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Can Outsourcing of Information Technology Foster Innovations in Client Organizations? An Empirical Analysis

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Abstract

There is a substantial body of literature on information technology (IT) outsourcing. However, little is known about employing IT outsourcing to generate innovation. In this paper, we articulate the *ex ante* as well as *ex post* contracting challenges that could preclude firms from realizing such business value through outsourcing. We develop and test a model linking innovation in IT outsourcing (process innovation and service innovation) to two complementary solutions to the contractual problems: credible commitments and contingent control rights. Alternative empirical estimation approaches support the basic thesis that contractual solutions are complementary in their association with enhanced innovation performance. Our study suggests that portfolios of complementary contractual provisions need to simultaneously address *ex ante* and *ex post* hazards through contract design in the outsourcing of innovative tasks. Theoretical and practical implications are explicated.

Keywords: Information technology outsourcing, contract design, control rights, innovation, process innovation, product innovation, multivalued treatment effects, bivariate probit