cost analysis as suitable theoretical foundation for analysis of the Scoping & Search stage. Asset specificity and technological uncertainty were important factors in defining the scope of the outsourcing and follows transaction costs logic related to physical asset specificity. However, the conclusions in this research deviate from transaction costs logic in several aspects.

Firstly, transaction costs theory would argue that in situations with limited supply market contestability, the possibility of opportunism and dependence, the firm would select hierarchical governance. Added to this is transaction costs associated with product/service complexity and asset specificity (Vining and Globerman, 1999). The research in this thesis finds that business critical outsourcing with its complexity in operation and high importance for the performance of
the outsourcer’s business best describes the position of business critical outsourcing as a hybrid closely related to hierarchy and not as market governance (Williamson, 1991).

Secondly, in the two cases TSIC and Hutchison quickly entered into single-source negotiations with Ericsson rather than a more traditional multi-party negotiation process. It seems from the case data that high business criticality and complexity in combination with strong cost pressures show that a TCA perspective is not sufficient to explain the dynamic nature of decision processes in business critical outsourcing. The latter has important consequences for the design of the negotiation process where the empirical data shows that a cooperative and relational approach becomes important in the Negotiation and Transition stages in business critical outsourcing relationship and supports Kern and Willcocks (2000) findings.

Thirdly, in both cases the outsourcer opted for negotiations in secrecy, carried out by a small group of senior managers. The interpretation of this is that business critical outsourcing is subject to strong reactions among staff pointing to a perceived need for secrecy whilst the complexity of the activity benefits from inclusion of staff that have detailed understanding of the operational aspects. This dilemma was addressed in both cases through the approach of open book negotiations and a cooperative stance in the Negotiation and the subsequent Transition stage. The word trust comes to mind and is used by both outsourcer and supplier as a risk mitigating mechanism.

Fourthly, the empirical data points to transaction costs related to technology uncertainty in combination with human asset specificity, opportunism and dependence. The complexity of technology, operations and the embeddedness within the outsourcer’s business means that the competences of staff and expertise specific to the activity are critical to the performance of the outsourced activity. The data suggests that contracts do not address transaction costs related to human asset specificity and offer no mechanisms that could mitigate risks associated with dependence or opportunism (Williamson, 2002).

Fifth, the empirical material shows that under condition of opportunism and dependence transaction cost logic applies for physical asset specificity but that human asset specificity deviates from transaction costs logic. The research has not been able to establish the cause of this difference in treatment. One reason could be an acceptance that contractual safeguards are
not available for human asset specificity and that the resulting transaction costs are found to be acceptable. Further research is required to uncover the mechanism at play and the causes of the difference in treatment of asset specificity between physical and human assets.

Sixth, the research identifies the dilemma facing the outsourcer of business critical activities; either to retain expertise in-house to mitigate dependence and opportunism or outsource the complete activity to mitigate poor operational performance, but risk loss of technological insights and dependence on the supplier. The research indicates the dominant transaction cost is technology diffusion which the outsourcer seeks to safeguard through the contract. However, the IP and access to future technological development is bound within people and human asset specificity. As suggested in point four above, the contract can not mitigate this risk.

The research bears out that managers take decisions within a frame and context set by external forces using transaction costs considerations and takes risks into account in the decision-making process. Furthermore, decisions taken in the Scoping & Search stage turn out to have consequences for the subsequent formal negotiations in the Negotiation stage.

8.2 Findings in the Negotiation and Transition stages

In the Negotiation and Transition stages the analysis is concerned with both the outsourcer and supplier’s perception of risks in the internal discussions on the merits and risks in a potential outsourcing decision. The research question in the Negotiation and Transition stages is:

RQ2  How do the outsourcer and supplier manage risks in the Negotiation- and Transition stages of a business critical activity?

The Negotiation stage should be seen in conjunction with the decisions taken by the outsourcer in the Scoping & Search stage. It is worth noting that a prerequisite for business critical outsourcing is that there is at least one willing and capable supplier that would be prepared to take on an outsourcing contract at a given price level. In this research the expected price level was communicated at the starting point of the Negotiation stage. It suggests that the first decision by the supplier is to decide if and under what circumstances it is willing to invest the time and money required to negotiate a deal. The empirical material points to a systematic and
structured approach taken by the supplier of outsourcing services in an effort to reduce their own transaction costs and risks. The Ericsson OBP process is comprehensive, detailed and has clear decision points for go no-go decisions based on a calculation of the return relative to the risks. Estimates by Ericsson suggest the cost of bidding for outsourcing contracts can range from $200,000 to $2.5 million. Entering into negotiations requires an early assessment of significant opportunities to reduce costs through economies of scale and an assessment of the opportunity costs in negotiating one deal in favour of another potential outsourcing deal. Once the decision is taken to enter into negotiations the focus shifts to keeping the production costs low and the price offered high enough to meet the suppliers internal targets set for profits and risks.

What is outside the control and influence of the supplier are the decisions taken by the outsourcer in the Scoping & Search stage regarding what is included in the potential outsourcing contract and the design of the outsourcing process. The empirical material suggests that business critical outsourcing favours single-source negotiations, negotiations in secrecy, and that assets that are being outsourced is competence, people and processes, some with high asset specificity and essential for high performance of the activity. The main risk mitigating action that the outsourcer offers the supplier is to approach the negotiations in a cooperative manner to reduce both performance and relational risks. Figure 79 remind us of the Das and Teng (2001) framework and the relationship between the dimensions of trust and control.

![Figure 79. Risk perception, trust and control](image)

Adapted from Das and Teng (2001)
8.2.1 Performance risk mitigation in the Negotiation stage

Competence trust-building actions and secrecy

The two cases support findings of previous research that focus and effort is expended on negotiating the output measures (Arino and Reuer, 2004; Arino et al, 2005) but also the development of competence trust. Das and Teng (2001) argue that competence trust-building reduces performance risks, however the decision to carry out the negotiations in secrecy reduces the ability of both parties to safeguard that the output measures are relevant and that the service levels stipulated in the SLAs are appropriate. The research identifies a dilemma facing outsourcing of business critical and complex activities. On the one hand there is a perceived need to conduct the negotiations in secrecy for both formal and business management reasons. On the other hand, outsourcing of business critical outsourcing requires detailed understanding of the activity. However this is difficult to obtain if only a select few senior executives are involved in the contract negotiation. It becomes clear in the research that the way TSIC and Hutchison tried to manage this dilemma was through a cooperative and ‘open’ approach to the negotiations.

Negotiation in secrecy creates information asymmetry and is particularly problematic for the supplier as there is limited opportunity for due diligence to verify and confirm the appropriateness of the SLAs. By implication, the supplier can only compensate for the risk of poorly designed SLAs through the price offered for taking over the outsourced activity. It therefore falls on the outsourcer to offer mechanisms and procedures that build confidence in the accuracy of the data that is offered to the supplier.

P4 Negotiating in secrecy reduces the possibility for both the outsourcer and the supplier to use competence trust building mechanisms to reduce perceived performance risks.

The empirical material indicates three types of risk reducing mechanisms that the outsourcer could apply:

- An open book negotiation and cooperative approach
- External and independent advice
- Joint design of the contract
The research finds that the decision to negotiate in secrecy result in attempts by the outsourcer to reduce performance risks through trust building. Das & Teng propose that: “A firm’s goodwill trust in its partner will reduce its perceived relational risk in an alliance, but not the performance risk” (Das and Teng, 2001, p257). However, the research in this dissertation does not support this proposition. In the two cases both the outsourcer and supplier applied goodwill trust actions in the Negotiation stage to mitigate performance risk, in addition to relational risks, in the dimensions of output control and competence trust and supports the findings by Sengun and Wasti (2007).

Social control actions and secrecy
Negotiating in secrecy also has another significant consequence. Das and Teng (2001) argue that social control is an important dimension that can reduce performance risks. It seems the outsourcer is trading off the costs and risks associated with organizational unrest and diversion of attention among staff if the possibility of outsourcing was known, with the reduced possibility of applying social control to mitigate performance risks, therefore:

P5 Negotiating in secrecy reduces the possibility to apply social control to reduce perceived performance risks and relational.

Output control and a cooperative stance
Both cases indicate that simplistic metrics such as percentage cost savings and headcount were the basis for initiating the principal decision by senior managers to outsource (see Nordigården (2007) for similar findings), and then left to the operational management team to work out how to deliver the savings whilst minimizing the level of risk of failure. The pressure on the managers negotiating the deals were evident in the empirical material and the word failure used in the previous sentence has two very different meanings. Failure means both not delivering the plan for cost savings by the deadline given but failure also means poor performance of the outsourced operation once it has been outsourced. The research also highlights how outsourcing can be used as a managerial device to affect change in operational behaviour and metrics used to manage performance.

A further finding is the time perspective in the output control dimension. A focus on the operational aspects would identify quality of data and information to agree the contract and SLAs. A focus on competitive advantage would identify future technological developments and
IP as important hence attempts to mitigate the risks in the contractual negotiations. In one case, Hutchison, this was an important aspect of the negotiations. However, as section 8.2.3 suggests, contractual safeguards related to competence and people with specific skills are not available.

The approach of an open book negotiation has the potential of ensuring that good and appropriate contractual details and SLAs are agreed with the hope that this reduces the performance risks once the contract is signed. The question is if this is sufficient to ensure a smooth and efficient Transition of the outsourced activity to the supplier. The empirical data suggests that despite a cooperative stance the Transition stage was difficult and problematic in both cases.

The question the findings raise is if those cost reductions were considered larger than the transaction costs and the risks involved in signing the outsourcing contract. It is worth reflecting on comments in the Hutchison case such as “only 10% of the negotiating team believed this type of outsourcing could be successful” and comments by the VP and Head of Networks at TSIC such as “up and until signing I was trying to find other solutions than this outsourcing deal” suggests there were real concerns over the risks. One answer must be that the perceived risks where lower than the potential benefits as in both cases the contracts were signed.

And what can we say about the success or otherwise of the two cases reported in this research?

With the benefit of hindsight we can now say that in the case of TSIC the initial contract was extended in scope and continues to this date 33. In the case of Hutchison several subsequent outsourcing contracts 34 have been signed between Ericsson and other Hutchison companies indicating satisfactory outcomes for both outsourcer and supplier of the initial contract with Hutchison Australia.

8.2.2 Relational risk mitigation in the Negotiation stage

The literature review called for more research into relational aspects of outsourcing (Kern and Willcocks, 2000) and the management of the outsourcing relationship (Ahlstrom & Nordin 2006). Relational risks defined in this research as: “concerned with cooperative relationships, or the

33 December 2009
34 Contracts with Hutchison Italy and Hutchison UK
probability that the partner does not comply with the spirit of cooperation” (Das and Teng, 2001, p253). Das and Teng suggest that relational risks are distinctive aspects of strategic alliances such as outsourcing. “Thus, relational risk is an unavoidable – and quite problematic – element of strategic alliances” (Das and Teng, 1999, p51). Given the costly consequences of failure we could expect that much emphasis is put into reducing relational risks in business critical outsourcing.

Goodwill trust-building and relational risks

What we find in the empirical research is that both outsourcer and supplier actively apply risk mitigating actions to reduce relational risks, but also that there are conditions which reduces the possibility to fully apply risk mitigating actions suggested by the theoretical model of Das and Teng (2001).

Firstly, goodwill trust-building is extensively used by all parties to mitigate relational risks in the cases reported here hence supports the proposition in Das and Teng (2001). The main risk mitigating actions used were:

P6. Goodwill trust-building is established by assessing the commitment at the most senior level in both the outsourcer and the supplier in business critical outsourcing.

The empirical material shows support for propositions in Das and Teng (2001) that goodwill trust and competence trust will enhance risk reduction in all control modes but raises a question. The findings support the proposition that goodwill trust-building is used to overcome the difficulty for the supplier and outsourcer in assessing the risk related output and behavioural control as well as social control under conditions of secrecy in the negotiations. However, in the research it becomes clear that goodwill trust is a pre-requisite for developing competence trust rather than an independent dimension together with competence trust. This is especially the case for the supplier who is dependent on the outsourcer for information and data with which to make an assessment of performance and relational risks.

P7. Goodwill trust-building precedes all other dimensions of trust and control

Supported by goodwill trust-building the negotiating teams in both cases jointly negotiated and developed the policies and procedures in the behavioural control dimension. The area with
limited attention was the social control dimension. This can be explained by the difficulty in engaging more broadly with staff in the organization due to secrecy. However, it seems that those aspects described as supporting social control are considered less important compared with competence trust-building, output and behavioural control dimensions.

The level and direction of risk mitigation actions in the Negotiation stage
The unit of analysis in the research is the outsourcing relationship as it is developed between the negotiating team in the outsourcer and the supplier. However the empirical material points to the fact that there are other parties affected by the decisions taken in the Negotiation stage. The empirical material shows that there is a particular sequence that has an impact on the performance and relational risks as the outsourcing process proceeds. The impetus for outsourcing in the two cases came from the company parent management, which is a level higher than the managers that negotiate and make decisions on the development of the outsourcing relationship.

Goodwill trust-building is generated by parent company executives in both the outsourcer and supplier through an understanding of the motivation and driving forces behind a decision to outsource a business critical activity. Statements such as “we will make this deal work” by the CFO of the supplier suggests that money and effort would ensure the competence to deliver or the public statement by the CEO of TeliaSonera AB to the stock market that TSIC would be profitable by end of 2003. These risk mitigating actions are directional and flow from the upper level of management down to the teams that negotiate the deal.

Following on from the trust-building that takes place in the goodwill trust dimensions are the risk mitigating actions to reduce risks in the output- and behavioural dimensions and in competence trust-building. These are bi-directional flows of give-and-take in the negotiation between outsourcer and supplier.

Social control is the last dimension that comes into play in the relationship process. It relates to all the staff within the organization that is being outsourced and all the staff and functions that remain with the outsourcer and have an impact on the performance and relational risks in delivering on the contract. The direction of social control is from the manager’s negotiation the deal and flows ‘downward’ into the organization. The timing of social control is after goodwill
and competence trust have been established and also after the output and behavioural control has been agreed in the contract. Figure 80 below indicates the level in the organization and the direction of the decision in the dimensions.

**Figure 80.** Decision flow in outsourcing

There is an organizational hierarchy and a sequential order in the dimensions that affect performance and relational risks, starting with goodwill trust-building, followed by competence trust-building and output and behavioural control and finally social control actions.

Furthermore, the research set out to study both outsourcer and supplier in business critical outsourcing. It finds that both outsourcer and supplier apply the dimensions in trust and control in a similar manner and in attach equal importance to them. Studying both outsourcer and supplier also made possible the insight that both parties were willing to approach the negotiation in a cooperative and open book approach. This may not be the general approach in business negotiations but could be explained by the nature criticality and complexity of business critical outsourcing, as once a contract is signed the success of the relationship is a joint responsibility.

The decisions taken in the Negotiation stage, and in the Scoping & Search stage, influence and impact the subsequent situation in the Transition stage. This brings us to the next step in the findings from the research, namely the Transition stage.
**8.2.3 Performance risk mitigation in the Transition stage**

In the Transition stage the whole organization of the outsourcer, the supplier, and any other external party that may have an interest in the outsourcing deal are now informed and the outsourcer and supplier must now manage jointly the risks in the Transition stage.

**Goodwill trust-building**

Decisions in the Negotiation stage turned out to have an impact in the Transition stage. Firstly, a decision to negotiate in secrecy reduces the ability to take risk mitigating decisions related to output and behavioural control since facts, figures and procedures in the contract and SLAs cannot be readily verified. Although the problems were similar in the two cases the responses were different. Hutchison took the cooperative route by showing willingness to change what was wrong in the contract whereas TSIC mainly followed the contract. A finding in the research is that taking a cooperative approach seems more effective than sticking to a contract that does not meet the reality on the ground; and this situation occurred despite an open book and cooperative approach in the Negotiation stage. It raises the question what the situation would have been if a more competitive multi-party negotiation approach had been taken by the outsourcer.

A cooperative and open book approach in the Negotiation stage may not avoid discrepancies and poorly drafted SLAs when negotiated in secrecy but it supports the use of a cooperative approach in the Transition stage when adjusting the contact and SLAs.

**Output control and performance**

The empirical data in the cases has not shed light on the cost in underperformance of the SLAs and the additional investments in the Transition stage relative to the estimated savings from the outsourcing contract. In the Hutchison case with a seven year contract this sum may be small relative to the overall cost savings but for TSIC the time to recover any extra costs is shorter. This is the dilemma between opting for a short contract period and more frequent re-negotiations and the costs of adjustments during the Transition stage. In the IS/IT industry the trend is towards shorter contract periods but this leads to a need for higher margins for the supplier\(^{35}\) to recover the initial costs to manage the Transition stage and hence less saving for the

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\(^{35}\) Discussion with Sales Director at CSC Australia
outsourcer. It seems shorter contract periods provide less dependence and contract break opportunities but result in shorter time to recover the initial costs to manage additional costs the Transition stage in business critical outsourcing.

Social control
The findings suggest that a cooperative and flexible approach can address the Social control dimension to a larger extent than sticking to the contract. The effect of this is to reduce the performance risk through a collaborative approach to the adjustment of the contract but also developing an inclusive relationship rather one of an arms-length buyer-supplier relationship.

Although social control can be effective in risk mitigation in the Transition stage as the outsourcing agreement is not longer secret, the scale and complexity of transferring hundreds of staff spread across geographical locations is not a simple task. The sheer effort and time required suggests risk mitigation through social control is a slow and delicate process. The empirical material points to the need for a deliberate, well planned and inclusive process executed by managers of the highest calibre.

8.2.4 Relational risk mitigation in the Transition stage
What stands out in the empirical material is the collaborative and relational approach by the Hutchison CTO. This was reciprocated by the new General Manager at HMS who “was bending over backwards” to build goodwill and a give-and-take attitude to improve the performance of the outsourced activity.

Goodwill trust-building
Sengun and Wasti (2007) found support for the hypothesis that goodwill trust and competence trust increased the use of social control and the empirical material in the Hutchison case supports this finding. Sengun and Wasti (2007) did not find support that goodwill and competence trust reduced the use of output control. However, the empirical in the Hutchison case suggests that in the Transitions stage both outsourcer and supplier apply competence and goodwill trust building and a switch to social control processes to manage performance risks and reduces the reliance of output control to manage performance risks. An example of goodwill-trust building is to invite the General Manager of HMS to join the executive board of Hutchison.
A finding in the research is the importance of third party relationships essential for the performance of the contract. In both cases it was realised how inter-connected the outsourced activity was with other parties in the outsourcer and the supplier. These relationships where in part addressed in the contract but primarily from a legal perspective rather than form a relational perspective. No research has been identified that considers and deals with 3rd party relationships in business critical outsourcing.

Social control
Although social control was given attention during the Transition stage in the Hutchison case the empirical material shows the significant disruption a large outsourcing deal creates for the staff in the outsourced activity. The staff that have to shoulder the change management challenge are the middle managers who themselves have just been confronted with a change of employer, and then have the job of convincing their reports of the benefits. The organization becomes internally focused whilst trying to adjust to a new situation, discovering new relationships with people that used to be colleagues but are now “customers”. The empirical material gives vivid examples of the challenge with the manager of the development department commenting “we were running at 30% efficiency the first six months whilst we where getting our heads around the new reality”.

P8. In the Transition stage social control reduces both performance and relational risks

8.2.5 Conclusions in the Negotiation and Transition stages
The literature called for a relational perspective in outsourcing research and the use of Das and Teng’s (2001) framework was selected for the research. The framework is theoretically driven and this research contributes by empirically applying Das and Teng (2001). The findings largely follow the logic and propositions suggested by Das and Teng (2001) however in some aspects this research deviates in the following ways:

Firstly, the research does not support the proposition that “goodwill reduces perceived relational risk but not performance risk” (Das and Teng, 2001, p257). The finding is that goodwill trust also reduces performance risks in output control and competence trust through the commitment from senior corporate executives. This finding may relate specifically to business critical outsourcing where the importance of the activity leads to decisions taken at the highest corporate level. This finding should also be seen in connection with the next finding.
Secondly, goodwill trust-building is established though commitment by parent company executives and goodwill trust-building precedes all other dimensions in the decision to outsource. This finding is a characteristic of business critical outsourcing which sets it apart from simple and less business critical outsourcing.

Thirdly, in the Das and Teng (2001) framework, social control impacts both performance and relational risks and can therefore be seen as important for overall risk reduction. An important finding for theory but also for practice is that social control is not applied during the Negotiation stage. It seems that the perceived need for secrecy prevents the application of social control in the Negotiation stage but is available in the Transition stage. This finding leads to the observation that the Das and Teng (2001) framework could be seen as a static framework for decision making similar to a make-or-buy decision. However, the finding shows that risk reduction is a dynamic and evolving process and that the dimensions in the framework have a temporal character. This is further identified in the following two points.

Fourthly, the Das and Teng (2001) framework does not identify or differentiate the location of the dimensions in the framework. This thesis contributes with the understanding that the goodwill trust-building dimension operates from the senior executive level, that competence trust-building, output and behavioural control operate at the organizational level of the contract negotiations, and that the social control dimension operates from the level of the contract negotiations towards the rest of the organization.

Fifth, the temporal sequence of the risk reducing dimension begins with goodwill trust-building followed by competence trust-building, output and behavioural control during the Negotiation stage, and finally the social control dimension which becomes active in the Transition stage.
9 INSIGHTS AND LEARNING INTO BUSINESS CRITICAL OUTSOURCING AND FUTURE RESEARCH

The research set out to describe and explain how outsourcers and suppliers manage risks in business critical outsourcing and the findings are reported in Chapter 8. This chapter is used to make additional remarks on findings that are outside the scope of the research questions but have not only some bearing on the findings but are contributions in their own right. The implications for practice and future research are offered in the last section of this chapter.

In particular, this research has identified the role and importance of senior company executives in setting the goal of and a deadline for the outsourcing decision. This was not explicitly part of the research questions but has an impact on the question of 'how' organizations manage risks in business critical outsourcing. The next section describes the findings related to the driving forces at different managerial levels and how this affects the perspective on risks.

9.1 Decisions at different managerial levels – from cost reduction to risk reduction

What this research alerts us to is an appreciation of the role of different managerial levels in the decision to a) consider outsourcing to meet specific business goals and b) the approach to the negotiation process. Theory and literature focus their attention on the make-or-buy decision and one gets the impression that the same management level takes all the decisions throughout the process. However, the case data bear out that the decision is a multi-level decision where different levels in the organization focus on different aspects of the reasons for outsourcing. The strength of the evidence in the two cases suggests that we must find a way to incorporate this into our models for outsourcing. Three managerial levels are involved in the outsourcing decision in the cases:
Parent company executives
This level represents executives at the corporate parent level in multi-business structures (Goold et al, 1994). At this managerial level the driving force for outsourcing is cost. There is limited discussion on the operational implication or risks such as dependence on the supplier, asset specificity etc. It is simply a decision with fiat; meet the cost targets and by a set date. This is not to say that company executives are not taking decisions with due care and consideration, nor that they don’t understand the strategic implications or some of the risks; it is only stating that the instructions to executives at the operational level are narrow and focused primarily on financial goals, and they may or may not stipulate that outsourcing is the solution to meeting the goals.

Executives in the operating unit
This level represents executives in a subsidiary company of the parent with full Profit & Loss responsibility for the unit’s performance. At this level managers are responsible for running the part of the business that must meet the cost targets set by senior executives. Managers at this level have a fuller understanding of the operational and strategic implications of outsourcing the operation and attention to risk is much in the mind of the executives. Their role is to identify what should be included in the outsourcing deal, the approach taken to the negotiation and the financial calculations that show that cost targets can be met. In the two cases the group of managers involved is small (2-3 people) and the initial deliberation is carried out in secrecy. The manager’s analysis identifies some of the associated risks and how these could be mitigated. It can be assumed that on occasions this analysis concludes that the risks are greater than the potential costs saved. This may result in a recommendation not to outsource an operation and instead recommend actions as to how the cost target can be met through continued in-house operation. Benson and Little (2002) report that “labour costs and flexibility proved to be significant objectives for organizations that had increased their level of outsourcing compared to those organizations that reduced their employment by other means. It confirms the general notion that outsourcing is used as a reactive, short-term cost cutting approach to achieved required flexibility.” (p26)

Managers in the operating unit
This level represents managers of departments and units that are directly or indirectly affected by an outsourcing decision. Once formal negotiations take place the circle of individuals that are
involved is increased. The role of the enlarged group, that in the two cases were no more than 3-4 people, is to work out the practical implications and financial consequences of outsourcing. They have direct impact on decisions regarding competence trust-building, output measures, behavioural control, goodwill trust-building and the elements of social control with the goal of mitigating performance and relational risks. This group in the decision process plays a critical role in the Transition stage when the outsourced activity is transferred to the supplier and hence the success or failure in the initial phase of the outsourcing contract.

Figure 81 indicates how the decisions cascade from a higher managerial level of the process to the next lower level. The finding is a theoretical interpretation of the findings and indicates how the driving forces transfer from the previous higher level to input in the next lower level. Is also indicates how the driving forces translate to measures and outcomes for the next level in the decision process.

Figure 81. Multi-level managerial decision processes

- Outsourcing of business critical activities is not a single decision. It is a managerial multi-level decision where different levels focus on different aspects of the decision.
It seems that the significance of a deadline for the decision has major impact on the perception of risks. However, the literature review did not identify the importance of a deadline and short timescales to conclude the outsourcing contract nor did it identify the impact of negotiating in secrecy for the performance risks in business critical outsourcing.

**Consequences of negotiating business critical outsourcing in secrecy**

The research identified the importance and the consequences of carrying out the negotiation in secrecy and within a small group of executives in the operating unit. The empirical data suggests this action had negative consequences for the Transition stage as the contractual details and performance measures were not matched with the actual working of the outsourced operation. The decision to negotiate in secrecy can be explained from two different perspectives. Firstly, the corporate governance for publicly listed organizations requires that major decisions, such as outsourcing of the operations of a telecom network, must be communicated to the stock market before other stakeholders to prevent insider dealings or speculation by people in the know. The 25% increase in share price for Hutchison (Australia) on the day of the announcement of the outsourcing contract justifies in part the decision to keep the negotiation in secrecy. The other explanation is that a broad engagement of staff in the discussions might risk unrest and defocusing on the daily activities in a business critical activity. However, the empirical data shows that the lack of insight and understanding in the Negotiation stage caused poor alignment of the contractual details with the reality of operations hence increasing the risks of poor performance in the Transition and Operational stages.

**9.2 Business critical outsourcing and goodwill trust**

The literature identified that the phenomenon of outsourcing is increasingly applied to activities that are near the core of the business (Kakabadse and Kakabadse, 2005) and it was with this in mind the telecom industry was selected for the research. The empirical material identified how significant and business critical some activities can be whilst not perceived to be core to the business. This research has identified the frontier of outsourcing and defined this as business critical outsourcing:

*Business critical are activities and resources that if not available or performed at the expected level would have a substantial and negative impact on the financial and strategic performance of the business.*
Whilst identifying and naming the frontier in the literature is important the significance lies in the approach taken when organizations outsource business critical activities and resources. The high complexity and business criticality of infrastructures such as telecom systems, IS/IT systems, and power distribution systems reduces the supply market to the extent that the outsourcer enters into single-source negotiations. The dilemma this exposes is on the one hand the need to meet the competitive pressure for efficiency and on the other hand transaction costs associated with a poorly contested supply market. The finding in this thesis is that this lack of supplier market for business critical outsourcing in combination with human asset specificity and recognition of bounded rationality forms the basis for a cooperative stance in the negotiation rather than the traditional competitive purchasing approach.

![Business Criticality vs. Complexity and the Supply Market](image)

**Figure 82.** Business criticality vs. complexity and the supply market

What the research has identified is that management of risk in business critical outsourcing in some aspects goes against the grain of practice:

- Single-source rather than competitive negotiations
- A cooperative and open book approach is taken

Some aspects also raise questions regarding established theory:

- Outsourcing of human asset specificity without strong contractual safeguards
- That social control is not applied as a risk mitigating mechanism in the Negotiation stage

And finally, that goodwill trust-building is the central force that is relied on to manage a complex and business critical relationship between outsourcer and supplier through the stages in outsourcing.
9.3 Implication for practice

The dissertation makes its contribution to practice of outsourcing in several ways.

Firstly, the research provides an empirical application of a theoretically derived model for managing risk in business critical outsourcing. Through the development of a stage based analysis model and the application of different theories this research has addressed the call by other researchers for a finer lens with which to understand the phenomenon of outsourcing.

Secondly, the research has identified that human asset specificity has particular importance in business critical outsourcing. Outsourcing people and competences results in a change in the level of risks in business critical outsourcing; from a position of credible contracting to a position of unrelieved hazard (Williamson, 2002).

Thirdly, this research takes the perspective of both the outsourcer and the supplier on the management of outsourcing risks to further our understanding of how the risks are managed. Managers should take a cooperative approach when considering outsourcing business critical activities and this research has found that:

- Management of risks is a joint responsibility of the outsourcer and supplier
- Management of risks is supported through a cooperative stance in the development of the organizational relationship.
- Goodwill trust-building through an open book negotiation process reduces risks under conditions of information asymmetry and lack of operational knowledge during contract negotiations.
- Negotiation in secrecy prevents applying social control as a risk reducing mechanism which may be detrimental in the transition and operation of the outsourced activity.
- Success in the Transition stage requires goodwill trust-building, mutual adjustments and flexibility outside the letter of the contract to mitigate the risk of failure of the whole outsourcing contract.
9.4 Future research

The identification of business critical outsourcing as the frontier of outsourcing research has importance and this thesis has made some contribution towards our understanding of the phenomenon. The research finds that the boundary between business critical activities to gradually come closer to the core of the business, and as this shapes the business environment the question is how to define core business when substantial and critical part of an organization is managed by external parties.

Business critical outsourcing is likely to be found in other industries and settings such as power infrastructure, integrated manufacturing operations and processing plants. The trend for business critical outsourcing is increasing not only in infrastructure type industries and if we relax the definition somewhat we find that the pharmaceutical industry is outsourcing its R&D (Quinn, 2000), the automotive industry outsource much of its innovation to the suppliers, and the list could go on. Further research on business critical outsourcing in other industries is called for.

On the theoretical front business critical outsourcing challenge some of the theoretical basis for decision making such that: firstly, how can we better understand why human assets with high degree of asset specificity are being outsourced whilst physical assets follows transaction costs logic and remain in-house?, and secondly, what safeguards could be used to avoid the loss of the expertise, skills, and experience that underpins human asset specificity?

In the research the Das and Teng (2001) framework has been both appropriate and helpful. The finding in the research that social control is not applied in business critical outsourcing negotiations raises the question of whether the framework should be modified or if other or additional mechanisms should be the dimension in the framework.

On a personal note, the research has identified the problematic area of innovation in business critical outsourcing. Innovation is the life blood for organizations’ future competitiveness and success, and my aim is therefore to embark on a study of how organizations that outsource business critical activities can secure and promote innovation and creativity when the relationship is governed by contract.
REFERENCE LIST


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## APPENDIX A

### INTERVIEW LIST

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<tr>
<td>Ericsson Australia</td>
<td>Brad Mead</td>
<td>Head of Hutchison Managed Services</td>
<td>Hutchison</td>
<td>Doug Maloney</td>
<td>General Manager Development</td>
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<td>Ericsson Australia</td>
<td>Michael Pease</td>
<td>Operations Director Ericsson Australia</td>
<td>Hutchison</td>
<td>Gordon McGill</td>
<td>General Manager Operations</td>
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<td>Ericsson Australia</td>
<td>Shane Nee Cowen</td>
<td>Director Outsourcing Engagements</td>
<td>Hutchison</td>
<td>Peter Lakmaker</td>
<td>Engineering Manager</td>
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<td>Ericsson Holland</td>
<td>Benoit Hansen</td>
<td>Telfort - Account mgr</td>
<td>Telfort Holland</td>
<td>Peter Steggerda</td>
<td>Director Customer Operations</td>
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<tr>
<td>Telfort Holland</td>
<td>Jurgen Vreugdenhil</td>
<td>Radio Planning Manager</td>
<td>Telfort Holland</td>
<td>Stuart Robinson</td>
<td>Planning &amp; Risk Manager</td>
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<tr>
<td>CSC Australia</td>
<td>Gary Tuckwell</td>
<td>VP Sales Support</td>
<td>AMP</td>
<td>Brenda Bray</td>
<td>Contracts Manager - Outsourcing</td>
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<tr>
<td></td>
<td>Ron Leeder</td>
<td>Director – Account Management</td>
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<td>CIO</td>
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<td></td>
<td>Dereck Binney</td>
<td>Chief Technology Officer</td>
<td>DIMIA</td>
<td>Cherryl Hannah</td>
<td>CIO</td>
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<td></td>
<td>Steven Battachio</td>
<td>Contracts Manager</td>
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<td>Narella Dotta</td>
<td>Deputy CIO</td>
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<tr>
<td></td>
<td>Joana Valente</td>
<td>Account Director - DIMIA</td>
<td></td>
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<td></td>
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<tr>
<td></td>
<td>Chris Cook</td>
<td>Director of Sales</td>
<td>CSC Australia</td>
<td></td>
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</tr>
<tr>
<td>IBM</td>
<td>Andy Dixon</td>
<td>Senior Manager - Outsourcing</td>
<td></td>
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</tr>
</tbody>
</table>
## APPENDIX B LITERATURE REVIEW 1990-1997

(Adapted from Nordigården 2007)

<table>
<thead>
<tr>
<th>Author</th>
<th>Example of driving forces for outsourcing</th>
<th>Cost reduction</th>
<th>Financial leverage; fixed to variable cost conversion, reduced size balance sheet</th>
<th>Focus on core competencies and core business</th>
<th>Accessing external competencies and resources</th>
<th>Increased company focus on fewer activities</th>
<th>Risk reduction or risk sharing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benson and Ieronimo, 1996</td>
<td>Improve service, costs, and flexibility</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Brandes et al., 1997</td>
<td>Combination of need for focus on competencies, cost efficiency and financial problems</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Bettis, 1992</td>
<td>Cost reductions</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deavers, 1997</td>
<td>Two surveys. (1) Improve company focus, access to world-class capabilities (learn from business partners), share risks and free up resources for other purposes. (2) Capacity constraints limiting expansion, access to specialist skills, and tools not available at the plant, cost cutting.</td>
<td>X</td>
<td></td>
<td></td>
<td>X</td>
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<tr>
<td>Ellram and Maltz, 1995</td>
<td>Cost reduction</td>
<td>X</td>
<td></td>
<td></td>
<td>X</td>
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<td>X</td>
</tr>
<tr>
<td>Fine and Capability, manufacturing competitiveness</td>
<td>X</td>
<td>X</td>
<td>X</td>
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</table>

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**APPENDIX B**

LITERATURE REVIEW 1990-1997

(Adapted from Nordigården 2007)
<table>
<thead>
<tr>
<th>Author, Year</th>
<th>Summary</th>
<th>1st</th>
<th>2nd</th>
<th>3rd</th>
<th>4th</th>
<th>5th</th>
</tr>
</thead>
<tbody>
<tr>
<td>Whitney, 1995</td>
<td>and technology condensed to (1) dependency of capacity and (2) dependency of knowledge</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Harrison and Kelley, 1993</td>
<td>(1) Capacity, (2) access to special machinery or engineering skills, (3) lower labour cost. But also to create a greater scope (product diversity)</td>
<td>X</td>
<td></td>
<td></td>
<td>X</td>
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</tr>
<tr>
<td>Higgins, 1955</td>
<td>Cost reductions, capacity or capital need, risk sharing, techniques, focus more on speciality</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
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</tr>
<tr>
<td>Hendry, 1995</td>
<td>Companies sought to reduce costs by contracting out services and activities. Expected benefits from outsourcing: costs savings, operational flexibility, financial flexibility, short-term responsiveness</td>
<td>X</td>
<td>X</td>
<td></td>
<td>X</td>
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<tr>
<td>Jennings, 1997</td>
<td>Cost reduction</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Lonsdale and Cox, 1997</td>
<td>Despite the amount of literature written on the danger of using headcount and cost-cutting as driver for outsourcing firms still to often base their decisions on costs and financial factors</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>McIvor et al, 1997</td>
<td>Firms are motivated primarily by short-term cost reductions</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
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<tr>
<td>Probert, 1997</td>
<td>Firms make-or-buy decisions are too often addressed from a cost comparison perspective</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Reference</td>
<td>Explanation</td>
<td>(1\times)</td>
<td>(2\times)</td>
<td>(3\times)</td>
<td>(4\times)</td>
<td>(5\times)</td>
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<tr>
<td>Quinn ans Hilmer, 1994</td>
<td>Strategic outsourcing and emphasis on core competencies the firm can leverage their own competencies and increase competitiveness. Also to let the supplier take some investment risks</td>
<td></td>
<td></td>
<td>(X)</td>
<td>(X)</td>
<td></td>
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<tr>
<td>Rothery and Robertson, 1995</td>
<td>Business process re-engineering (search for world-class manufacturing and flexibility), re-engineering tool, organizational restructuring, changing technology, costs. Mechanisms for acquiring new dialogue, ideas (access)</td>
<td>(X)</td>
<td></td>
<td></td>
<td>(X)</td>
<td></td>
</tr>
<tr>
<td>Welch and Nayak, 1992</td>
<td>Historical, many firms have made outsourcing decisions based on unit costs. Outsourcing has advantages that drive: convert fixed costs to variable costs, balance work force requirements, reduce capital investment needs, reduce costs by utilising supplier's economies of scale and lower wage structure, gain access, focus resources on high value activities</td>
<td>(X)</td>
<td>(X)</td>
<td>(X)</td>
<td></td>
<td>(X)</td>
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<tr>
<td>Winkleman et al, 1993</td>
<td>Two main drivers; costs and strategic shifts. Outsourcing has helped companies to ameliorate competitive pressure, squeeze profit margins, eliminate investments, higher quality, access and increase efficiency.</td>
<td>(X)</td>
<td>(X)</td>
<td>(X)</td>
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<tr>
<td>Proportion of papers in each category (%)</td>
<td>15/18 = 83.3%</td>
<td>6/18 = 33.3 %</td>
<td>11/18 = 61.1%</td>
<td>2/18 = 11.1%</td>
<td>6/18 = 33.3 %</td>
<td>4/18 = 22.2 %</td>
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<tr>
<td>Author</td>
<td>Example of driving forces for outsourcing</td>
<td>Cost reduction</td>
<td>Financial leverage; fixed to variable cost conversion, balance sheet driver</td>
<td>Operational quality, capacity flexibility, response, and performance</td>
<td>Focus on core competencies and core business</td>
<td>Accessing external competencies and resources</td>
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<tr>
<td>Abrahamsson et al, 2003</td>
<td>Focus on core, lower costs and convert fixed costs to variable (ease the balance sheet)</td>
<td>X</td>
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<tr>
<td>Augustson, 1998</td>
<td>In an IT context access to external competencies, cost and focus</td>
<td>X</td>
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<tr>
<td>Bragg, 1998</td>
<td>Acquire new skills, focus on strategy and core functions, avoid major investments, handle overflow, improve flexibility, reduce costs and improve performance</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<td>Cachon and Harker, 2002</td>
<td>Economies of scales</td>
<td>X</td>
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<td>Carlsson and Lind, 2005</td>
<td>Companies value investments that yield cost reductions and short payback time. Balance sheet management to improve financial performance</td>
<td>X</td>
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<td>Canez et al, 2000</td>
<td>Firm's make-or-buy decisions are of the made purely on the basis of costs. Driving</td>
<td>X</td>
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<td>Ellram and Billington, 2001</td>
<td>Potential advantages of obligation contracts (e.g. outsourcing): cost reductions and risk reduction.</td>
<td>X</td>
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<tr>
<td>Fill and Visser, 2000</td>
<td>Costs but the authors also review other articles and say that 5 main driving forces are: costs, core business, quality, cooperation and finance</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Greaver, 1999</td>
<td>Organisationally driven (improve effectiveness and flexibility), Improvement-driven (access and risk management), financially driven, revenue driven (access), cost driven</td>
<td>X</td>
<td>X</td>
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<td>Gilley and Rasheed, 2000</td>
<td>Improved financial performance or non-financial performance (e.g. heightened focus on core competencies, quality improvements) and spread risks</td>
<td></td>
<td>X</td>
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<tr>
<td>Harland et al, 2005</td>
<td>Focus on core activities to reduce costs, providing short-term financial benefits and balance sheet improvements as well as improve flexibility (handle market developments)</td>
<td>X</td>
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<td>X</td>
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<tr>
<td>Author</td>
<td>Reason Description</td>
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<tr>
<td>Heywood, 2005</td>
<td>Put forward three basic reasons for outsourcing: the desire to concentrate on core activities, the need to improve the service and need to reduce costs</td>
<td>X</td>
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<tr>
<td>Linder, 2004</td>
<td>Facilitate organizational change and rapidly launch new strategies</td>
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<td>X</td>
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<td>Quinn, 2000</td>
<td>Access to innovation by strategic outsourcing (tap the capabilities of external knowledge leaders)</td>
<td></td>
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<td>Wasner, 1999</td>
<td>Cost reduction, volume flexibility, increased capacity, improved quality, innovative capability of suppliers.</td>
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</table>

| Proportion of papers in each category (%) | 12/15 = 80 % | 8/15 = 53.3 % | 9/15 = 60 % | 5/15 = 60% | 5/15 = 60% | 1/15 = 6.7 % | 5/15 = 33.3% |
APPENDIX C DATA REDUCTION PANEL (EXAMPLE)

Examples of panel data transferred from interview transcripts. The analysis is done in three steps with the first two as reduction steps and the third is an analysis step where the identified risk reduction is assigned an analytical description. The forth step is an assessment of the level of risk mitigation. The process is repeated for each dimension in each stage and for each case.

Negotiation stage - TSIC
Performance risk – Competence trust-building

What actions and decisions where taken to reduce performance risk through increased confidence trust

<table>
<thead>
<tr>
<th></th>
<th>1st data reduction step</th>
<th>2nd data reduction step</th>
<th>Primary analysis</th>
<th>Level of Risk mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>B2 3/24</td>
<td>We were thinking about going to a traditional supplier for these services, however none of the traditional suppliers had the willingness to cover that many countries. Their coverage was spotty</td>
<td>none of the traditional suppliers had the willingness to cover that many countries. Their coverage was spotty</td>
<td>Assess of suppliers willingness to supply</td>
<td>Low</td>
</tr>
<tr>
<td>B2 3/24</td>
<td>At the same time the vendors like Lucent, Ericsson, Alcatel were approaching us to engage in managed services</td>
<td>At the same time the [equipment] vendors were approaching us to engage in managed services</td>
<td>Suppliers making approaches</td>
<td>Low</td>
</tr>
<tr>
<td>B2 4/24</td>
<td>We figured of the managed services vendors that we’re talking to, who would be the best</td>
<td>who would be the best fit naturally without having to do a lot of</td>
<td>Estimate the required knowledge and process transfer required</td>
<td>Medium</td>
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<td>-------------------------------------------</td>
<td>-------------------------------------------</td>
<td>-------------------------------------------</td>
</tr>
<tr>
<td>B2</td>
<td>fit naturally without having to do a lot</td>
<td>reconstruction of knowledge and processes</td>
<td>reconstruction of knowledge and processes</td>
<td></td>
</tr>
<tr>
<td></td>
<td>of reconstruction of knowledge and processes on the vendor’s side.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4/24</td>
<td>we determined that Ericsson would be the</td>
<td>Ericsson would be the best fit…</td>
<td>Assess fit</td>
<td>High/medium</td>
</tr>
<tr>
<td></td>
<td>best fit Ericsson would be the best fit, they’re our suppliers for Juniper products, they run our voice network</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B2</td>
<td>We buy technology from them, they have a</td>
<td>We buy technology from them, they have a</td>
<td>Assess existing relationships</td>
<td>High</td>
</tr>
<tr>
<td>4/24</td>
<td>relationship with Marconi, and there was not an issue getting a relationship with CNL and Nortel</td>
<td>relationship with Marconi and CNL and Nortel</td>
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</tr>
<tr>
<td></td>
<td>the issue was going to be Lucent because Lucent wanted to be the same business</td>
<td>the issue was going to be Lucent because Lucent wanted to be the same business</td>
<td>Assess the competing suppliers willingness to supply</td>
<td>Medium/high</td>
</tr>
<tr>
<td>B2</td>
<td>at the time Lucent did not have the proper relationships</td>
<td>Lucent did not have the proper relationships</td>
<td>Check quality of relationship with competing sub-suppliers</td>
<td>Medium</td>
</tr>
<tr>
<td>4/24</td>
<td>Ericsson also showed a lot of eagerness and hunger, and they have proven to us that the restructuring to move ahead into this managed services business, they were putting a lot of effort and money and resources to go after this managed services business</td>
<td>Ericsson also showed a lot of eagerness and hunger… proven to us that the restructuring to move ahead into this managed services business… putting a lot of effort and money and resources</td>
<td>Is the supplier demonstrating effort and keenness?</td>
<td>High/medium</td>
</tr>
<tr>
<td>B2</td>
<td>4/24</td>
<td>Credibility … and they assigned a lot of people to this immediately and it was not just some of the other vendors, they sent us templates, this is what we can offer</td>
<td>Credibility … and they assigned a lot of people to this immediately</td>
<td>Does the supplier invest its resources in the negotiations?</td>
</tr>
<tr>
<td>-----</td>
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<td>--------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------</td>
<td>-------------------------------------------------</td>
</tr>
<tr>
<td>B2</td>
<td></td>
<td>Ericsson treated it as a special case because we were going to be the first pan-European for any vendor.</td>
<td>Ericsson treated it as a special case</td>
<td>Does the supplier make special efforts in the negotiations?</td>
</tr>
<tr>
<td>B2</td>
<td></td>
<td>We knew what we wanted and we figured if we ran a screening of the vendors and looked at what they’re doing straight ahead, then we could decide which one was the best for us</td>
<td>we ran a screening of the vendors and looked at what they’re doing… then we could decide which one was the best for us</td>
<td>Benchmarking</td>
</tr>
<tr>
<td>B2</td>
<td>5/24</td>
<td>can Ericsson pull this off? They can pull it off on a national basis, they’ve shown us examples of companies like Telforth in Holland but this is more or less international? doing something, co-ordinating with someone on the other end that is in a different country. So are they able to pull that off on a pan-European and transatlantic basis.</td>
<td>can Ericsson pull this off? are they able to pull that off on a pan-European and transatlantic basis?</td>
<td>Check reference with a sceptical mind</td>
</tr>
</tbody>
</table>
**Negotiation stage - Ericsson**

**Performance risk – Competence trust**

What actions and decisions were taken to reduce performance risk through increased confidence trust

<table>
<thead>
<tr>
<th></th>
<th>1st data reduction step</th>
<th>2nd data reduction step</th>
<th>Primary analysis</th>
<th>Level of risk mitigation</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1</td>
<td>we had a fairly good track record over a couple of years where we had</td>
<td>we had a fairly good track</td>
<td>Prior supplier</td>
<td>High/medium</td>
</tr>
<tr>
<td>Code</td>
<td>Date</td>
<td>Description</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------</td>
<td>------</td>
<td>-------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/10</td>
<td>delivered other parts of the network, which we are talking about here, a type of managed service. So so I think. So we were not really in the market for outsourcing in this view</td>
<td>record over a couple of years performance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A1</td>
<td>They saw that we were being able to deliver what we had sold, they did not view us as an alternative for taking over field services, they did not see us as an option</td>
<td>they did not view us as an alternative for taking over field services Supplier core competence Low</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A1</td>
<td>it took about half a year to start up the discussions and to reach a first LOU, it took 4-6 months to prove that we could actually do this</td>
<td>From informal to formal discussions From informal to formal discussions Medium</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A1</td>
<td>we also started using a former consultant of the customer and we placed him within the customers organisation, got an agreement on that from the customer and paid for him.</td>
<td>a former consultant of the customer and we placed him within the customers organisation Using external and impartial expertise High/medium</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A1</td>
<td>we did not listen to their advice on which subcontractors to use out in the market</td>
<td>we did not listen to their advice Taking advice from others Low</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A1</td>
<td>[what would you have done differently] Procurement of subcontractors and the management of those subcontractors if you select to do that instead of acquiring the qualified staff with part experience in this field</td>
<td>Take on sufficient resources with expertise and experience Do not take on too few qualified resources Low</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A1</td>
<td>[the consultant] was helping us very much in consolidate their overall cost structure with subcontractors, from all types of market and to work with a solution</td>
<td>the consultant] was helping us very much in consolidate their overall cost structure with subcontractors External advice to establish cost and performance Medium</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A1</td>
<td>5/10</td>
<td>They were very keen on us getting other customers, that we’re building on the competence and experience from others, because they want us to have more experience than they do</td>
<td>Outsourcer supporting supplier to strengthen his business</td>
<td>Achieve economies of scale</td>
</tr>
<tr>
<td>-----</td>
<td>------</td>
<td>---------------------------------------------------------------------------------</td>
<td>------------------------------------------------</td>
<td>---------------------------</td>
</tr>
<tr>
<td>E40</td>
<td>1/3</td>
<td>Commercial Risk Rating Model (CRRM)</td>
<td>Risk assessment in stages with increasing degree of data quality</td>
<td>Formalised risk assessment by supplier</td>
</tr>
<tr>
<td>E40</td>
<td>3/3</td>
<td>Country and political risks are assessed based on external agencies indices.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A4</td>
<td>7/10</td>
<td>one of the reasons for outsource is to put more focus on your own core business. Technology shifts cost a lot of money, there is a lot of pain in it. Obviously economies of scale is done by somebody who has got a bigger business, who is dealing with a number of operators. Our story is to our customers, join the club and have the benefits and advantages</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## APPENDIX E

### INTERVIEW STRUCTURE

**TSIC Interview Structure**

- **Negotiation**
  - Negotiation process?
  - Who designed the process?
  - Who was involved in the process?
  - What was successful?
  - What was difficult?
  - What types of risks influenced the negotiation process?

- **Transition**
  - What was the organizational set-up during Transition?
  - Who designed the process?
  - Who was involved in the process?
  - What was successful?
  - What was difficult?
  - How was the transition accepted among staff and suppliers?
  - What types of risks influenced the stage?

<table>
<thead>
<tr>
<th><strong>NEGOTIATION</strong></th>
<th><strong>TRANSITION</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TCE</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Uncertainty</strong></td>
<td></td>
</tr>
<tr>
<td>Taking on a long-term commitment could be risky, could you describe the type of external uncertainties that you considered during negotiation of the contract? From your point of view? From TSIC?</td>
<td>What was most uncertain during the transition period? What processes did you apply in trying to reduce these uncertainties?</td>
</tr>
<tr>
<td><strong>Frequency</strong></td>
<td></td>
</tr>
<tr>
<td>What was your expectation of frequency of adaptations or re-negotiations of the contract once it was signed? What has been the actual outcome? Describe the cost (time/resources) used to deal with the re-negotiations?</td>
<td>How would you describe the frequency or intensity of the interaction during transition compared with the on-going operation? Do you think the costs were higher, lower or as expected?</td>
</tr>
<tr>
<td><strong>Small-numbers</strong></td>
<td></td>
</tr>
<tr>
<td>This is a single source contract, what were the implications of this from your perspective?</td>
<td></td>
</tr>
<tr>
<td><strong>bargaining</strong></td>
<td><strong>Information Impactedness</strong></td>
</tr>
<tr>
<td>----------------</td>
<td>----------------------------</td>
</tr>
</tbody>
</table>
| point of view when you signed?  
   At the end of the contract?  
   Do you think you will be in a powerful situation at the end? | - Describe your perception of the information that you had versus the information that TSIC had?  
   - How would you describe the importance of the info difference?  
   - Did you attempt to minimize this in the agreement?  
   - Try and describe the “cost” of this information gap |
| **Opportunism** | **Did you discover gaps in the information/your understanding during transition?** |
| Long-term business agreements are delicate relationships, what could happen if either party behave opportunistically?  
   Did you consider this during the discussions?  
   Did you try and minimize the possibility and how? | How did you close the information gap between you and TSIC?  
   Did you invoke the written contract at any time?  
   Did you experience any opportunistic behaviour during this period?  
   Did you spend time or resources safeguarding proper behaviour? |
<table>
<thead>
<tr>
<th>Trust Building and Control Mechanisms</th>
<th>Reduction in Relational Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Goodwill trust-building</strong></td>
<td></td>
</tr>
<tr>
<td>1. Establishing mutual interest</td>
<td>Moderate</td>
</tr>
<tr>
<td>2. Individual and team-level trust</td>
<td>Moderate</td>
</tr>
<tr>
<td>3. Joint dispute resolution</td>
<td>Moderate</td>
</tr>
<tr>
<td><strong>Behavior control mechanisms</strong></td>
<td></td>
</tr>
<tr>
<td>4. Policies and procedures</td>
<td>High</td>
</tr>
<tr>
<td>5. Reporting structure</td>
<td>Moderate</td>
</tr>
<tr>
<td>6. Staffing and training</td>
<td>Moderate</td>
</tr>
<tr>
<td><strong>Social Control Mechanisms</strong></td>
<td></td>
</tr>
<tr>
<td>7. Decision-making processes</td>
<td>High</td>
</tr>
<tr>
<td>8. Rituals, ceremonies, and networking</td>
<td>Moderate</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Trust Building and Control Mechanisms</th>
<th>Reduction in Performance Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Competence trust-building</strong></td>
<td></td>
</tr>
<tr>
<td>9. Proactive information collecting</td>
<td>High</td>
</tr>
<tr>
<td><strong>Output control mechanisms</strong></td>
<td></td>
</tr>
<tr>
<td>10. Setting objectives</td>
<td>High</td>
</tr>
<tr>
<td>11. Planning and budgeting</td>
<td>High</td>
</tr>
<tr>
<td><strong>Social Control Mechanisms</strong></td>
<td></td>
</tr>
<tr>
<td>7. Decision-making processes</td>
<td>High</td>
</tr>
</tbody>
</table>
Research Question: How Do Organizations Manage Risk in Business Critical Outsourcing?

The objective of the research is to study how organizations a) establish the criteria related to risks in the decision to outsource; and b) aspects of risks included in the transfer of resources in the agreement.

The construct Risk is for the purpose of the research focused on the perception of relational risks and the perception of performance risks in the outsourcing relationship. Specifically, risks related to e.g. force major or technology provision is not included in the research study.

To structure the different aspects of the research the questions are subdivided into the following areas with specific sub-questions related to the selected theoretical perspective.

<table>
<thead>
<tr>
<th>Name of Contract:</th>
<th>Start date:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duration:</td>
<td>Value:</td>
</tr>
<tr>
<td>Description of Services:</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Name</th>
<th>Turnover/Sales</th>
<th>Profit</th>
<th># Total Staff</th>
<th># staff Outsourced</th>
<th>Market Position</th>
<th># of subscribers</th>
<th>Market share</th>
<th>5 year growth</th>
<th>Other Outsourcing relationship</th>
<th>Name</th>
<th>Turnover/Sales</th>
<th>Profit</th>
<th># Total Staff</th>
<th># staff Insourced</th>
<th>Market Position</th>
<th># of subscribers</th>
<th>Market share</th>
<th>5 year growth</th>
<th>Other Outsourcing relationship</th>
</tr>
</thead>
</table>
The Decision to Outsource

This question is primarily related to the internal process of the outsourcer when deliberating over the decision to outsource a specific part of the Operation or keep it in-house.

Description of the decision process:
Who instigated the decision process?
How was the decision process designed?
What was the original objective with outsourcing this particular part of Operations?

What was the expected benefit of the outsourcing?
- Financial
- Service Levels
- Organizational

What were the expected costs of outsourcing
- Set-up costs?
- Monitoring costs?
- Co-ordination costs?

Performance Risks
What were the criteria related to performance risk used in evaluating outsourcing compared to maintaining an in-house operation? E.g.

Financial performance risks
- Investments costs?
- Operational cost reductions?
- Incentive calculations?
- Flexibility to external events and forces?

Market Related risks
- Market position?
- Customer related?

Services level risks and their consequences
- How are these measured?
- Compared with what? Financial, Market or?
Organizational risks and their consequences
- How are these measured?
- Compared with what?

How is overall performance risk measured?
How important is risk in performance relative to other decision criteria?

Relational Risks
In comparing the in-house versus Outsourcing alternative, what type of relationship risks was identified? E.g.
- Organizational compatibility?
- Trust and integrity?
- Knowledge and Intellectual Capital?
- Single sourcing issues?
- Flexibility to external events and forces?

Services levels and their consequences
- How is this measured?
- Compared with what?

Organizational consequences
- How is this measured?
- Compared with what?

How is overall relational risk measured?
How important was overall relationship risk relative to other criteria for the decision?
How do these strategic resources add value and increase performance?
How could this performance be measured?
How are the risks in transferring the resources safeguarded in the formal contractual agreement?
How are the risks in the resources safeguarded in the management of the relationship?
What processes are constituted that address aspects of performance risks?
What processes are constituted that address aspects of relational risks?
# APPENDIX G EMPIRICAL DATA LISTING

v5 27 July 2008 – This list describes the archival material that is included in the dissertation.

<table>
<thead>
<tr>
<th>Source</th>
<th>Case</th>
<th>Date</th>
<th>Type of data</th>
<th>Description</th>
<th>Relevance*</th>
<th>Code</th>
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<tbody>
<tr>
<td>Ericsson</td>
<td>OBP Overview</td>
<td>25/3/05</td>
<td>Slides 12 pages</td>
<td>Overview of Outsourcing Business Process (OBP). The doc is available on Ericsson intranet with drill down facilities to detailed documents and templates.</td>
<td>5</td>
<td>E1</td>
</tr>
<tr>
<td></td>
<td>OBP TG0 Opportunity qualification overview</td>
<td>28/5/03</td>
<td>1 page</td>
<td>Overview of objective with TG0 meeting incl. functional participants and supporting documentation</td>
<td></td>
<td>E2</td>
</tr>
<tr>
<td></td>
<td>OBP TG0 Business case development overview</td>
<td>28/5/03</td>
<td>1 page</td>
<td>Development of initial business case (primarily by scoping potential savings) as a basis for deciding to invest in joint business foundation setting for the opportunity</td>
<td></td>
<td>E3</td>
</tr>
<tr>
<td></td>
<td>OBP TG0 Scoping of Service overview</td>
<td>28/3/05</td>
<td>1 page</td>
<td>Identification of the parts of the operator’s current business that represents outsourcing opportunities.</td>
<td></td>
<td>E4</td>
</tr>
<tr>
<td></td>
<td>OBP TG0 Sales tactics overview</td>
<td>28/3/05</td>
<td>1 page</td>
<td>Sales tactics plan matching customer and local Ericsson unit capability. Focus on, strategic fit, key success factors, power base mapping, but no reference to risk</td>
<td></td>
<td>E5</td>
</tr>
<tr>
<td></td>
<td>OBP TG0 Customer qualification overview</td>
<td>28/5/03</td>
<td>1 page</td>
<td>Listing of potential outsourcing opportunities in a market unit including operators with no current opportunities</td>
<td></td>
<td>E6</td>
</tr>
</tbody>
</table>
|                    | OBP TG0 Outsourcing Opportunity Qualification Support Document | 24/10/02 | Excel spreadsheet | 1. Market unit evaluation of potential customers  
- Relationship  
- Operational potential  
- Risks  
2. Market unit customer evaluation  
- further detailed analysis  
Results presented in tables and graphs | 5          | E7   |
|                    | Managed Service Business Guidelines  | 24/4/04  | 12 pages     | Guidelines for the development and decision process related to outsourcing business opportunities |            | E8   |
|                    | Minutes of meeting template–Sales Decision point 3 (SDP-3) Contract signing | 2 pages  | Generic checklist before contract signing. Reference to Overall risk assessment | 3          | E9   |
|                    | Letter of Intent template           | 6 pages  | Provides structure and sections for inclusions into a LoI | 2          | E10  |
|                    | User manual Initial Outsourcing Business case model | 11 pages | Guideline and overview of the information required to build a business case for outsourcing | 2          | E11  |

282
<table>
<thead>
<tr>
<th>Document Referenced</th>
<th>Page</th>
<th>Title</th>
<th>Date</th>
<th>Pages</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>OBP TG1 Joint agreement to secure commitment</td>
<td>285/03</td>
<td>1 page</td>
<td>Meeting objectives to establish a baseline for developing an outsourcing proposal and get commitment from customer CEO and CFO</td>
<td>4</td>
<td>E12</td>
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<tr>
<td>OBP TG1 Development of Letter of Intent</td>
<td>28/5/03</td>
<td>1 page</td>
<td></td>
<td></td>
<td>E13</td>
</tr>
<tr>
<td>OBP TG1 Development of customer sales tactics</td>
<td>28/5/03</td>
<td>1 page</td>
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<td></td>
<td>E14</td>
</tr>
<tr>
<td>OBP TG1 Scoping of Service pre-TG1</td>
<td></td>
<td>1 page</td>
<td></td>
<td></td>
<td>E15</td>
</tr>
<tr>
<td>OBP TG1 Developing the business case presentation</td>
<td>28/5/03</td>
<td>1 page</td>
<td></td>
<td></td>
<td>E16</td>
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<td>OBP TG1 Outsourcing project set-up</td>
<td>28/5/03</td>
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<td>E17</td>
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<tr>
<td>OBP TG1 Meeting Overview</td>
<td>28/5/03</td>
<td>1 page</td>
<td>Confirmation if the Joint Business Foundation has confirmed sufficient customer interest in the outsourcing opportunity to justify a Feasibility Study and proposal development. Key indicator is a Letter of Intent</td>
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<td>E18</td>
</tr>
<tr>
<td>OBP TG1 Summary report template</td>
<td>29/10/03</td>
<td>5 pages</td>
<td>Structure and headings for report in support to TG1 decision</td>
<td></td>
<td>E19</td>
</tr>
<tr>
<td>OBP TG1 Business case development overview</td>
<td>28/5/03</td>
<td>1 page</td>
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<td></td>
<td>E20</td>
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<tr>
<td>Tollgate procedures for OBP - 2002</td>
<td></td>
<td>14 slides</td>
<td>Overview of the OBP tollgates and support documents</td>
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<td>E21</td>
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<tr>
<td>OBP TG2A – Assessment Kit</td>
<td>12/3/03</td>
<td>2</td>
<td>List of documentation in support of decision at TG2</td>
<td></td>
<td>E22</td>
</tr>
<tr>
<td>OBP TG2A Negotiation strategy Overview</td>
<td>28/5/03</td>
<td>1 page</td>
<td></td>
<td></td>
<td>E23</td>
</tr>
<tr>
<td>OBP TG2A Presentation of proposal overview</td>
<td>28/5/03</td>
<td>1 page</td>
<td>Presentation package to customer CEO/CFO on results from Feasibility study. Objective is to gain customer support for Heads of Agreements</td>
<td></td>
<td>E24</td>
</tr>
<tr>
<td>OBP TG2A Assessment overview</td>
<td>28/5/03</td>
<td>1 page</td>
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<td>OBP TG2A HoA agreement overview</td>
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<tr>
<td>OBP TG2A Internal &amp; External communication overview</td>
<td>28/5/03</td>
<td>1 page</td>
<td>Process steps and structure of communication in Ericsson and customer organization regarding the outsourcing of activities to Ericsson.</td>
<td></td>
<td>E27</td>
</tr>
<tr>
<td>OBP TG2A Heads of Agreement Development document</td>
<td>28/5/03</td>
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<td>Document Name</td>
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<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
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<tr>
<td>OBP TG2A To-Be development overview</td>
<td>28/5/03</td>
<td>1</td>
<td>The purpose is to define, describe and prepare to verify, the future Customer/Ericsson situation and transition related to the outsourcing agreement. The results is structured to enable comparison with the As-is model of pre-outsourcing.</td>
<td>E29</td>
<td></td>
</tr>
<tr>
<td>OBP TG2A Business case development overview</td>
<td>28/5/03</td>
<td>1</td>
<td>Business case development to compare the cost and revenues of the As-is and To-be cases to assess the potential value of outsourcing. Quantified risk (risk premium) and pricing to be calculated.</td>
<td>E30</td>
<td></td>
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<tr>
<td>Directions on How to use [Service] Scoping tool vPA3</td>
<td>14/8/02</td>
<td>1</td>
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<tr>
<td>OBP TG2A Customer As-is detailed study overview</td>
<td>10/4/03</td>
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<td>E32</td>
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<tr>
<td>OBP TG2A Customer Information Input Specification</td>
<td></td>
<td>10</td>
<td>Document structure and process to collect information from the customer in order to minimize concerns and friction in preparation for the transition phase.</td>
<td>E33</td>
<td></td>
</tr>
<tr>
<td>OBP TG2A Assumptions and special adjustments, appendix 2</td>
<td></td>
<td>8</td>
<td>Information on specific issues that need addressed in order to reduce/minimize the risk to Ericsson.</td>
<td>E34</td>
<td></td>
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<tr>
<td>OBP TG2A Outsourcing pricing principles &amp; guidelines</td>
<td>2002</td>
<td>42</td>
<td>Description of pricing principles and examples.</td>
<td>E35</td>
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<tr>
<td>OBP TG2A User manual – Pricing and profitability analysis tool</td>
<td>31/8/04</td>
<td>8</td>
<td>Description of input and output of price calculations.</td>
<td>E36</td>
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<tr>
<td>OBP TG2A template Agreement for Managed Operations Services</td>
<td>28/10/03</td>
<td>31</td>
<td>Heading and detailed descriptions of contractual specifications in outsourcing agreements.</td>
<td>E37</td>
<td></td>
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<tr>
<td>OBP TG2A Outsourcing Feasibility study report</td>
<td>41/8/03</td>
<td>39</td>
<td>Structure, headings and detailed description of content in feasibility report.</td>
<td>E38</td>
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<tr>
<td>OBP TG2B Guidelines for commercial risk rating of managed services operations/managed capacity</td>
<td>12/2/03</td>
<td>3</td>
<td>Description of risk types.</td>
<td>E39</td>
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<tr>
<td>OBP TG2B General risk assessment</td>
<td>23/10/02</td>
<td>12</td>
<td>Listing and description of general risks including probability scoring and consequence assessment</td>
<td>E40</td>
<td></td>
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<tr>
<td>OBP TG2B Risk management &amp; methodology overview</td>
<td></td>
<td>12</td>
<td>Description of risk management processes and advice on risk mitigation.</td>
<td>E41</td>
<td></td>
</tr>
<tr>
<td>OBP TG2B Risk management within outsourcing projects</td>
<td>11/6/04</td>
<td>3</td>
<td>Description of processes and tools to be used in assessing operational, commercial and political risks. The domain and nature of the risks can change as the project moves from bid, to transition, and into service operations</td>
<td>E42</td>
<td></td>
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<td>Document Title</td>
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<td>Pages</td>
<td>Description</td>
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<tr>
<td>Agreement for Outsourcing/Managed Service – Exhibit 1 Service specification</td>
<td>15/12/03</td>
<td>68</td>
<td>Detailed specification of service scope and activities</td>
<td>E44</td>
<td></td>
</tr>
<tr>
<td>Agreement for Outsourcing/Managed Service – Exhibit 2 Key Performance Indicators</td>
<td>15/4/03</td>
<td>24</td>
<td>Detailed description of KPI’s and targets for the outsourced operation</td>
<td>E45</td>
<td></td>
</tr>
<tr>
<td>Agreement for Outsourcing/Managed Service – Exhibit 4 Responsibility matrix</td>
<td>15/12/03</td>
<td>25</td>
<td>Detailed description of responsibility and accountability for operations of managed services of telecom operations</td>
<td>E46</td>
<td></td>
</tr>
<tr>
<td>Agreement for Outsourcing/Managed Service – Exhibit 6 Transition plan</td>
<td>5/12/03</td>
<td>8</td>
<td>Heads of agreement that describes the responsibility and organization during the transition phase.</td>
<td>E47</td>
<td></td>
</tr>
<tr>
<td>Agreement for Outsourcing/Managed Service – Exhibit 15 Change control procedure</td>
<td>29/10/03</td>
<td>5</td>
<td>Description of the contract managers powers and responsibility relating to the implementation of agreements and any agreed changes to the agreement</td>
<td>E48</td>
<td></td>
</tr>
<tr>
<td>Ericsson Management team</td>
<td>11/2/03</td>
<td>1</td>
<td></td>
<td>E49</td>
<td></td>
</tr>
<tr>
<td>Ericsson Global Services Cutting the cost for mobile operators WIS 2004</td>
<td>44 slides</td>
<td></td>
<td>Description of how Ericsson can help operators cut their operating cost (OpEx). Examples of cost calculations in parts of the operations such as billing, roll-out etc.</td>
<td>E50</td>
<td></td>
</tr>
<tr>
<td>BUGS Product code structure</td>
<td>29/6/04</td>
<td>17</td>
<td></td>
<td>E51</td>
<td></td>
</tr>
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