

Performance Management of Suppliers in Outsourcing Project: Case Analysis from the Financial Services Industry

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This study investigates the characteristics of an effective performance management framework for outsourcing projects in a UK-based financial services organisation and how this may contribute to the success of the outsourcing arrangement. The analysis draws on outsourcing and performance management theory, and uses both primary and secondary data. Valuable information was found on objective setting, performance measurement and performance improvement in the outsourcing project. An adapted version of the Balanced Scorecard, termed a Logic Scorecard, is suggested as a measurement tool; a service credit system and a continuous improvement schedule used to enhance supplier performance. The Performance Management Framework, which is one of the pillars of the Supply Chain Operations Reference (SCOR) Model, was developed, and provides practitioners with step-by-step guidance for the implementation of performance management in outsourcing projects. This combines both suggestions for performance management before and after the outsourcing decision, thus considering the entire outsourcing lifecycle. The proposed 10-step Framework for outsourcing not only incorporates strategic propositions but also shows its implementation at an operational level.

Keywords: Performance management, Outsourcing, Framework, Financial Services, Case Study

1. INTRODUCTION

The notion of outsourcing and its use as a business strategy has come a long way. This started in the 1980's when research focused on the idea of transaction cost theory (Williamson, 1985) and the concentration on core competencies of a firm (Peters and Waterman, 1984). Just as the economic society developed from a rather industrial to a more service-oriented economy, so did outsourcing. In the last twenty years, service outsourcing has become very popular (Amiti and Shang-Jin, 2005). Many different service industries now outsource business processes including the financial services sector, where most back office operations can be outsourced easily, giving institutions the opportunity to improve their process efficiencies (Tas and Sunder 2004; Busi et al. 2008). However, there is a trend for outsourcing projects not to meet expectations, or even to fail. A study

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that backs this argument was conducted by the German management consultancy Steria Mummert in 2008, which asked 512 managers about the experiences they made, or still make, in their outsourcing projects. 30% of the managers said that they were content with the implementation of their business process outsourcing (Steria Mummert Consulting 2008). Many researchers have engaged in finding the reasons for failure of outsourcing projects. Post-outsourcing supplier management was named one of the major issues with regard to poor outcomes in contracting-out (Fan 2000). This research investigates the characteristics of an effective performance management framework for outsourcing projects in a UK-based financial services organisation and how this may contribute to the success of the outsourcing arrangement.

Understanding, measuring, and managing the performance of suppliers in outsourcing, or any Supply Chain project, is a key challenge. Due to the complex nature of the supply chain and its management, researchers have used the Supply Chain Operations Reference (SCOR) Model, which integrates well-known concepts of business process re-engineering, benchmarking, and process measurement into a cross-functional framework (Li et al 2011, Lockamy and McCormack 2004). The Supply-Chain Council developed the SCOR Model as a cross-industry standard for supply chain management. SCOR is a process reference model designed for effective communication among supply chain partners (SCC 2012). As an industry standard it also facilitates inter-, and intra-supply chain collaboration, horizontal process integration, by explaining the relationships between processes (i.e., Plan-Source, Plan-Make, etc.). The SCOR Model is based on three pillars (of process modelling, performance measurement, and best practices) (Feng et al. 2010) and five distinct management processes: plan, source, make, deliver, and return (Archie 2004).

In this paper, the authors focus on the key management processes listed within SCOR Model 'source', where we discuss the criteria for supplier selection in the outsourcing project and the importance of performance measurement in the sourcing process (aligned to one of the pillars of the SCOR Model, i.e. performance measurement). Sourcing in the context of the SCOR Model is defined as processes that procure goods and services to meet planned or actual demand (SCC 2012). Issues such as material acquisition, vendor certification and feedback, service level agreement, sourcing quality, in-bound freight, vendor contracts and initiation of vendor payments is included within the sourcing part of SCOR Model. This paper discusses vendor contracts, service level agreements (SLA), and other issues related to management of suppliers in an outsourcing project.

This research proposes a modified Balance Scorecard (BSC), termed a Logic Scorecard, that is directed at the supply chain level to measure and manage supplier performance (Kaplan and Norton 1996). The research includes discussion on BSC, which was used as a performance measurement tool in the case study, discussed to assess the performance of suppliers with respect to SLA, reliability, responsiveness, cost of operations and flexibility of services. These are also considered as key performance metrics within the SCOR Model.

The focus of the paper is to examine how an effective performance management framework, for suppliers, in outsourcing projects is developed and how this management approach can contribute to its sustainably. The aim of the study was achieved by addressing the following objectives;

- To identify key success factors and frameworks for effective performance management in outsourcing from literature

- To elaborate on the implications of performance management on the outsourcing process and the outsourcing contract and vice versa
- To develop a best practice framework for performance management in outsourcing for the financial services industry, including how to set up goals, measure performance and initiate actions for improvement

The key contribution of the paper is the development of a performance management (PM) framework, building upon and extending the PM Framework proposed by Weimer (2009) and McIvor (2009), for the implementation of performance management in outsourcing projects. The proposed PM Framework combines suggestions for performance management before and after the outsourcing decision, considering the entire outsourcing lifecycle.

The rest of the paper is organized as follows- Section 2 includes a literature review of outsourcing in the services sector and in particular the financial services industry, followed by Section 3, research methodology, to include information about case study methodology. This is followed by a description of the case study firm in Section 4, including analysis of qualitative data, and discussion in Section 5. Section 5 includes a proposed Framework for performance management in outsourcing projects, followed by concluding remarks.

2. BACKGROUND RESEARCH

One of the most quoted definitions of outsourcing conceptualises this concept as “*a contractual agreement between the customer and one or more suppliers to provide services or processes that the customer is currently producing internally*” (Elfing and Baven 1994). Literature distinguishes between various sub-concepts related to outsourcing, best classified by two criteria. Firstly the legal relationship of contracted parties, differentiated by internal and external outsourcing. Barthélemy and Geyer (2005) referred to internal outsourcing as “quasi-outsourcing”, an approach where an organisation outsources a process to an entity which acts in the same way as an external vendor but is still owned by the parent organisation. In contrast, external outsourcing hands the business process to an entirely independent third party provider (Gay and Essinger 2000). Secondly, the location of service performance, where the outsourcing approach can be classified into four sub-categories; service performance onsite; onshore-outsourcing, where the service is performed at a different site but still within the same region (Hodel et al. 2006); off-shoring - where production processes or services are outsourced to another, often remote, country; and near-shoring- to outsource production to countries closer to the home country of the parent company (Bock 2008).

2.1 Outsourcing and links to performance management

According to Neely et al. (1995) performance measurement is defined as the process of quantifying the efficiency and effectiveness of action. In other words, it helps an organisation assess the performance of its processes regarding effectiveness and efficiency, and is credited as the most important tool to support governance and control (Weimer, 2009).

Performance management is a very recent approach that has developed from performance measurement (Taticchi et al. 2010). Whereas literature regarding performance measurement

mostly focuses on producing data, management is concerned with converting this information into actions to improve performance and thereby delivers a more holistic concept. Neely (2005) pointed out in his review of the current status of performance measurement, that this area has not been extensively investigated and proposed further research about external performance management systems (Folan and Brown 2005). The underlying concept can be found in many articles about supplier performance evaluation, which provide an indication of how a performance management system should be designed to assess the supplier effectively, although no framework has yet been developed to take account of the organisational, industry and market conditions. As confirmed by Jiang (2006), outsourcing does normally lead to a firm's cost-efficiency, but limited improvements to productivity and profitability.

Seen as a means to allow firm's to focus on core processes, improved product and service offerings and to speed time to market, Power (2004) highlighted that these are only obtained if firm's devise, deploy and maintain good outsourcing relationships. Power highlighted traps to avoid including lack of senior management commitment, lack of planning, poor communication, ignoring risks, not using good internal resources, rushing things through, lack of culture fit and having no formal governance programme. Tas and Sunder (2004) identify major drivers for outsourcing as well as off-shoring in the financial services industry. Improvements in communications make it possible for financial institutions to outsource processes without losing control. Outsourcing management systems fosters the outsourcing of more complex business processes where skilled labour in countries such as India or China and globally accredited standards such as ISO, promote the application of this business strategy.

Outsourcing is often said to be a partnership, however, experience has shown this not always to be the case. As both parties have different profit motives the only way to effectively control any opportunistic behaviour is the outsourcing contract (Pai and Basu 2007), using a set of key contractual elements (Platz, 2007). In general, an outsourcing contract should set out in clear and precise terms, and in ordinary language, the scope of the work to which it applies and define clearly the roles, responsibilities, liabilities and expectations of the parties governed by the contract (Gay and Essinger 2000). However, where significant improvement in organisational performance has been found, many organisations have not found the magnitude of improvement hoped for (Elmuti, 2003). Procuring the right contractor then commencing and managing the contract can pose several issues, requiring a robust approach (Davis, 2004); according to Varma (2006), the two prerequisites are formulation of strategy and performance evaluation.

The most important elements to include in the outsourcing contract are specifications for service levels and quality, to encourage vendor performance and discourage underperformance (Platz and Temponi 2007), including guidelines that explain the measures taken in case of poor performance by the supplier (Gay and Essinger 2000) as well as measures for over-performance (Sadler, 2000). It is also noted (McIvor, 2009) that applying performance management techniques in the outsourcing process can be challenging due to incomplete information, comparison difficulties and inadequate performance management systems. Basu (2001) noted that real time transparency of information has redefined the performance management process.

2.2 Performance management systems in outsourcing projects

Gottschalk and Solli-Saether (2005) describe stakeholder management as the second most

important factor for success in outsourcing, after the correct selection of the process or service to be outsourced. They suggest that the relationship between buyer and vendor has to be managed efficiently and effectively to secure the success of the project. Weimer (2009) goes further and constitutes that the success of an outsourcing project solely depends on the professionalism in managing the outsourcing supplier's performance.

Regarding key success factors, Aron and Singh (2005) stress the importance of internal measurement before the outsourcing decision, to later compare whether the outsourcing service provider performs better than when the process or service was still performed in-house. Benchmarking within the industry is required to appreciate and set the performance and cost levels to be achieved after outsourcing (Schoeninger 2004).

The focus in the operations phase is performance management and adjustments to the contract (Hodel et al. 2006). Change requests have to be considered to allow the contract to adjust to the changing environment (Dzierzon 2005) with associated regulations (Würz and Blankenhorn 2010). Basu (2001) considers the selection of appropriate performance metrics a critical success factor for the outsourcing project and which require regular review. Dittrich and Braun (2004) stress the importance of hard and soft measures and categorize them into technical and qualitative ones. Pai and Basu (2007) classified performance metrics into four categories, namely volume of work, quality of work, responsiveness and efficiency.

Weimer (2009) pointed towards the most vital information need for organisations engaging in outsourcing as being the areas of service reporting and performance management. As such, organisations have to develop measurement and reporting tools that produce relevant information on service levels, quality and customer satisfaction. Only if this information can be generated, can the outsourcing project become a success story (Weimer 2009).

The most commonly used tool in the outsourcing environment is the Balanced Scorecard (BSC) approach (Würz and Blankenhorn 2010), providing executives with a comprehensive framework that translates a company's strategic objectives into a coherent set of performance measures (Kaplan and Norton 1993, 2001). BSC uses the category of finances, customers, processes, and innovation and growth to keep track of the execution of activities/actions by the staff/ department/ business functions and to monitor the consequences arising from these actions (Kaplan and Norton 1996). The data gained has to be used to find solutions to problems and by that, improve the supply process. More than just a measurement system, the BSC is a management system that channels core competencies and emerging technologies toward strategic goals and business objectives (Kaplan and Norton 1996, 2001). The BSC has increasingly developed itself a respective de-facto standard or reference model for performance management. The BSC approach takes a strong process perspective and thus is decidedly compatible with the SCOR Model (which is also a process reference model) (Poluha 2007; Pretko 2001).

Giving compensation or shared savings is a very effective tool to foster good supplier performance. On the other hand, it can be important to penalise the supplier for poor performance, so that the supplier always focusses on reaching the service levels (Mullin 1996). Pai and Basu (2007) took this approach one step further and suggest a practical approach called a Service Credit System. Service credits are payments to the outsourcing service buyer, when the supplier does not meet the service levels. Service credit is not to compensate the buying party for its losses; it is used as an incentive tool (Pai and Basu 2007).

A further concern with regard to the design and implementation of performance management in outsourcing is communication management (Weimer and Seuring 2008). By building trust through communication, the post-contract transaction costs can be reduced (Würz and Blankenhorn 2010).

2.3 Issues for performance management systems in financial services outsourcing

The process has to be evaluated with regard to the internal business risk (Büchner et al. 2008). The best measure to execute this analysis is classification into the four risk perspectives identified by Gewald and Dibbern (2009) - Performance risk, Financial Risk, Strategic Risk and Psychological risk.

Government institutions such as the Basel Committee on Banking Supervision, the Committee of European Securities Regulators and the UK Financial Services Authority (FSA) have stressed the necessity of legal regulations related to, for example, supplier dependence, legal or IT risk (Büchner et al. 2008). They see a major increase in risk for these organisations following an outsourcing strategy (Wright 2005).

Evans (2005) analysed the regulations imposed by the UK Financial Services Authority and found that the identification of potential risks and necessity of systems for management and control of these risks are of major concern within these regulations. This set of rules demands the development of a secure supplier contract and the employment of this contract within a relationship management system including the necessity of internal and external due diligence and the introduction of a performance measurement system.

Another area of interest quoted in literature regarding performance management in financial services outsourcing is the statement of auditing standards (SAS) 70 which has developed to become an international standard for the evaluation of supplier performance control systems (Büchner et al. 2008). The underlying control reports give the outsourcing organisation an independent view on the processes and performance of the supplier.

2.4 Performance management frameworks for outsourcing projects

To be able to develop an effective performance management system in outsourcing, actions have to be taken at the correct step of the outsourcing process, also called the outsourcing lifecycle. Many authors have subdivided the outsourcing lifecycle into various phases. The number of phases and their scope and definition depends on the research study, varying between two and four (Fill and Visser 2000; Marshall et al. 2004; Weimer 2009), the most prevalent being Weimer's Three Phase Model.

McIvor (2009) developed a framework for performance management in outsourcing, Figure I, to give an organisation a guideline for the implementation of performance management throughout the course of the outsourcing process. The design and implementation process is split into four stages (McIvor et al. 2009).

The first stage of the Framework, process importance analysis, identifies the contribution by the process to corporate success. Core competencies that contribute to competitive advantage remain in-house, whereas non-core competencies are considered for outsourcing. The research study uses the critical success factor (CSF) method to identify critical and non-critical processes.

<<Add Figure 1>>

The second stage, process capability analysis, is concerned with the evaluation of whether the outsourcing organisation is capable of performing the process on the same or a higher level compared to potential external suppliers, using cost analysis and benchmarking. Once the first two steps are accomplished the third stage, choosing the sourcing strategy based on the analysis results, can be executed, Figure 1. The decision will then be whether to outsource or to perform internally. The last step in McIvor's (2009) Framework is implementing and managing the outsourcing arrangement, once the decision has been taken in favour of outsourcing. Here, a sub-classification into contract management, managing and evaluating the relationship is made. Although McIvor gives some indication on how to manage and evaluate the supplier, a clear tool or guideline for design and implementation that could be adapted for the majority of outsourcing projects, is not given.

This gap in the literature was closed by Weimer (2009) with his approach to transform the Balanced Scorecard for internal use into a performance measurement tool in outsourcing projects. Weimer's Outsourcing Lifecycle Model firstly contains an assessment phase from setting up the right outsourcing strategy, through goal-setting to signing of the outsourcing contract (Dittrich and Braun 2004). After selecting the companies with the most appealing offerings, there will be joint building of an outline framework for the outsourcing project including the development and negotiation of service level agreements (SLA) (Parish 1997). After a plan for the transition of the process or service and the development of a business case, the final supplier is chosen (Weimer 2009) and the signing of the outsourcing contract with the chosen supplier is possible.

Weimer's second, transition phase, concerns the processes or services which are moved from the organisation to the supplier according to the transition plan established in the assessment phase (Dittrich & Braun, 2004). The aim of this being to shift the outsourced operations efficiently to the service provider so that the agreed service levels are met after a short period of time (Weimer, 2009) using defined performance measurement.

Weimer's third phase, operations, commences when the service level agreements are met for the first time and ends when the outsourcing project is over and the process or service is handed back to the parent organisation or an alternative supplier. Throughout this phase continuous improvement and the adjustment of the processes are of major concern (Weimer 2009). Additionally the performance measurement of the supplier according to the service levels is performed with measurement tools (Hodel et al. 2006) and based on the results of this, actions are planned and implemented. Many researchers share this view (Hodel et al. 2006; Basu 2001; Würz and Blankenhorn 2010). The objective of his work was to identify the relevant information necessary for an organisation to effectively manage the outsourcing project, specifically service reporting and performance management.

Considering these findings in the literature, one can conclude that performance management includes far more than merely measuring the performance of the supplier. When designing a performance management system, it is important to consider all facets of the outsourcing relationship and include measures and guidelines for each eventuality. Regarding the very limited literature available on performance management in outsourcing, the two afore-mentioned

frameworks appear a good match and appropriate starting point for practitioners who are about to implement performance management in their outsourcing project. In summary, there has to be more research conducted with regard to a holistic model for performance management in outsourcing. The performance management Framework proposed in this paper will give an indication of how this model could look and provide a basis for further investigation in this area.

3. RESEARCH METHODOLOGY

Secondary data collection through a literature review provided general descriptions of performance management in outsourcing projects and surrounding topics, in order to develop a better understanding of the topics and related issues (Saunders et al 2009). Primary research was undertaken in the form of a case study in a large financial services firm in the UK. The appropriate data collection method for the case organisation was in the form of interviews, for analysing and comparing the information to the literature review findings. A case study is a useful strategy in the early phase of research, where there may be no previous work for guidance (Meredith et al. 1989; Collis and Hussey 2003) or where existing theories seems inadequate (Eisenhardt 1989). Furthermore it is the right research method when a theoretical approach should be evaluated according to its applicability in practice (Ghauri and Gronhaug 2002). Both of these requirements hold for this research study.

The most important factor in case studies is the unit of analysis. The unit of analysis “*is the kind of case to which the variables or phenomena under study and the research problem refer, and about which data is collected and analyzed*” (Collis & Hussey, 2003, p.68). For this case study method, the unit of analysis is a UK-based financial services institution and the performance management of suppliers in its outsourcing projects. Literature has already documented a limited research volume regarding the topic of performance management in outsourcing projects within the financial services industry.

Qualitative data collection methods such as interviews, is the most appropriate method, when the study is exploratory and when the questions asked are numerous and open-ended (Saunders et al 2009). In the case of this research study, both requirements can be confirmed. As already indicated, due to the limited research conducted and the aim of gaining new information on this topic, this study was defined as exploratory. This fact also implied that the questions of this research study had to be open-ended, to gather as much valuable data as possible to be able to construct a holistic insight. The interviews were conducted with eight members from the senior management (involved in the outsourcing projects), with each interview lasting for sixty minutes. The interviewees included in the research were two Operations Directors (hereafter termed as Int. 1, Int. 2 for the case analysis), four outsourcing project co-ordinators (Int. 3, Int. 4, Int. 5, Int. 6), and two supplier manager (Int. 7, 8).

For exploratory studies, as in this case, both semi-structured and in-depth interviews are possible research methods (Saunders et al. 2009). In semi-structured interviews, the researcher has a list of questions but no fixed questionnaire, so he can adapt the questions to the situation. In-depth interviews give “the opportunity for the researcher to probe deeply to uncover new clues, open up new dimensions of a problem and to secure vivid, accurate inclusive accounts that are based on personal experience” (Easterby-Smith et al. 2008). For this paper, characteristics of both approaches were combined using a list of prepared questions, included in Appendix 1. The

interview itself was in-depth and gave the respondent the chance to freely express knowledge about the research topic. This also allowed the researcher to get a holistic picture of performance management in outsourcing in the particular organisation.

4. CASE ANALYSIS

The case organisation is a very large financial services institution in the savings, investments and pensions sectors, situated in the UK. The organisation is well-established and operates internationally, with a global customer base. They have recently developed an outsourcing strategy in their organisation - this case analysis relates to a multi-million pound IT-outsourcing project currently in the transition stage (i.e. second stage of Weimer (2009) model) and its corresponding performance management system. Problems in the area of information technology came to light in the form of a capability gap analysis for project execution, both with regard to skills and number of workers. Following that, a business case was developed by the procurement and finance departments to find options the organisation could pursue to solve this situation, described as being similar to a make-versus-buy scenario.

Off-shoring the IT-process to India was the most appropriate action, resulting in a study tour to India to get to know the suppliers and their facilities, capability, capacity and the cultural fit to perform the service. After this visit, the request for a proposal was developed and sent to the potential suppliers; scores were assigned to a number of criteria including capacity, geographical location, quality and KPIs; site visits, including facilities, cultural fit, quality, personnel, confidence and their capability and cost. Having reduced the number of potential outsourcing suppliers to four, further field trips were made to India to explore the technical capabilities of these suppliers. This trip to India was termed the “*the technical deep dive*” by one Operations Director (Int. 1) to explore the technical abilities of these suppliers. In the end, the organisation signed a contract with two supplier in line with the objectives to close the capability gap in the organisation and secure the continuity of their IT-systems. This whole process took ten months but ensured the correct final decision was taken, having summarised all criteria into two categories, *capability and pricing*, to meet objectives and close the capability gap in the organisation.

4.1 The outsourcing contract

The outsourcing contract in the case of the IT-outsourcing project was negotiated between the organisation and the supplier. The procurement and legal department of the organisation were engaged in the negotiation to guarantee that the final document does not include any loopholes that would allow opportunistic behaviour of the suppliers. Furthermore, one Operations Director outlined that the supplier manager, who will be responsible for the contract and relationship management was “*actually involved in the contract negotiation, so they understand what it is that they are inheriting*” (Int. 2).

The outsourcing contract consisted of a number of documents, including a rough timeline for the outsourcing project, a governance schedule and manual, and the service level agreement (SLA). Both the Supplier Managers confirmed that the SLA was signed for a time frame of five

years within which a transition phase of 18-24 months was planned before service delivery fully moved to the supplier, implying an operations phase of three years where the process could be adapted and improved (Int. 7, 8). The governance schedule and manual included performance management actions including when and how check-ups and benchmarks were to be executed. The service level agreement described the quantitative performance objectives agreed on the basis of internal process data and were also compared to benchmark data to make sure that the service levels represent the market standard (Aron and Singh 2005). With a service level observance (SLO) period, these agreed service levels were monitored over the first six months of transition, and also included guidelines for '*service credit regime*' (i.e. financial penalty). This will force the supplier to pay a financial penalty in case of poor performance (Pai and Basu 2007).

4.2 Critical success factors for performance management system in outsourcing projects

The first success factor related to the continuous measurement of processes or services against the market during the whole contract duration. It was confirmed by the Operations Directors that this benchmarking could be carried out by the organisation throughout the whole contract period (Int. 1, 2). According to the benchmarking results, the price could be changed, but only in favour of the organisation. Additionally the contract included a provision that foresaw formal, independent benchmarking by a third party provider after 18 months of the contract had elapsed (Int. 7, 8).

The second success factor related to the effective management of the contract throughout the time it was valid for. Consensus was found by both the Operations Directors as well as the Supplier Managers themselves, that the major player for contract management is the supplier manager, dedicated to manage the relationship with the supplier. Responsibilities include those from supervising the service credit system to handling contractual change requests after benchmarking sessions (Int. 1, 2, Int. 7, 8).

Thirdly, the selection of the right performance measurement system and the underlying performance metrics were critical for outsourcing success. The key performance indicators (KPIs) finally selected for a particular outsourcing project depend "*on the nature of the relationship and the service you're buying*" (Int. 7), so the decision of what to measure has to be treated per service. This decision can also be driven by obligations imposed by legal bodies. It is not a "*one size fit*", but the organisation is able to "*plug and play it*" (Int. 8), from their listed KPIs. The organisation implemented the Logic Scorecard as its primary performance measurement tool for outsourcing to measure performance. The same Supplier Manager also concluded that this Logic Scorecard allows the organisation to control the supplier's operational delivery and by that guarantees that the supplier "*is meeting its obligation, both operationally, legally and commercially*" (Int. 7). Performance results were checked by both parties for correctness of data. Their scorecard has six categories; leadership, on-time service delivery, gross margin, innovation, customer satisfaction and risk, each with its own set of metrics.

Different projects may use different metrics - in the case of this IT-outsourcing project, an example of an applied measure would be the number of bad fixes; for example, the number of times an IT problem has been supposedly fixed but occurred again after a short time. A very recent additional category in the Logic Scorecard is innovation. All four Project Co-ordinators agreed that this is discussed with the supplier on an on-going basis to ensure motivation and continuous improvement, by the addition of a clause regarding shared best practice (Int. 3-6).

Following from the performance measurement, the two Operations Directors interviewed (Int. 7, 8) rated the conversion of the measurement results into improvement actions, as one of the critical success factors for their performance management in outsourcing. Interviewees stated that it makes sense to talk through the scorecard results with the supplier after each month to get to know the supplier's current situation and also to talk about solutions in case of underperformance. However, this is often not enough to motivate the supplier to improve performance.

The case study organisation included a service credit regime in its outsourcing contracts for the two IT-suppliers. The way this service credit regime works in the financial services institution can be best illustrated with an example. In this example it is assumed that the service level was set at 95%. If the supplier scored 94% in a three month period the supplier would have accumulated a service credit and consequently the organisation would impose a financial penalty due to underperformance. If the supplier scored 95%, then the supplier has completed the objective in line with the service level agreement. If the supplier scored 99% for three months in a row, the supplier would earn a service debit, could balance his service credit and would be exempted from previously imposed penalties. The service credit that a supplier can accumulate is capped in the contract and should not exceed this cap. If this cap is exceeded more drastic actions will be taken (Int. 3-6).

Other companies may not only implement a service credit system in their contract, but also try to improve supplier performance by giving them incentives when outperforming the service levels; the case study organisation neglected this step. Supplier incentives are not used, but instead a service credit procedure. The Financial Services Institute fears that if incentives are used, the supplier might hold the service levels artificially low during the service level observance period to set low levels as a standard and be able to gain a financial benefit in the operations phase by outperforming these low standards. Earning service debit to balance out poor performance is the preferred approach, as discussed above and confirmed by the four Project Co-ordinators interviewed (Int. 3-6).

A fixed communication infrastructure was used through the introduction of a triple-layer communication network to handle the supplier relationship. An operations manager was used to monitor the day-to-day service delivered by suppliers (a very technical role) and to communicate with the supplier, regarding performance measurement and any upcoming problems that need solved collaboratively. Those at executive level (confirmed by the Operations Directors themselves) get involved in case of escalation of problems which require senior management intervention (Int. 1, 2).

A final, consensual, factor frequently mentioned in the interviews with all Project Co-ordinators as well as Supplier Managers with regard to performance management of the IT-suppliers, was risk management. This was described as especially important in the financial services sector, both due to the impact that an insufficiently screened project could have on the operations and due to the compliance with legal requirements imposed by the Financial Services Authority (FSA) (Int. 3-6, Int. 7, 8). For the IT outsourcing project, risk management was executed throughout the whole outsourcing process from setting up the business case, to managing the supplier performance. The FSA provides rules and regulations on business case analysis so that a risky outsourcing project will not be executed. Additionally, one of the Operations Directors pointed out that "the case organisation has to give evidence for robust processes in terms of exit and business continuity planning. Performance management itself has to follow risk requirements

according to the FSA” (Int. 1)

This type of risk management was described as a bottom-up approach, managing and improving supplier performance with the help of data gathered on an operational basis. Statements on audit standards, which are another instrument of regulation by the FSA, provide the companies a top-down view of the supplier’s financial standing, strategic outlook and their controls.

4.3 Performance management at an operational level

The performance management process for the IT-supplier was defined in the governance manual which is an operational working document included in the outsourcing contract, which is overseen by the supplier manager (Int. 7, 8). As stated earlier, the SCOR Model provides a common process-oriented language for communicating among supply-chain partners in the following decision areas: plan, source, make, and deliver. The SCOR Plan process deals with those processes that balance aggregate demand and supply for developing actions which best meet sourcing, production, and delivery requirements (Lockamy and McCormack, 2004). Thus, by knowing the operational service processes, the supplier manager was able to better detect opportunities for improving both the supply process and the quality of service through the application of the Logic Scorecard to the IT-department and discuss monthly changes to the metrics with the person in charge. The supplier manager is also part of the monthly, quarterly and half-yearly governance meetings which include a review of the service level agreement, the key performance indicators and analysis of the supplier’s performance over the preceding month. All include the creation of action plans for improving the service in the next month (Int. 7, 8). In addition to the actions discussed above, the quarterly meeting also focuses on the innovation delivered by the supplier and discussion of best-in-class practices of suppliers. The half-yearly meeting also involves executives from the case study organisation and the IT supplier, who meet to discuss the effectiveness of the outsourcing and whether the outsourcing strategy results have met expectations.

In addition to these operational and strategic meetings, the organisation also has the right to visit sites and facilities of suppliers on a regular basis in the outsourcing contract. One Project Co-ordinator stated that *“Not until you do those types of audits or those spot checks [...] [you figure out] how it's actually working on a day-to-day basis, that you truly get to see what's going on”* (Int. 4). These site visits are very important for the successful performance management and contribute to a high learning effect (Int. 3-6).

4.4 Assessment of the performance management system in the case organisation

Within the organisation, there have been major changes with regard to performance management in outsourcing projects already undertaken in recent years. Historically, supplier management was performed by the business function on an ad-hoc basis, so steering the supplier was generally only as good as the person working in the business function (Int. 8). With the introduction of the Logic Scorecard, supplier performance management for outsourcing projects was given more attention. It is recognised that if the project were to commence again, two aspects would be undertaken differently; the period for definition of requirements would be elongated to secure its completeness, and internal roles and responsibilities for the outsourcing project would be

better defined, to minimize the risk of the supplier approaching different organisational levels and functions. This would stop the possibility of the supplier “playing” off departments against each other during the assessment phase; *“good communication is paramount to success, otherwise costs and performance suffer”*, confirmed by both Supplier Managers (Int. 7, 8).

Regarding performance management for sustainable success for the outsourcing project, all interviewees stressed the importance of it *“because it means that [the] supplier knows that the end of the journey isn't when the contract is signed”*. This is especially vital with regard to the value lost due to an increase in transaction cost when the supplier is poorly managed. Another factor, confirmed by a Project Co-ordinator, that supports the significance of performance management is related to change control because *“you're going to discover that the way you thought you were going to make this work, maybe wasn't quite right or an assumption that was made was incorrect”* (Int.7). With a proper performance management and governance model, *“these changes can be easily adapted and the project can move forward on an improved process base”* (Int. 1, 2, Int. 7, 8).

5. DISCUSSION

Segmentation of the outsourcing lifecycle (Weimer 2009) was confirmed by the research conducted. Weimer (2009) suggested that the outsourcing lifecycle can be segmented into three phases, namely the assessment, transition and operations phases. This segmentation was confirmed by the research conducted in the case study organisation. In the case under consideration, the assessment phase took ten months, the transition phase was planned to be eighteen to twenty four months following an operations phase of two and a half to three years at a total contract length of five years. Literature and practice showed many similarities for work carried out in each phase, although the research study in the case organisation gave a more detailed indication of the processes throughout the outsourcing lifecycle. What was neglected by literature, but especially emphasised by the interviewees was the importance of defining requirements and supplier selection prior to proceeding with the outsourcing project, particularly in terms of performance management. Investing time in supplier selection and eventually contracting the right one, has a positive influence on later performance and can therefore ease relationship management (Folan and Brown 2005). Consequently, performance management does not begin when setting goals in the service levels but already in selecting the most suitable supplier for the outsourcing project (Weimer 2009).

Literature suggested that the contract has to define the role, responsibilities, liabilities and expectations, fix the service levels and give a clear guideline on actions taken for good as well as poor performance (Gay and Essinger 2000). The outsourcing contract in place in the case organisation incorporated these aspects in its entirety. With the help of a governance schedule and manual, the legal document elaborates on the roles and responsibilities during the operations phase. The service level agreement defines the expectations towards the supplier while the service credit system explains the consequences of below and above-average performance (Pai and Basu 2007).

Literature stressed the importance of continuous measurement of the process before and after the outsourcing decision (Schoeninger 2004; Aron and Singh 2005). The research has proven that this is common practice in outsourcing projects in the financial services industry. The potential

process for outsourcing was analysed in its entirety and a business case was developed on the basis of performance and cost data, as well as the ability to benchmark the process against the market throughout the contract period.

Contract management is a critical success factor in both the literature and practical application in financial services. According to a number of authors, contract management is concerned with dealing with adjustments to the contract, using change requests (Hodel et al. 2006; Dzierzon 2005; Würz and Blankenhorn 2010). The case organisation employs a supplier manager who handles these contract changes and the supplier relationship in general. In practice these contract changes usually become necessary after the service level observance period, when service levels need adjusted, and after benchmarking, when the price of procuring the service has to be aligned with the market.

The Balanced Scorecard was identified as the most suitable performance measurement system for outsourcing projects in the literature (Basu 2001; Weimer 2009; Würz and Blankenhorn 2010). The BSC in its original condition is not explicitly directed at the supply chain process. This research proposes a modified BSC, termed a Logic Scorecard, that is directed at the supply chain level to measure and manage supplier performance- thus is decidedly compatible with the SCOR Model which also takes a strong process perspective in measuring and managing performance at the Supply Chain level (Poluha 2007; Kaplan and Norton 2001; Pretko 2001).

The IT outsourcing project gives proof to the aforementioned statements. The case organisation introduced the Logic Scorecard as their performance measurement tool for the outsourcing suppliers which is a BSC adjusted to the requirements of the outsourcing environment. As opposed to the four standard measurement categories in the BSC, the case study organisation adapted the categories to the situation. For each of the six categories of their Logic Scorecard, they developed a number of project-specific measures to ensure the project can be measured and managed effectively. This emphasised the statement by the interviewees who underline that the selection of performance measures needs to be very project-specific.

For the conversion of the gathered data into actions for improvement, a number of authors from the field of outsourcing have suggested a causal analysis and a service credit system (Dzierzon 2005; Mullin 1996; Pai and Basu 2007). Both aspects have been covered in the performance management system in the case organisation, where their service credit regime is in place to penalise the supplier financially for poor performance.

For performance management in outsourcing projects to be successful, communication between the two contractual parties is another key for success (Weimer and Seuring 2008). The case organisation followed this suggestion and implemented a triple-layer communication infrastructure, with the supplier manager being the key point of the outsourcing relationship. Risk management is one more major area of concern that, when executed diligently, can contribute to the success of performance management (Wright 2005). Literature suggests that a risk analysis take account of internal business risk and compliance risk (Büchner et al. 2008). The case organisation approached this risk analysis with regard to both aspects, in line with FSA regulations, as well as having contingency plans.

5.1 Development of an effective performance management framework

Following the comparison of literature with the findings of the case organisation, a ten-step performance management framework for outsourcing projects (Figure 2) was developed. Both the frameworks for performance management in outsourcing projects developed by McIvor (2009) and Weimer (2009) played an important role in this updated framework. Both are very generic in terms of project execution and the supplier relationship in the operations phase; the framework which was developed provides detailed propositions on implementation for practitioners.

<<Add Figure 2>>

5.1.1 Stage 1: Problem detection

The first stage of this framework concerns problem detection to identify areas of concern within the business. This step is not part of McIvor's (2009) outsourcing process, as in his research study, the entire organisation was screened for potential business process outsourcing. In the case organisation, outsourcing was considered after a capability gap within the IT-infrastructure was observed. Acting after the detection of such a problem is a further way of commencing the outsourcing process.

5.1.2 Stage 2: Process importance analysis

Stage two is part of McIvor's (2009) outsourcing framework and is associated with detecting whether the service under consideration for outsourcing can be given to a supplier without losing competitive advantage. This analysis was not a part of the outsourcing project conducted by the case organisation, but is essential for sustainable success of both the outsourcing project and the outsourcer's future company performance, where the critical success factor method should be used.

5.1.3 Stage 3: Process capability analysis

The third step was also suggested by McIvor's (2009) outsourcing framework and evaluates the capability of the organisation to perform the potential process for outsourcing at the same or higher level than the market, at the same or lower cost. This internal analysis also plays an important role for the performance management of the supplier, as it gives an indication regarding cost and service level targets during supplier selection. The detection of the capability gap in the case organisation has shown that it is also a very valuable tool for making an outsourcing decision.

5.1.4 Stage 4: Business case

Stage 4 is to state the business case. This step is not a part of the framework developed by McIvor (2009) but has been covered by Weimer (2009). The case organisation did implement this step for the financial analysis of the outsourcing project. In the course of the business case analysis, the financial figures needed were collected and compared to the company's requirements, in terms

of Internal Rate of Return.

5.1.5 Stage 5: Outsourcing decision

Having accomplished the first four steps of this Performance Management Framework, the data to enable a decision in favour, or against outsourcing has been gathered. While in McIvor's framework only process importance and capability were named as criteria for the outsourcing decision (McIvor 2009), the research conducted in this study has indicated that the business case has to be considered as well. For the outsourcing decision to be positive, the project has to maintain the same level of competitive advantage, hence there has to be a capability gap in the organisation and the project has to satisfy financial requirements.

5.1.6 Stage 6: Requirement definition

The performance management framework by McIvor (2009) fully neglects stages 6 and 7. However, for the case organisation, the definition of requirements was a vital aspect and is therefore included in the Framework. A holistic definition of process and service requirements was vital for an effective supplier selection process. Despite organisational pressure to quickly go out to the market, enough time needs taken to ensure the completeness of data used.

5.1.7 Stage 7: Supplier evaluation and selection

Again, McIvor (2009) does not include this aspect in his framework. Nevertheless, the research conducted in the case organisation provided a number of factors to indicate how to evaluate and select the supplier. The evaluation of potential suppliers should be carried out using two criteria; capability and price. Selecting an inappropriate supplier can have a serious impact on the overall business performance; capability normally receives a higher weighting than price. However, this cannot be generalized, as it is project-specific.

The supplier selection process should be divided into two steps. Firstly, the potential suppliers need screened on capability, capacity and cultural fit (in case of off-shoring). Once the number of suppliers has been reduced on this basis, a detailed analysis can be conducted on capability and price until the final decision is taken.

5.1.8 Stage 8: The outsourcing contract

As the outsourcing contract is the legal basis for the outsourcing relationship, it should include as much detail about roles, responsibilities, liabilities and expectations as possible. More information is discussed above, in section 4.1.

5.1.9 Stage 9: Performance management considerations

After the outsourcing contract has been signed, and by that the basis for a successful outsourcing project has been established, the outsourcing organisation has to think about a number

of considerations to bring this basis to life and manage the performance of the supplier in the transition and operations phase, effectively.

- **Contract Management.** For effective performance management the contract has to be managed after signature. Therefore a supplier manager has to be nominated. This person has to manage the service level observance period and the benchmarking procedures during operations and to implement potential changes into the contract. Observing and enforcing the service credit systems is also among the responsibilities of this position.
- **Performance measurement.** The implementation of a modified Balanced Scorecard, termed a Logic Scorecard, as a performance measurement tool is required. The performance measures integrated in the Logic Scorecard should be chosen specifically for the project, but most importantly should include metrics for assessing cost, quality and delivery.
- **Continuous Improvement.** Performance measurement is only worth doing when the results lead to improved actions. This study has shown four actions that can improve the supplier's performance and the procurement process in general. There should be monthly governance meetings with the supplier in which performance can be analysed and improved action plans developed. Additionally a service credit system can motivate the supplier to deliver at, or above, service levels. To improve the process, a continuous improvement schedule should be implemented.
- **Communication management.** A triple-layer communication infrastructure with a supplier manager as a centre point, is required. The operational layer should manage the day-to-day operations. The supplier manager forms the second layer for contract management and the overall supplier relationship management. The third layer is the executive layer, is only required where there is breach of contract.
- **Risk management.** This is of major importance in the financial services industry. This study suggests a risk analysis throughout the assessment, transition and operations phases. Another recommendation to outsourcers is the application of the statements of auditing standards, which can provide an organisation valuable information on suppliers' contingency plans and performance control systems.

5.1.10 Stage 10: Performance management at an operational level

To convert all these considerations into actions, a governance schedule and manual have to be part of the outsourcing contract. The governance document should foresee monthly, quarterly and half-yearly governance meetings, with changing topics on the agenda and changing participants to ensure that every critical topic is discussed throughout the contract period. Furthermore, frequent site visits should be conducted to ensure the outsourcer is always updated and gets hands-on experience regarding the supplier's capability, capacities and dedication.

6. CONCLUSION

In addition to a review of literature from the field of outsourcing and performance management, primary research was conducted in the form of interviews at a financial services institution. This

compared and contrasted theoretical and practical findings and drew final conclusions on what requires consideration when outsourcing.

The research findings from the interviews at the multinational financial services case organisation have predominantly confirmed the literature review findings and supplemented the theoretical information with practical suggestions for contract implementation. The outsourcing process in the case organisation has given an insight to how financial services organisations manage their outsourcing projects from initial decision-making to the final signing of the outsourcing contract, and highlights the need for consideration for performance management to be taken much earlier than actually anticipated. The case study organisation is aware of the importance of performance measurement, which is one of the pillars of the SCOR models and is dedicated to continue to focus on the other pillars of the SCOR model in its daily working practices. The research briefly discusses the use of the BSC approach to measure the performance of their key suppliers in an outsourcing project. The BSC and the SCOR model together present an organized, systemic, and disciplined means of effectively measuring supply chain performance.

By combining the information sets from primary and secondary research, a Performance Management Framework was developed. The particular focus of this ten-step Framework was to develop a process-style model to implement performance management into a particular outsourcing project, from problem detection to the implementation of performance management in day-to-day operations.

There has been limited research in this area and the papers' findings bear a number of managerial implications. Both literature and primary research emphasise the importance of performance management for outsourcing projects in general and underline their standpoint by referring to research that has identified a major increase in transaction costs in the case of a poorly managed supplier. With regard to the performance management system itself, the study closed a gap in the literature by providing practitioners with a step-by-step Framework that may easily be applied to a great variety of outsourcing projects, where performance management considerations give a practical guideline for their application in a number of areas, including contract management, performance measurement and improving supplier performance.

Despite these implications, the study is limited in its generalisability by a number of factors. This study has investigated performance management in IT outsourcing projects with a special focus on the financial services industry. Considering this circumstance, the findings might only be partly applicable to other industries. Additionally only one company was under investigation while conducting the primary research, so the results might be biased by the application of performance management in this particular organisation. The fact that a qualitative research approach was chosen by the authors has left room for interpretation, meaning that the results gained through interviews might be interpreted differently by other researchers.

These limitations also imply the direction of future research for consolidating the performance management system presented above, in terms of applicability and effectiveness. Researchers should assess whether the application of this process-like performance management Framework is possible in a real-world business environment. The authors also aim to further develop this Framework by including directional arrows and feedback loops, if required, between different parts of the Framework. This can be developed by testing the Framework in different scenarios and incorporating the feedback from interviewees in the existing Framework. Starting with financial

services organisations, academics can further evaluate whether this system is also appropriate for other industries, both in manufacturing and services. Findings from such research studies can then be used and incorporated in the Framework presented and lead to further investigations in the respective areas.

As discussed before, outsourcing as a business strategy has come a long way. Despite the increasing application and the extensive research conducted on this topic, the insights into performance management issues remained scarce. This research study has countered this scarcity and supplies a holistic and effective Framework for performance management of suppliers in outsourcing projects in the financial services industry. This Framework may help companies to minimize the risk of project failure and consequently ensure the sustainable success of their outsourcing arrangements.

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Figure 1: McIvor's performance management framework (Source: McIvor et al. 2009)

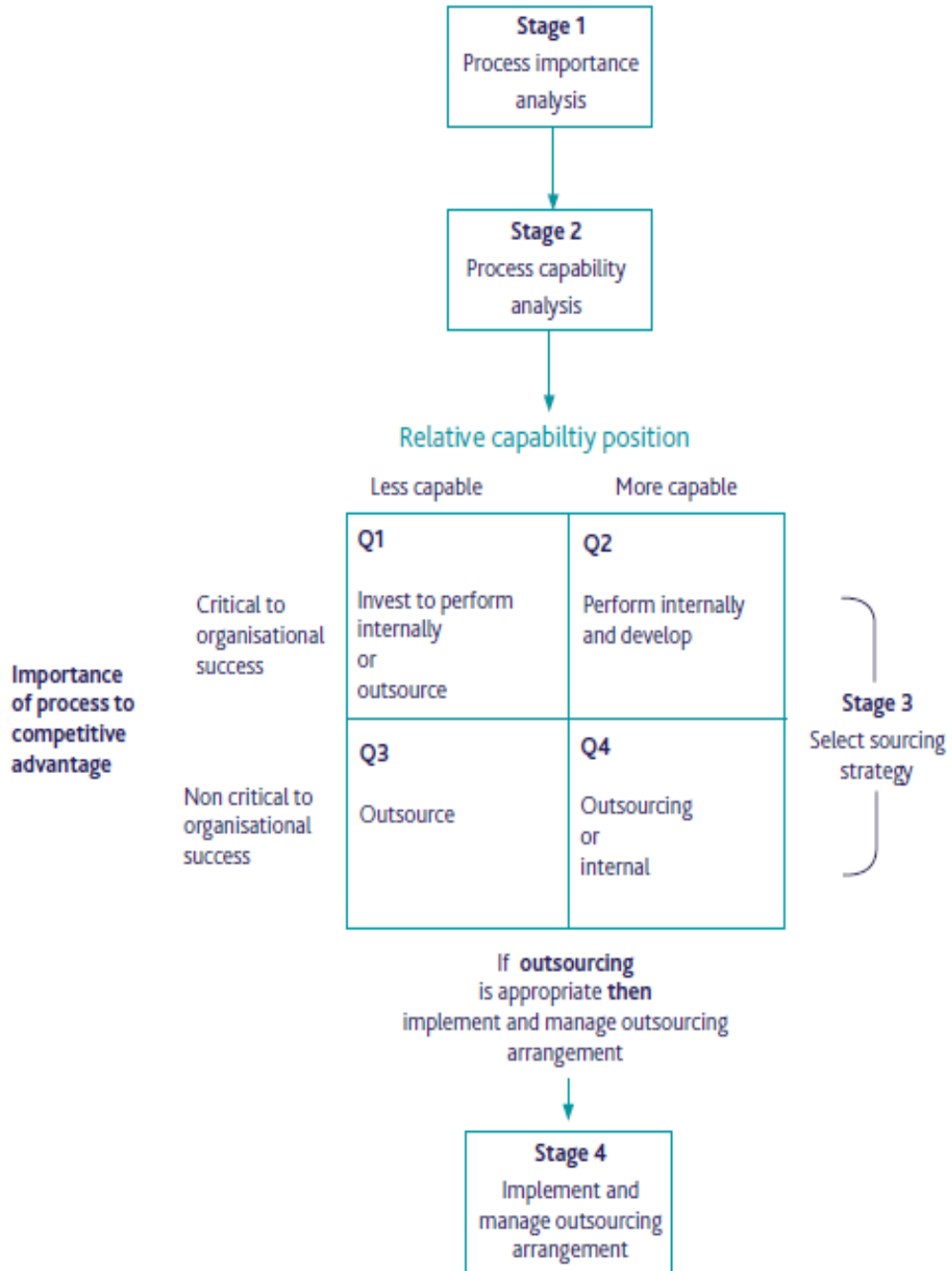
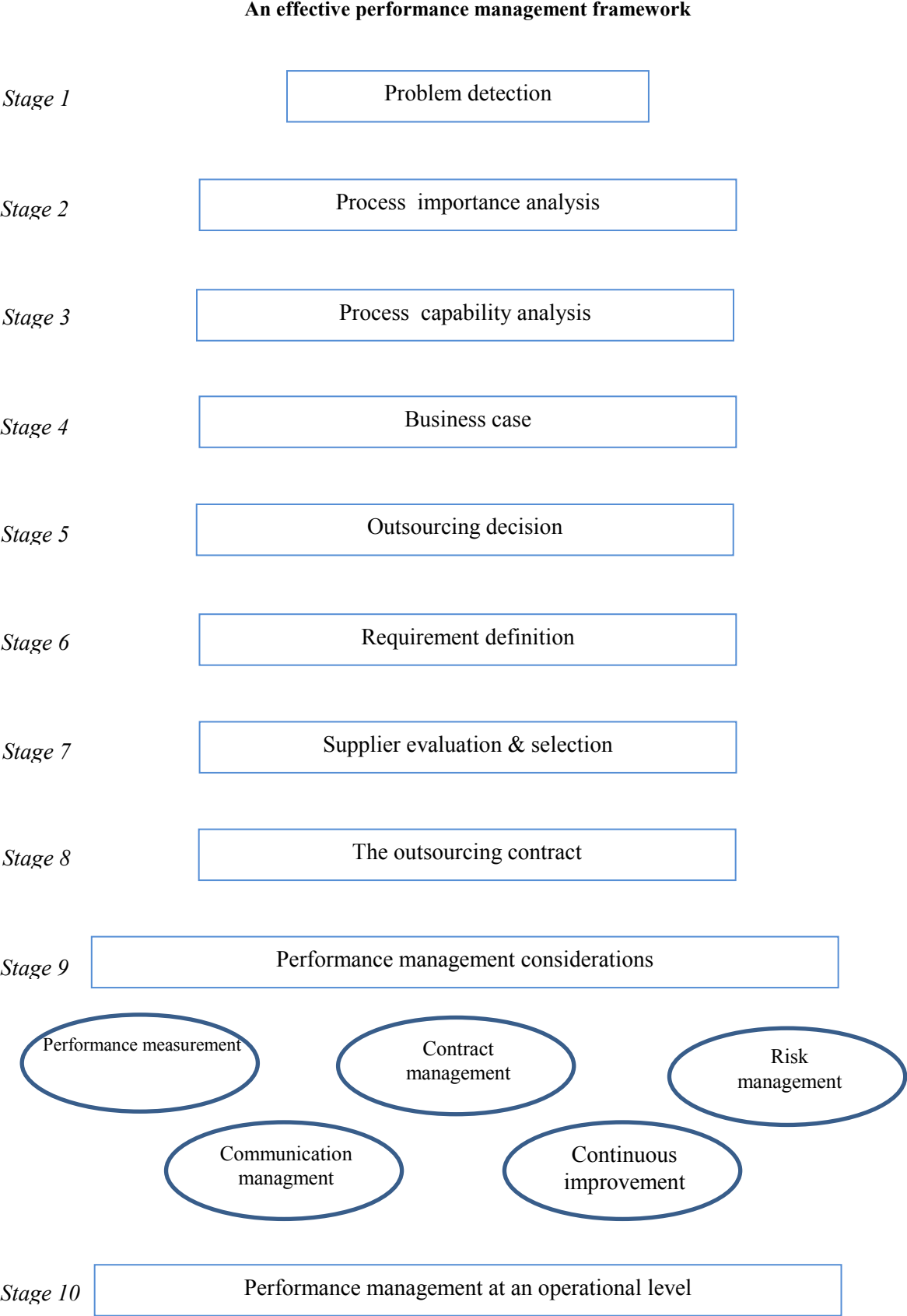


Figure 2: Performance Management Framework for outsourcing projects



APPENDIX 1

The outsourcing process	<ul style="list-style-type: none"> ▪ Can you please describe one particular outsourcing project of your choice that your organisation has executed in recent years? ▪ Has there been a process importance analysis conducted before the selection of a potential process for outsourcing has taken place? How? ▪ Has there been an internal process capability analysis conducted? How? Is the gained information compared to supplier/market data? How? ▪ Based on which criteria was the final outsourcing decision taken? Importance/Capability? Other criteria? ▪ Is the outsourced process also benchmarked against suppliers and competitors in the operations phase of outsourcing? How?
The outsourcing contract	<ul style="list-style-type: none"> ▪ Could you describe the contract negotiation process? Who is involved? ▪ Based on which data are the service levels agreed upon? Internal data, supplier data, market data? ▪ Can you briefly describe the content of the service level agreement, for example service levels, service measures, service procedures, agreed penalties/rewards, confidentiality?
<p><i>Key success factors for the PMS</i></p> <p>Communication management</p> <p>Risk management</p> <p>SAS 70/AAF 1/07</p> <p>Timing</p>	<ul style="list-style-type: none"> ▪ Is there a communication management infrastructure in place? How has it been developed? ▪ Is there a dedicated department for relationship/communication/performance management of the outsourcing supplier? ▪ Has your company performed a risk analysis before starting the outsourcing project? How? What were the criteria under consideration? Internal business risk, compliance risk? ▪ Does your company use one of these reports or similar for performance evaluation/capability analysis of suppliers? Could you describe the process and personnel involved? ▪ At what stage in the outsourcing lifecycle (assessment, transition, operation phase) were the respective actions taken in order to implement a holistic/fully functional performance management system?
<p><i>PMS</i></p> <p>Selection of KPIs</p> <p>Measurement system in operation</p>	<ul style="list-style-type: none"> ▪ How did the process of setting up and implementing the performance measurement system and in particular the KPI-system look like? ▪ What type of performance measurement system is applied? Outsourcing scorecard? Other system? IT-supported? ▪ How was the selection of KPIs managed? Which KPIs were selected? ▪ Is the selection reviewed continuously? How? ▪ Could you briefly describe the day-to-day performance measurement of your supplier? What does this process look like?
Performance improvement	<ul style="list-style-type: none"> ▪ How is the data gained in performance measurement converted into improvement actions? ▪ Is there a causal analysis conducted in case of not meeting the targets? ▪ What improvement programs are designed? In cooperation with the supplier?
Assessment of PMS	<ul style="list-style-type: none"> ▪ To what extent does your performance management system contribute to the overall success of your outsourcing project (in %)? ▪ What processes/characteristics of your performance management system would you mark as ideal for your project? Is there anything you would like to improve? ▪ Can performance management contribute to a sustainable success of the outsourcing project? How?

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