

# Master Thesis

The role of contracts in outsourcing relationships



**Radboud Universiteit Nijmegen**

Student	Ioannis Malegiannakis
Student number	4778510
Department	Faculty of Economics
Master Specialization	Accounting & Control
Supervisor	Drs. R.H.R.M. Aernoudts
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## Abstract

Outsourcing is a practice followed by an increasing number of firms every year. While outsourcing provides great advantages to the firms, it is a practice that must be treated with great caution in order for the outsourced services to be delivered successfully. The main factor to achieve that, is to set the common goals of the cooperation and to manage successfully the relationship between the firms. The aim of the thesis is to investigate how the contract, as the first tool in an outsourcing relationship, manages to govern the relationships between the firms before and after the initiation of their cooperation. To be able to observe how the contract acts and influences the actions of the employees, the use of Actor Network Theory and its insights are used to observe how the contract acts as an actor – network. The contract is the foundation of the relationship that sets the rules and guidelines of the cooperation, but also gives freedom to both parties of the cooperation to act accordingly so that the content of the contract can be honored.

## Table of Contents

Abstract.....	1
1. Introduction.....	4
1.1 Introduction.....	4
1.2 Research Problem.....	4
1.3 Research Question.....	6
1.4 Outline of research .....	7
2. Literature review .....	8
2.1 Introduction.....	8
2.2 Prior Research .....	8
2.2.1 Positivistic studies in outsourcing .....	9
2.2.2 Interpretive studies in outsourcing.....	11
2.3 Insights developed from the Literature Review.....	17
3. Theoretical Framework- Actor Network Theory (ANT).....	20
3.1 Introduction.....	20
3.2 ANT Review .....	20
3.3 The process of translation.....	22
3.4 Further insights on translation .....	23
3.5 The concept of framing and overflowing.....	24
3.6 The concept of black-boxing.....	25
3.7 Issues regarding ANT .....	26
4. Methodology.....	27
4.1 Research Methodology .....	27
4.2 Research Method.....	27
4.3 Research objects.....	28
5. Results.....	29
5.1 Phase 1: How the contract affects choosing the client and the negotiation process .....	29
5.2 Phase 2: Implementation of the contract .....	34
5.3 Phase 3: The role of contract during overflows .....	37

6. Conclusion.....	41
7. Discussion .....	43
8. Limitations and suggestions for further research .....	44
Appendix:.....	45
References:.....	47

## 1. Introduction

### 1.1 Introduction

Due to globalization and the rise of competition, an increasing number of firms resort to outsourcing in order to gain a competitive advantage and to become more efficient. Outsourcing is a business practice which involves the contracting of a business process, an activity or service to a third party. Many benefits for the firms are attributed to outsourcing. These benefits include among others lower costs, better results from an outsourced activity because of the expertise and knowledge of the outsourcer, the ability for firms to innovate, since they can focus more on their in-house activities. The central element with regard to outsourcing that offers interesting research opportunities is how to control the outsourcing relationship. Different studies have been performed on the topic, using different perspectives and different research methods. What becomes clear from these studies is that there is still no real common body of knowledge, but it is slowly developing.

The decision to outsource has important implications for the further development of a firm. To take the decision to outsource, a firm must take into account different factors, such as the goals of the firm, the firm's strategy, the functions that need to be outsourced and for the choice for the firm that will be the provider of the outsourced service.

### 1.2 Research Problem

The aim of this research is to focus on the relationships between firms that take part in an outsourcing relationship. In order for outsourcing to succeed, it is important that the firms in the outsourcing relationship interact and cooperate. When firms outsource, they allow a third party to manage a part of their activities. Concerns regarding these activities thus rise, such as the quality and delivery time of the outsourced service, the control of the client firm over the service provider (outsourcer), and the responsible and ethical conduct of the provider of the outsourced product or service. In order for these concerns to be mitigated or eliminated, both firms must understand the objectives, strategies and responsibilities that are part of the outsourcing relationship. In some cases these concerns had serious impact on the outsourcing relationship. Illustrative of this is the work

by Maelah, Aman and Hamzah et al. (2010), where the investigated firm that outsourced services was unsatisfied with the service of the provider and decided to stop the cooperation. The authors thus created a theoretical framework on how firms can effectively bring back their outsourced activities in-house.

In order to mitigate problems within an outsourcing relationship, the first instrument that is used is the contract. The contract is essentially the control instrument that governs an outsourcing relationship. However, the contract that governs an outsourcing relationship is not per se an instrument only. Depending on the research perspective taken, be it either interpretative, positivist or critical, a contract can be further understood as being more than just an instrument. A contract governs the relationship and as such it has agency and is able to act. Other studies have conceptualized elements within the outsourcing relationship in ways to eliminate threatening issues in terms of control mechanisms such as trust, monitoring and of course the contract itself.

To explore how the relationships between firms in outsourcing cooperations are formed, developed and shaped, prior research investigates concepts of contracts, control mechanisms and trust (and how these 3 elements interact) that are used as mediators to help ensure that the relationships are developed so that the goals are achieved and the collaboration remains. Examples of such research are given in the next paragraphs.

Several examples of prior studies investigate how control mechanisms and trust achieve control in an outsourcing relationship. Dekker (2004) investigates issues in inter-organizational relationships (coordination of tasks and management of appropriation concerns) and observes how formal and informal controls interact based also on insights from transaction economics theory. Mouritsen and Trane (2006) investigate how trust is formed based on the needs, goals of networks of firms and how management control technologies contribute to that forming of trust.

Vosselman and Van der Meer-Kooistra (2009) investigate the control and trust interaction in accounting as a way to mediate the relationships between firms. Minnaar, Vosselman, van Veen-Dirks, and Zahir-ul-Hassan (2016) investigate the interaction of contracts, controls and trust in an outsourcing relationship between two firms. In the work of Zahir-

ul-Hassan, Minnaar and Vosselman (2016) the inter-organizational relationships are investigated based on the controls and the form of governance of the firms.

In the literature, trust and controls are mostly used to describe how the relationships in outsourcing cases develop. In addition, most studies are based upon Transaction Cost Theory. While this theory takes into account all transaction costs (and how to minimize them) in order to find the right provider of a service, it does not take into account the varieties and goals (Dekker, 2004) that are visible between firms, the social mechanisms that are in place and the informal types of controls such as trust.

### 1.3 Research Question

To examine the lacuna in knowledge with regard to outsourcing relationships this thesis investigates the outsourcing relationships using the lens of Actor Network Theory (ANT) and aims to understand how the three elements (contracts, controls, trust) interact.

The choice to use ANT stems from the lacking ability of quantitative positivist research to explain how contracts become actors, actor-networks and how eventually contracts become “black boxed”. Positivist research is not able to provide an understanding of the processes that occur when an outsourcing relationship begins, develops and takes shape over time. When two firms wish to start a collaboration they first have to sign a contract. The contract is a commitment from both sides that shows the obligations of each firm, the rules of conduct, the responsibilities, the goals and the objectives of the relationship. The contract is the first mediator for an outsourcing relationship because the cooperation begins with it. In many cases when the contract is not orderly arranged from the beginning, problems start to emerge. The contract must be connected to the strategy of the firms and it’s role must be made clear to all employees because if employees cannot understand what is being asked from them within the boundaries of the contract and the strategy of both firms then they cannot work efficiently. After the contract, mechanisms, controls, monitoring and trust interact together to ensure that the contract is being honored without problems. When control and trust fail, the contract is the last stronghold that drives and guides the outsourcing relationship. Because the contract in literature is mostly seen as a black box and exists as a typical procedure, one cannot see how it is operationalized and how it takes action when other actors, human and non-human fail.

This is why ANT can provide a contribution to observe how the different actors interact with each other when examining outsourcing relationships. Therefore the research question that guides this study is:

*“What is the role of contracts in an outsourcing relationship?”*

The aim of this thesis is to investigate the role of contracts in outsourcing relationships and by viewing the topic from an interpretative perspective instead of a positivist perspective. ANT provides a performative approach and knowledge about how the relationships between firms develop. ANT proposes that a system can effectively be approached if we look at all the parts of it and that all parts are of equal importance in the system. In the research question, the use of ANT will enable the investigation of the importance of the contracts (In the literature contracts are seen as something static that change only when circumstances demand for them to change) and how they shape and affect the relationships together with tools such as controls and trust (Investigation of the system as a whole). These prior studies do not however examine how a contract may become an actor on its own. Prior studies do not aim to understand the performativity of a contract, nor do they provide an understanding of the translation processes that surround a contract, which in essence are the central element of outsourcing.

#### 1.4 Outline of research

The remainder of the thesis is structured as follows. Chapter 2 contains the literature review on the topic of outsourcing ending with insights and knowledge gained from former studies. Chapter 3 contains the theoretical background that will be used for the research question. Chapter 4 contains the research methodology. Chapter 5 contains the results from the research. Chapter 6 contains the conclusions of the research and discussion regarding the results. Chapter 7 contains a discussion on the findings of the research. Chapter 8 discusses the limitations of the research and suggestions for further research.



## 2. Literature review

### 2.1 Introduction

The purpose of writing a review is to identify theories used in prior research, different methods applied and provide an overview of results of prior research. This review aids in identifying gaps in knowledge at the topic of study. Furthermore, it will aid in the development of a conceptual model/sensitizing framework for use in this study to answer the research question. Within prior research different applications of research methods are visible. Some scholars approach the topic from a positivist perspective, while others take an interpretive approach. Within the positivist perspective, scholars use a contingency approach, within which different hypotheses are formulated based on theory. Within the interpretive approach, scholars use different theoretical approaches, such as for example actor network theory. Often transaction cost theory is used in both streams of research as a starting point. Either to develop hypotheses or as a sensitizing framework to perform an actor network theory study. Within the review, the connection between the studies is shown. The studies reviewed, follow both the positivistic and interpretive paradigms (mainly interpretive) investigating issues in the topic of outsourcing. The review begins with studies that refer to direct benefits of outsourcing in the accounting and audit sector like the quality of financial reporting and the effectiveness of audit functions in cases of outsourcing. It continues with studies that give answers as to why firms outsource, what are the issues and disadvantages that rise in outsourcing relationships, how firms manage the relationships and with what actions. Finally, the review closes by summarizing the most important points obtained from the literature review and how the topics in outsourcing connect to each other.

### 2.2 Prior Research

Outsourcing is a business practice which involves the contracting of a business process, an activity or service to a third party. Nowadays, many firms in order to develop themselves and to be competitive, they resort to outsourcing. Outsourcing can take several forms such as accounting and finance outsourcing, human resource outsourcing, business process outsourcing. The main focus of this research is on

outsourcing related to accounting and financial tasks. With the decision to outsource one must take into account the advantages and disadvantages of that choice. More importantly an organization should have clarity why it would want to outsource activities and with what goals. Benefits of outsourcing are considered the cost reduction of processes, the experience, capabilities and expertise of the provider. The possibility to innovate is also a reason to outsource. Usually, the non-core activities that an organization performs that have a low value (e.g. routine activities, or activities that do not improve customer value or drive profits) are outsourced to a third party, thus leaving the firm to focus on its primary functions and strategies.

The most often mentioned disadvantages of outsourcing in prior research have to do with the loss of control of the functions that are outsourced, the risk of providing confidential data of the firm to a third party, managing the relationships in the outsource agreement and disruption of activities when activities have been outsourced to a third party. In order to mitigate the possible disadvantages of outsourcing, Krell (2007) in his study on outsourcing provides guidelines on how to properly outsource activities. The decision to outsource must be made based on the strategy of the firm and the decision process consists of three steps. The first is the actual argument of why to outsource and with what goals, the second is the selection of the “right” provider and the third is essentially on how to manage the relationship between the two firms that enter into an outsourcing cooperation.

### 2.2.1 Positivistic studies in outsourcing

To see what the effects of outsourcing are, Höglund and Sundvik (2016) investigate the impact of outsourcing accounting tasks on the financial reporting quality between SMEs that outsource and SMEs that do the processes internally. By using a regression that calculates the quality of the total accruals of the firms, they find that firms that purchase accounting services have higher reporting quality and that longer outsourcing tenure also leads to better reporting quality. In addition, they find that if a firm purchases additional services from the same provider that does not necessarily increase the reporting quality.

Everaert, Sarrens and Rommel (2010) investigate Belgian SMEs and their decision to outsource accounting tasks under the TCE model. They form a regression model with

outsourcing intensity as the dependent variable and their main contributions are ,that under TCE, accounting tasks (routine and non-routine) are outsourced more intensively the less frequent they are. In addition, asset specificity plays an important role. Tasks that are specific for a firm are very costly to be outsourced and this also creates barriers if the client wants to change a provider. Institutional constraints also play a role in the decision to outsource and to what to outsource. Balakrishnan, Eldenburg, Krishnan and Soderstrom (2010) investigate the outsourcing decisions of government and for-profit hospitals combining institutional theory and TCE. Because of institutional constraints and issues such as limited funds, the transaction costs for the government hospitals are higher. By creating regression models that tested the costs of outsourcing and their implications of services when they were related to clinical and non- clinical costs, the government hospitals in the paper tended to aim for less outsourcing activities in general and in cases they outsourced, they outsourced non-clinical activities that were cheaper. From this it is understood, that in combination with the literature from the SMEs, institutional pressures affect outsourcing since SMEs lack funding, thus outsourcing non-core activities and also outsourcing selective tasks.

In the work of Sedatole, Vrettos and Widener (2012) the use of management control systems is investigated as a tool to mitigate moral hazard in the decision to outsource and when it is efficient to outsource based on levels of cost saving. Based on TCE they investigate the choice of airlines to outsource maintenance activities. With a regression model they investigate outsourcing with transaction risk as independent variable and incentive compensation and monitoring as management control mechanisms. When firms decide to outsource activities they have to take into account the transaction risks, the costs that occur and monitoring the provider. They find that cost savings through outsourcing can be achieved through incentive contracts and monitoring, but desired transaction risk levels can be achieved better only through incentive contracts.

Studies on outsourcing in the audit part provide several insights and implications for firms and also insights regarding the impacts of outsourcing on issues such as whether audit functions should be outsourced, the quality of reporting and potential risks.

Prawitt, Sharp and Wood (2012) question in their way the implementation of the SOX act and it's goal to tackle the issue of outsourcing internal audit tasks. They examine whether internal audit outsourcing and the type of the provider that provides the service is linked to accounting risk. By forming a regression model with accounting risk as the dependent variable they find that companies that do outsource their internal audit functions (IAF) reduce their accounting risk (due to the knowledge spillover argument) independent of the provider and in regard as to doing the audit in-house. Abbot, Parker, Peters and Rama (2007) also question the SOX act on this matter and they imply that outsourcing could be beneficial and could improve the quality of the internal and external audit. Assuming a firm has an effective audit committee that demands high quality reporting they find that the committees prefer to outsource specialized IAF to external auditors while they were reluctant to outsource routine audit activities to external auditors. Another issue that is created when a firm outsources it's audit functions, is the degree of the reliance on the reports that the external auditor of the firm might have so he can form an opinion. In the work of Glover, Prawitt and Wood (2008), which is based on attribution theory, the external auditor's reliance decision is investigated when a firm outsources it's IAF. Using a regression model with reliance as a dependent variable their results show that external auditors perceive IAF more reliable and objective when they are outsourced and they rely more on outsourced IAF when inherent risk is high. However external auditors trust more in-house IAF when internal auditors perform objective tasks.

### 2.2.2 Interpretive studies in outsourcing

In the paper of Jayabalan, Raman, Dorasamy et al. (2009) the outsourcing of accounting function is investigated in SMEs in Malaysia. From their research the authors investigate whether SMEs outsource their accounting functions, which functions are outsourced the most and what are the satisfaction levels of the service. A qualitative method with questionnaires was used to find out the preferences of firms regarding outsourcing and their perception of the quality of the services. Their findings indicate that around 60% of the firms outsource accounting functions and that the most common functions outsourced include financial reporting, account payable management reporting and bookkeeping. In addition, 68% of the respondents rated their satisfaction of service as neutral or above.

While in the research the preferences of the firms to outsource are seen, it is not investigated why they outsource and if there is any strategy behind this decision. In the paper of Everaert, Sarens and Rommel (2007), the degree of outsourcing, the outsourcing strategies and the reasons to outsource are investigated in Belgian SMEs. With a survey based on questionnaires among Belgian SMEs, they find that 1/3 of the overall activities of the firms are outsourced. In particular, for the accounting tasks, 53% of the firms follow selective outsourcing and 12% of the firms follow a total outsourcing strategy. The main reason found for outsourcing includes the expertise and knowledge of the provider and the reduction of costs.

While in the last study more answers were given as to why firms outsource, their reasons for outsourcing had more of a practical nature. The reasons to outsource are connected with efficiency of tasks done by the third-party and the expertise of the provider. They are not yet connected with the strategy and goals of the firms.

Outsourcing as a way to achieve ulterior goals is investigated in the paper of Nielsen, Mitchell and Nørreklit (2015), where management accounting information is used to investigate how it affects the decision to outsource. By "*considering the organization as a social construction created by human beings*" (Nielsen, Mitchell and Nørreklit, 2015, p. 67) they investigate how managers shape the decision making process and how it affects the environment of the firms. In this case the investigation focused on the decision to outsource and how it affected the firms. With the use of an actor-based method that includes the steps of pre-understanding, understanding, and post-understanding they investigate in a case study how two companies decided to outsource and with what goals. With this approach they tried to capture the actions of individuals or groups of individuals between each firm and how these actions led to the outsourcing decisions and their arrangements. From their results they conclude that the first firm outsourced because it wanted to change strategy. The firm aimed to separate core and non-core activities so it can focus on core competencies and to reduce the complexity of its product portfolio. The other firm already had a strategy but with outsourcing tried to ensure that it keeps its innovative capabilities. This study shows that in both cases, outsourcing can have deeper

implications and provide support to a firm that has a specific strategy and vision. In both firms there is a clear connection between strategic choices and outsourcing of activities.

While outsourcing can benefit firms, it is not easy to actually outsource because there are challenges that need to be overcome first. Major factors that may impede the outsourcing relationship are the relationships between two firms that are shaped in an outsourcing agreement, issues of quality of services perceived by the client and issues of control over and services provided by the third party. In the work by Lacity and Willcocks (2017) it is mentioned that conflicts in outsourcing relationships are unavoidable. In their work they create a framework of three types of conflicts in order to improve the mapping of problems in the relationships of 13 firms and provide solutions. The three types of conflicts are commercial conflicts (threats to economic performance), service conflicts (threats to quality of service) and relationship conflicts (threats to the quality of the relationship).

In the case study of Maelah, Aman and Hamzah et al. (2010), the outsourcing relationship of two firms comes to an end and the accounting outsourcing turnback process is investigated. Because of the relationships of the two firms and the bad quality of the services of the provider, as perceived by the client, the termination of the cooperation is researched. The authors create a framework to guide firms that want to end an outsourcing agreement in an orderly way as possible. The main issues that the client firm faced include a steady and segmented flow of accounting tasks that were brought back in-house, the continuous negotiation of contracts, the financial difficulties the client firm faced so it can fund again the activities by itself and the reluctance of the provider to end the agreement.

To be able to understand how an outsourcing agreement works and the relationships between firms and how this kind of agreement functions properly one must understand better how outsourcing works. Crucial in outsourcing is the relationship between two firms and how to govern and manage the relationship and with what mechanisms and controls, so that the objectives of the alliance are met. A theory that is often used to investigate outsourcing is transactions cost economics (TCE). Transaction cost theory has different applications. It can either be used as an instrument for calculation, in the sense that the transaction costs are conceptualized as being measurable, or as providing a sensitizing

framework. When TCE is used as a sensitizing framework, its aim is focused on solving problems of coordination. TCE is then seen as providing solutions to control problems. By using this theory, firms make their decision to outsource so that they choose a provider while minimizing transaction costs and also this is how they organize their structure.

Van der Meer-Kooistra and Vosselman (2000) in their case study investigate how inter-firm relationships are governed. They form a framework based on TCE and forms of governance to study how inter-firm relationships are governed and controlled. Additional to the TCE insights they add the notion of trust as a mediator of managing inter-firm relationships. To structure a management control system to manage relationships they have to take into account three phases of action before forming the relationship. These are the phase of contact, contract and execution. These three phases are observed under the three forms of governance shaped by the authors. These are the market, bureaucracy and trust forms of governance. In addition, they take into account contingency factors connected with TCE and revolving around characteristics of the transaction itself, of the transaction environment and of the transaction parties. With this framework they observe how two firms manage their outsourcing relationships and how the controls shape the process.

The form of governance and the controls are shaped based on the aims of the firms, their goals, and their own characteristics. Phua, Margaret and Lillis (2011) study the level of convenience firms have when they decide to change outsourcing provider and how controls affect those decisions. With a multiple case study method based on TCE and the forms of governance the investigated firms followed, they investigate how firms take that decision and how they change their control methods to make the change. When changing a third-party provider, transaction costs occur such as costs of finding a new supplier, costs related to the new contracts and costs to oversee the transfer operations and monitoring them. The form of governance (market, bureaucratic, hybrid) and its controls, affect the capability of a firm to change provider and in some cases, in order to change provider, firms had to change their governance and controls in order to adapt to the new cooperation.

Another important issue in outsourcing is how to control the performance of the provider and how to build and manage the relationships between the firms. An important step to govern the relationship is the contract itself. The contract is the beginning of the relationship and it must be complete so that the agreement serves all parties and makes sure that the obligations on both sides are met. According to Baiman and Rajan (2002) a contract is complete if *“there are no restrictions on the feasible set of contracts from which the contracting parties can choose, all information that will be jointly observed by the contracting parties can be specified by them at the time of contracting and will be verifiable by a court and there are no out of pocket costs associated with writing or enforcing contracts”* (Baiman and Rajan, 2002, p.2). A complete contract can be a guide for both parties to commit, to act accordingly to what it's written and give less space for both parties to act opportunistically or shirk. An efficient way to organize a contract is to allocate the tasks that must be accomplished by both parties and to choose the contractual arrangements which will govern the relations.

Another solution to aim for successful outsourcing relationships is the active role of management control systems in managing these relationships. Langfield-Smith and Smith (2003) in their case study investigate how control mechanisms and trust achieve control in an outsourcing relationship. In the beginning because of the new cooperation and the general contract that underwent modifications later, the relationship did not work well. Due to these problems, management systems were developed to promote communication and the cooperation of the two parties while enhancing the competition between employees. In addition the social control of trust also played a role. Trust in this case aided in creating a basis for communication that helped convey the goals between the employees of the firms and helped in the transactions. Trust is essential to the strengthening of the relationship partners, *“making the relationship more durable in the face of conflict and encouraging interactions”* (Langfield-Smith and Smith, 2003, p.284). Dekker (2004) in a case study investigates issues in inter-organizational relationships (coordination of tasks and management of appropriation concerns) and sees how formal and informal controls interact to tackle control problems in the relationship of two firms based on a framework with insights from transaction economics theory and the type of governance (market, hierarchy or hybrid governance). Mouritsen and Trane (2006) in



their case study on three firms, investigate how trust is formed based on the needs and goals between networks of firms and how management control technologies contribute to that. . Vosselman and Van der Meer-Kooistra (2009) investigate the control and trust interaction in accounting as a way to mediate the relationship between firms. Control and trust are two complementary elements and both are needed for the orderly development of relationship between firms. Minnaar, Vosselman, van Veen-Dirks and Zahir-ul-Hassan (2016) combine the interaction of contracts, control and trust in an outsourcing relationship between two firms. The contract is seen as an artefact that can be designed, negotiated, changed according to the needs of the firms, the conditions and its performativity. In the beginning of their case study because the contract was not carefully formulated it created issues such as debates and conflicts. As a result the contract later was negotiated. Before the negotiation of the contract the formal and informal controls that took place between the firms shaped the relationships between the firms to compensate for the weaknesses of the contract. In the paper of Emsley and Kidon (2007) again the notions of control and trust are investigated to discover how relationships between firms develop. The relationships are distinguished between the operational level of employees and the executive level of employees. In a case study of a joint venture alliance between airliners the authors try to investigate the relationships of trust and control to mediate the relationships between the firms. They do that by studying the relationships of three types of controls (output, behavioral, social) in regard to the development of competency and goodwill trust. They find out that information from the three control types increases the presence of competence trust at the operational level but only the social control builds goodwill trust at the executive level. In addition goodwill trust is seen as a more fragile type of trust since it's affected mainly by social controls. In the work of Zahir-ul-Hassan, Minnaar and Vosselman (2016) the inter-organizational relationships are investigated based on the controls and the form of governance of the firms. In their field study the relationship of the two firms is shaped by the governance system of the client firm and changes through time according to the approach of the top management. From an immobilized type of governance through friction and time the two parts started to trust each other thus leading to a socializing type of governance. Later with the change of the top management of the client firm the form of governance changes

once again to an individualizing one thus changing the relationships again and leading to re-bargaining of the contract. The study shows how governance can affect the relationships in an outsourcing cooperation and what the impacts of each type of governance are. Mahama and Chua (2016) investigate also how an outsourcing relationship is developed using Callon's 3-phased translation model. They indicate that a relationship is not something "ready-made" but it is a continuous dynamic process that always needs to be developed because in such relationships matters of concern and conflicts always rise. They show how the relationships were formed by many different actors. The contracts are the beginning of the relationship setting the guidelines, the philosophy of the firms and what they want affect the relationship, calculative accounting practices also affected decisions and finally they investigated how trust was shaped as a way to manage the inter-firm relationships.

### 2.3 Insights developed from the Literature Review

Although the two paradigms differ greatly, the review shows how the different studies are intertwined and how the two streams of research are connected to one another. The review furthermore shows how research from the one different paradigm can be beneficial to the other.

From the review it is derived that outsourcing accounting tasks provides benefits to the firms due to the expertise of the provider, it reduces costs and increases the reporting quality. TCE plays an important role and is a strong theoretical base for outsourcing decisions. By using the framework, assumptions and knowledge of TCE firms may get some indications and insights that will help them in the decision to outsource or not and what to outsource. Further literature focuses on issues of outsourcing routine and non-routine tasks and core and non-core activities of firms. When outsourcing, the transaction risk is also an issue that firms must always have their focus on. Studies in the audit part complement the results of studies proving the benefits of outsourcing accounting tasks since it is shown that firms that outsource IAF reduce their accounting risk and that outsourced IAF in specific tasks are considered more reliable.

Studies in investigating the outsourcing decision of firms, show the preferences of the firms, their outsourcing strategy and which functions they outsource. Other studies

complement the literature by investigating the decision to outsource further. While some firms just want to benefit from the advantages of outsourcing (e.g. expertise of provider), other firms outsource as part of their business strategy. They use outsourcing to develop further, to innovate or to focus on improving their main core activities and excel in their industry.

Outsourcing has also its potential drawbacks with studies that investigate conflicts between firms. In extreme cases other studies provide frameworks and guidelines on how to exit from an outsourcing agreement.

From the literature it is understood that the most important point in outsourcing is to manage and govern the relationships of the firms. Many studies try to investigate this topic and the most common theoretical background to start is TCE and the forms of governance the firms follow. Each firm decides its forms of governance based on its industry, its goals, its third-party service provider and changes the governance type according to the needs of the circumstances.

Finally in the context of management control systems a vast literature is revolving around notions of control and trust to manage relationships. Control and trust are shaped continuously under the development of the relationships of the firms. Each cooperation is unique and control and trust are “used” accordingly to make sure that the cooperation fulfills each goal. A main conclusion is that these two notions are complementary in managing the relationships of the firms and whether controls or trust have a stronger influence in a cooperation depends on the firms. In addition, studies show that control and trust act differently on different levels of hierarchy (operational level, executive level). The contract is an important part in the beginning of the outsourcing relationship since it defines the rules of the cooperation but it is only taken account in the beginning of the cooperation or when it needs to be negotiated due to problems that rise in the outsourcing relationship. Within prior research we see that the notion of control and trust is central and that the contract is taken as something stable or black boxed. This study thus aims to reopen this black box and attempts to understand the role of the contract as an actor, as it is as such that the contract, when perceived as an actor, governs the outsourcing relation.

The insights from the literature review depict the importance of managing the outsourcing relationships so that the relationship can thrive. An important part of managing the relationships are the controls, formal and informal. The literature review on managing outsourcing relationships sets the foundations of the thesis so that it can investigate further and provide new insights on how outsourcing relationships are managed. By reflecting upon how the contract can be considered as a governing and control tool, the aim is to investigate how it affects the actions of the employees in such relationships and how all form of controls are shaped so that the contract can be honored. Therefore the aim is also to give further knowledge in control shaping under the influence of the contract.

### 3. Theoretical Framework- Actor Network Theory (ANT)

#### 3.1 Introduction

Managing the relationships between firms is the most crucial part in outsourcing. It can make the difference in making an outsourcing cooperation work efficiently or making it function with many problems creating drawbacks for both firms. The main theoretical background for governing the relationships are forms of governance and TCE. While TCE takes into account transaction costs and how to minimize them it does not take into account the social mechanisms that occur between the firms and types of control such as trust. Control and trust are investigated by many studies to give answers about how to manage relationships but in this thesis the role of contract will be added to see how it can help in managing these relationships. The contract is referred in studies as the beginning of the cooperation. It states the guidelines, the objectives, the terms and obligations of the agreement. After it is compiled it is only revisited by firms when they have problems so it can be negotiated. In this thesis the contract will be investigated as to how it can affect the relationship of firms. Because the contract is an artefact, a non-human actor, the use of Actor Network Theory will be used to provide a theoretical framework that will help us understand how the contract functions in an outsourcing relationship.

#### 3.2 ANT Review

Actor – network theory is an approach to social theory and a research methodology and it is also known as the sociology of translations. It was created and shaped by the work of John Law, Bruno Latour and Michel Callon. This theory treats social relations (including power and organizations) as network effects and is concerned with mechanics of power (Law, 1992). ANT observes “*how entities take their form and acquire their attributes as a result of their relations*” (Law, 1999, p.3). This kind of network is consisted of actors that interact with each other and affect how the whole network functions. A main assumption of the theory is the heterogeneity of the actors, meaning that actors are divided into human and non-human and that all actors that act and affect the network are of equal importance. To be able to understand the theory, an explanation of the notions of actors and networks is provided in detail to show how these two elements connect to form and influence a network.

The first important step is to understand the meaning of the network in this theory. According to Latour (1996) the network does not entail necessarily the meaning of a technical network such as a train or telephone network. In addition, the network is not associated with studies in social networks because it does not concern itself with social relations of individual human actors. Because ANT inspects human and non-human actors, one of the aims of ANT is to *“rebuild social theory out of networks”* (Latour, 1996) where all the elements of the networks that have the power of affecting the network are accounted for. Another characteristic is that the notion of “distance” between the elements of the networks does not exist. Components of the network that may seem far away, actually they can be very close or connected if we trace their connections or impacts of one on the other. The importance of the network in ANT lies in the connections of its elements (actors), in tracing these connections and how the elements affect each other and the whole network. The actor in ANT is each element in the network that acts or when an activity is given to it by another element. The actor *“can literally be anything provided it is granted to be the source of an action”* (Latour, 1996). A main assumption of ANT is the heterogeneity of the actors. That means an actor can be human or non-human. Both elements are considered actors when they perform any kind of action in the network. Example of non-human actor could be the technology or a machine that affects the productivity of the work of employees in a factory. The actors that are in the network are not perceived as fixed entities but as flows in the network that circulate, affecting other elements and being affected by the other elements simultaneously. Their attributes are changed through these interactions in the sense that an element may gain more power over another or its acts may have bigger impact. The actor-network refers to the whole cooperation of the elements of the networks, how these elements interact and how the networks eventually function in an entity. The aim of ANT is not to explain how these elements work, but to observe their actions and their impacts in the network and how they connect to other elements. *“ANT is not about traced networks, but about a network-tracing activity”* (Latour, 1996, p.378). According to Law (1992) organizations are an achievement, a process and so ANT by observing the way organizations are functioning it can give answers to the “how” questions regarding structure, power and organization. Law in his approach argues that

the actor-network *“is nothing other than patterned networks of heterogeneous materials”* (Law, 1992, p. 381). To be able to understand the social interactions that occur in an organization or a network, it is important to observe that the communication of the elements can be mediated by a network of objects (e.g. computers). It can also be mediated by a combination of objects and people. With an example of the learning process at school, a teacher is an actor that tries to convey knowledge. But objects such as projectors also act and collaborate with the teacher to contribute to the teaching process.

### 3.3 The process of translation

Translation as a process to decipher the interactions of the actors can be divided into four distinctive moments or distinctive parts. These according to Callon (1984) are the problematization, interestment, enrolment and mobilization.

Problematization refers to identifying and exploring a problem that occurs in a network by an actor or group of actors. The problem then is defined and accepted when the other actors in the network recognize it as their own problem. By embracing the problem the actors “understand” that their goals cannot be reached in the presence of this obstacle, unless they cooperate with the other actors and align their interests. The actor that obliges the other actors of the network to align interests then becomes indispensable and thus an obligatory passage point is created. The goals of the other actors are blocked when the problem occurs. Because they cannot achieve the goals by themselves they resort to aligning their interests with the main actor. In the case of the obligatory passage point the actors understand that by uniting with that specific main actor, only then all the goals of the network will be achieved. The main actor acts as a driving force and mobilizes the network. The stage of interestment refers to *“the group of actions by which an entity attempts to impose and stabilize the identity of the other actors it defines through its problematization”* (Callon. 1984, p.8). During problematization the actors understand that they have to align their interests but the level that an actor chooses to connect or not with the others refers to interestment. If the actors finally do choose to participate in the cooperation, then the network becomes stable in the sense that the goals of actors are clear, the problems they face are

recognized and all are willing to cooperate. The network thus becomes black boxed. All its elements are working to achieve goals without focusing any more on the components of the network. The next stage of translation is enrolment. When an actor manages to identify itself successfully to the main actor of a network then enrolment is achieved. Each actor in a network has its role and function. To be able to cooperate, the actors negotiate to determine their roles in the network. Because an actor chooses to participate in a network does not necessarily mean that it can successfully interact with other elements. Thus enrolment “*designates the device by which a set of interrelated roles is defined and attributed to actors who accept them*” (Callon, 1984, p.10). The final stage of translation is mobilization. Mobilization refers to the ability of the main actor to “choose” other appropriate representative actors that will represent the goals of the network. The main actor as an obligatory passage point will develop methods to achieve the goals of the network by ensuring that the other actors’ interests do align with those of the main actor. In addition, the other actors when enrolled will act as spokespersons of the main actor. They will try to enroll additional actors of the network to achieve completions of their goals and the main actor’s goals.

### 3.4 Further insights on translation

How each actor in a network identifies itself, functions, affects other elements of the network and has a role, describes the process of translation. For Law (1992) translation is like a verb. A continuous process that denotes change. The actors in a network with their actions and characteristics continuously cause interactions in the network. Law (1992) indicates four findings when it comes to translating interactions of actors. The first finding implies that some actors can be more durable than others in the sense that their ability to create interactions in the network is better. Thus a strategy would be to use these kind of durable actors to establish the relationships in the network. For example, through the main actor a lot more actors can connect and interact in the network. The second finding refers to different actors that may have various ways of acting at a distance. This finding implies that an actor can affect other actors in the network in which their connections could be stronger or weaker. The third finding supports that the translation process is more efficient if it anticipates how the other actors react and respond. In the case of the mobilization of allies, if the spokesperson



actors know how potential new actors will react they can strategize better in order to have better chances of enrolling them and aligning them to the same goals of the network under the main actor. The final finding refers to the scope of ordering. This finding implies that each translation process is local. A main actor has specific power to order and affect other actors in the network. This power is greater when more actors are linked, connected and interact with and through the main actor.

### 3.5 The concept of framing and overflowing

The actor-network contains all the interactions of the actors that reside in a network and the process of translation aids in describing how the actors affect the network, how their power affects other actors and how the network achieves its goals. To be able to organize these interactions, Callon (1998) based on previous work of Goffman (1971) creates the concept of framing/overflowing. When trying to organize these interactions a boundary is created. The actors understand and accept the frame in which their interactions will be shaped, will gain meaning, and impact with their significance and content the network. An issue that is created is that when a network is framed, it places the outside world in brackets but it does not sever all the links it has with the outside world. (Callon, 1998). By framing, one can observe the interactions that take part in a network but also has the ability to observe how these interactions could also affect elements outside of the network.

In the case of the contract, to negotiate and form a contract, an adequate framing is needed to manage the actions and set the rules and obligations of the actors. How will the actors interact and affect each other, will depend on the framing of the contract. In addition, not only the framing of the contract will affect the relationships and interactions for example of two parties that form a network but also it can affect other entities.

When framing, Callon(1998) discerns two dimensions/approaches of framing. According to him, the first approach considers that framing is the norm, where framing is desired in order to map the interactions and to map the actions of the actors that create these interactions in order to achieve certain goals. However it is difficult or impossible to frame completely and effectively the actors and this creates overflows that threaten the framing. That leads to the second approach that considers the overflows as the norm.

This approach treats overflowing as the rule because framing is a difficult procedure that is always imperfect and also very costly. Again in the case of contracts framing is very difficult because except the tangible elements that exist in order to manage the successful relationship of a cooperation between firms the context of contracts also includes “*intangible elements (concepts, materials, substances, experimental devices, researchers etc.) which help to delineate and structure the frame within which it will be performed*”. (Callon, 1998, p. 254). All these elements participate so that they can frame the contract and its performance.

The issue that rises from the two approaches has to do with how an actor can perform and interact. The actions of the actor and its performativity can be observed through the framing of the network (that has set rules and guidelines) and the interactions of its elements. Or more focus can be given on the overflows and observe how the actor will respond to the overflows. In this case overflows can be seen as a driving force that make the actors perform producing changes in the network.

### 3.6 The concept of black-boxing

Through the process of translation and in particular when the steps of interestment and enrolment are completed the network becomes stable. It becomes stable in the sense that the actors of the network are identified, they have agreed to cooperate and interact in order to achieve the common goals of the network. The stable network then it becomes a “black-box”. This term is mentioned in Latour’s (1987) work and it stems from the sector of cybernetics when a piece of machinery or a set of commands is too complex. The black box entails all of the intricate interactions of the network but it is considered one thing. It is a simplified entity which no one questions about what it does and only the inputs and outputs that enter and exit the black box are observable. Law (1992) also proposes that when a network acts as one entity, it disappears and only the actions of that entity can be observed. This process is referred as punctualization where all the components of the network are considered one entity and thus they become simplified.

### 3.7 Issues regarding ANT

While ANT provides an alternative way to observe networks (mainly of the heterogeneity factor) there is also some criticism that challenges its insights. Lowe (2001) mentions that during the effort to fathom the network the researcher may deviate from his course providing in the end an incomplete or misleading research story. That raises concerns of not recognizing the boundaries and extent of the network so that creates difficulties in monitoring and observing the interactions of the network. Another issue that is raised by Miller (1997) is recognizing the actors of the network. Miller suggests that it could be very difficult to list all the actors that reside in a network and that the researcher might have no clue where to stop. Following the actors could be a challenging effort since some actors could exist on the border of the boundaries the networks set. Regarding the boundaries of the networks Lee and Hassard (1999) support that ANT may sabotage itself because it “*fails to forge its own internal and external boundaries*” (Lee and Hassard, 1999, p.392). The critique of the above authors may derive from the possibility that an actor can recruit more actors thus expanding its links and network causing difficulties in setting boundaries and mapping the actors. Finally another major critique on ANT is related to the assumption of heterogeneity. Chua (1995) in her work (investigating how accounting systems function in organizations) does not treat inanimate objects as actors, because humans are the ones who make sense, for example, the accounting numbers and utilize them to achieve the goals of the organization. Humans act and have agency to achieve goals while machines or technology have no agency.

## 4. Methodology

This chapter describes and explains the methodology that was chosen to investigate the role of contract in outsourcing relationships.

### 4.1 Research Methodology

The aim of the thesis is to explore what are the impacts of the contract and how the contract affects the behaviors, decisions and thoughts of other actors in an outsourcing relationship. A qualitative research methodology in the form of a case study was deemed appropriate to investigate the research question. With the insights and background theoretical framework of ANT, the aim is to observe, how and in what way the contract engages other actors and their actions. In other words how a non-human-actor like the contract, performs as an actor-network, and how it affects control and trust interactions in outsourcing relationships. The aim is also unlock the black-box of the contract and see how the translation process unfolds step by step.

### 4.2 Research Method

To obtain knowledge about the research question an interpretive approach was used. In total seven interviews were conducted to observe how the participants perceived the presence of the contract in their work. In the thesis the research question is investigated only from the viewpoint of the outsourcer. Semi-structured interviews were conducted with a help of a questionnaire so that the discussion could be guided but also give freedom to the participants to express themselves freely. The questionnaire can be found in the appendix. Before the interview, discussions with the participants took place. They were informed about the topic of the thesis and they reviewed the questionnaire. The interviews were recorded and transcribed. Only in the case of one interview (because of the participant's wish not to be recorded) hand written notes about the results were taken.

The results of the interviews were divided into three parts based also on the form of the questionnaire. The first part contains questions that investigate the role of the contract from it's first negotiation process until it's completion and signing. The second part contains questions that investigate how the contract affects the relationship during the

provision of the service. The third part contains questions that investigate how the contract affects the relationship when problems occur at the delivery of the service. The results of the interviews were extracted after they had been categorized and coded with the use of ATLAS qualitative data analysis software. The main codes that were used to categorize the results are the following:

Code 1: How contracts affect the choice of partners and how they are negotiated.

Code 2: How do contracts act when implemented.

Code 3: Relationships between client and outsourcer.

Code 4: Controls of clients and outsourcer.

Code 5: Problems during service/overflows.

### 4.3 Research objects

The research objects are all participants that work in outsourcing departments providing mainly accounting and finance services. Employees from different levels of hierarchy were chosen to observe if the contract has different impacts depending the employee. The participants derive from the following firms:

Two participants (one manager and one associate) from the Business Process Outsourcing department of PwC in Athens, Greece. The BPO of PwC focuses mainly on accounting and payroll outsourcing services.

Two participants (two directors) from the Outsourcing department of Grant Thornton in Athens, Greece. The outsourcing department focuses mainly on payroll and IT business consulting outsourcing services.

One participant (manager of the payroll department) from the Business Process Solutions payroll department of Deloitte in Athens, Greece.

Two participants (two entry level employees working on accounting outsourcing services) from the Business Operations department of Tata Consultancy services in Budapest, Hungary.

## 5. Results

To be able to understand how the contract performs as an actor-network, it is necessary to be aware how the contract affects the outsourcing relationship during its negotiation and later at the start and continuation of the service. This section describes how the contract affects the actions of the employees in outsourcing agreements. To observe the performativity of the contract, the results are divided into three phases. The first phase aims to observe how the contract affects the actions of employees and other actors during its negotiation and during its shaping before it reaches its final form. The second phase aims to observe how the contract performs after it is implemented and the outsourcing relationships have started, in order to observe how employees act under the contract's influence. The third phase aims to observe how the contract affects the relationship in cases where overflows occur, meaning what the contract does when problems arise in the delivery of the service.

### 5.1 Phase 1: How the contract affects choosing the client and the negotiation process

The contract is the initial step of negotiating the outsourcing agreement and lays the foundation of the relationship. An important issue to remember is that the contract is tailored and is special for each outsourcing agreement. To begin an outsourcing relationship the outsourcer must first search for clients. To find new clients the outsourcer takes part in events, meetings and the top employees try continuously to find new clients. Senior managers, directors and partners undertake this task. Screening is also a first action undertaken to see whether the client is financially strong, his reputation, whether the client is punctual with the payments etc. In some firms finding clients is also part of the firm's strategy. For example, PwC aims to increase its revenues and expand in a specific market (outsourcing accounting and financial activities in maritime sector). The firm will do a research, to see the strongest potential clients of the sector and approach them for a cooperation. Another tactic used by all firms is cross-selling of services. Another department of the firm may bring in contact its clients with the outsourcing department so a new client in the outsourcing department will occur. All these actions are a way of ensuring that the outsourcer finds suitable and

trustworthy clients. In that sense the contract is the result of the effort and careful strategy of the outsourcer to ensure safety of the cooperation and safety of obtaining revenues from the cooperation. The “hunt” of new partnerships is a careful thought plan and here it is observed how the problematization phase occurs. The outsourcer tries to find potential customers with a certain strategy and the contract defines what the problems between the two firms are. For the outsourcer to find new clients, and for the client to understand the need for help in managing it’s activities by an expert. So the contract is the starting point for the cooperation so that each firm can achieve it’s goals and it must be as efficient as it can be.

To approach a client, the outsourcer makes a first contact with the representatives of the client firm to map the situation. With the first contact, the needs and wants and the problems of the client are discussed so the outsourcer fully understands what the client needs and the outsourcer illustrates how he can provide the service and a description of the service. After the first meeting, both sides investigate whether the cooperation is beneficial so they can proceed in finalizing the agreement. For the outsourcer, the main point of the negotiations is to define the fee of the service. For the outsourcer the fee is very important. The fee is translated into time needed for a specific agreement or project and the number of people that will be occupied for the service to be delivered. The outsourcer weighs the benefits and costs of receiving a project to take his decision. From the outsourcer’s perspective the contract also shows the outsourcer’s capability to accept a project and the workforce and fee levels that the outsourcer demands influence the terms of the contract. In other words the contract includes in a way the restrictions of the outsourcer regarding the service he will provide. In this stage the issue of the enrolment of the actors occurs. If the outsourcer does not have the “strength” to provide the service, even if he wants to cooperate ( interestment) in the end he might be facing a problem of delivering the service effectively and thus he cannot enroll successfully to do so.

Contracts include in general the services that will be provided, how will they be provided, by whom, when will they be provided and what the fee for the service will be. Exhaustive clauses usually are not included, only in cases where clients have really

specific needs and in the cases of very demanding clients of multinational caliber. The focus is always on depicting very clearly the description of the services needed. In some cases after a project began new issues emerged.

*“For the client in the beginning or during the duration of the project new needs may rise that even the client hasn’t realized them yet or the client did not express them for us to understand them. So a negotiation can occur around the scope or the fee.”*

(Interviewee no.2, Project Manager)

In addition exhaustive clauses are avoided in contracts so that both the outsourcer and the client respond to potential problems regarding the delivery of the service.

*“Of course there is no way that there are no clauses in a contract, right? That is a fact. But usually we pay attention that the clauses that are included are not exhaustive so that they can be manageable.”*

(Interviewee no.7, Director of Outsourcing)

In that sense the contract represents how well the relationship has been established or how well both sides understand each other. In other words the contract shows how effectively the phase of problematization has been completed. A successful problematization can be achieved when everyone in the cooperation has identified all the problems so the cooperation can be beneficial to both parties. The contract in this case represents the effectiveness of the level of problematization that has been achieved.

The contract in general is formed with some flexibility, but with also the aim to “correct” possible voids in it’s scope and so it can transform again to the needs of the cooperation. It enables actors to act more freely and adjust accordingly to the working needs of the cooperation. That is because each client is different. Some clients for example are very demanding on the time schedule, others they do not take the fee into consideration as long as the service is delivered.

*“Yes...sometimes the deal is sealed by the senior manager. So you adjust sometimes the work based on the contract. Or in other cases the contract is built based on the*



*work.... What I mean, is that the fee is agreed from the beginning. For example, the manager may agree for the fee to be 10.000 euros and not agree on how many people, not even the deadline.... In that case we adjust our work based on the fee... There is also the other case where you can see how much work is needed and say. Good. For this project we need 10 people. So how much is the fee? This amount of fee is needed for the deal to be sealed. In both cases there is communication between the project manager that undertakes the project and the client.”*

(Interviewee no.5, Associate)

From the above case it is understood that the flexibility the contract provides, influences and defines the actions of the outsourcer (based on the demands of client). The outsourcer can make decisions to organize and plan accordingly, so that the service can be delivered. In this sense the contract is built in such a way that it can anticipate changes in the cooperation and engage actors to act accordingly to satisfy the cooperation.

In addition the contract is built consciously with flexibility and the fact that a “perfect” contract does not exist is understood by the directors. A contract is the foundation of the relationship that sets the ironclad rules so that a cooperation can begin to develop and thrive.

*“You cannot always “dress” in a contract exactly all the details. It is too hard. In a contract you will contain the basics and you will “photograph” the activities. From that point, issues can occur for which you have to convey to the client in that specific moment. Reporting some of these issues is not included in the contract (note: meaning that the outsourcer is not obliged by the contract to notify the client). In that case you can’t say to the client it is not included in the contract. You do that because you want to help the client.”*

(Interviewee no.7, Director of Outsourcing)

This flexibility the contract has can be seen as a countermeasure and also as an ability of the contract to anticipate how the actors will react based on occasions and help them to deliver the service.

While the contract adds flexibility in the outsourcing relationships it is also of equal importance that it must be adequate, well thought and efficiently designed. In another case the outsourcer agreed on a specific fee, but in the process it turned out that the actual work did not represent the fee that was agreed.

*“It happened for example, that the fee was agreed and then we investigated and we found out that the work was more than we anticipated. This situation turned out bad for us.”*

(Interviewee no.5, Associate)

From this case it is understood that the contract also reflects the ability of the outsourcer to understand the needs and problems of each client and estimate the resources that will be needed. In addition, not understanding fully the contract has not only financial implications for the outsourcer, since now the outsourcer will need more people, time, and effort to deliver a project. Again the contract sets the issue of the problematization. Specifically for the outsourcer the problematization is more challenging and more weight is put on the outsourcer because he is the expert and he has more responsibility in mapping and understanding the needs of the client.

Finally, the outsourcers also understand the importance of safety for the client and safety is one of the outsourcer’s priority. In every outsourcing activity the client entrusts the in-house activities to a third-party. In a sense the client becomes vulnerable since he has no immediate control of the outsourced activities. The client becomes depended. So the client needs assurance that the activities are entrusted in proper hands.

*“The contract is the thing that covers the quality of the services. In the contract it must be inferred that the client will receive high quality services. That is the purpose of the contract. And the safety the client feels. Because the client doesn’t use his own resources but uses an external partner, so he must feel trust. So the contract must cover quality and trust.”*

(Interviewee no.4, Director of Outsourcing)

From the above case we see that the contract is a tool, a promise that engages to guarantee safety from both sides and to set the foundations of trust in the cooperation.

## 5.2 Phase 2: Implementation of the contract

In this section it is observed how the contract influences the outsourcing relationship once it is implemented and the cooperation begins. Once the final contract is being completed, the managers and senior managers of the firm convey the obligations and the fee of the contract. While the contract is not a secret, not all employees (especially those on the lowest levels of hierarchy) are fully aware of the contract terms. They are only informed about the fee and the work that needs to be done. In the discussion with all the directors and the managers it is clear that they do not convey all the terms of the contract to everyone because they believe that this is not necessary. So for the employees in the lowest ranks the contract is only seen as an obligation that they must fulfill. Project managers and higher ups are mostly concerned with what actions to undertake in order to make sure that the contract's terms are honored. For the higher ranking employees the contract has a more significant meaning since the contract engages them to work more consciously to meet the terms. From these results it is understood that while the contract engages all actors in the cooperation there are different levels of problematization and interestment between the different levels of hierarchy. Managers and Directors are "translating" each step of the contract so they can provide the service while employees of the lower ranks seem only to be enrolled and follow "blindly" the contract by doing what has been assigned to them by their supervisors. The contract does not have the same magnitude of understanding or importance for the latter.

Another reason for not "revealing" all of the contract's content is confidentiality. Confidentiality is of major importance and issue for all of the managers and directors. By revealing to the respective employees what is needed, they ensure that the service is delivered but also the interests of the clients' are safeguarded. In addition, they believe that revealing the whole content of the contract to the employees does not add value to the work. In the case of the manager of the payroll department the contract has a more "static" property for him. The contract is divided mainly into two parts. The legal issues

and the scope of work where the service is defined in detail. In addition, the contract for him has different levels and according to his thoughts:

“The contract is not the tool itself. Parts of the contract are the tool and based on those parts one must reflect and work accordingly to satisfy the parts that each employee has undertaken.”

(Interviewee No.6, Manager of Payroll Department)

Finally for the manager the contract does not have an active role in managing the outsourcing relationships and that issue is to be solved with what governance tools are used in an outsourcing relationship so that it can be governed effectively. In this case the contract only frames and defines what needs to be done. The actions that will lead to completion and delivery of the service are determined by the governance policies that will be adopted by the cooperation.

In outsourcing relationships, where accounting and finance services are provided, communication and interaction are a key factor. In these kind of services these two elements are required for the successful delivery of service. That is because the outsourcer needs information, documents and data from the client in order to provide the service. Cooperation is of great importance. The contract in this case engages also the client, because if the client does not provide the necessary information when needed, that causes delay to the outsourcer and that means delay of the service. In all cases the outsourcer and the client try together to ensure the delivery and quality of the service. The contract sometimes defines only the work that needs to be done and then gives freedom to both sides to take action through communication and cooperation so that the service can be delivered.

*“For example the contract stated that I had to go to the client eight times a month. The contract did not tell you which days you should go. This is a matter of communication with the client. For example we say I will go to the client twice a week. When is it ok? Tuesday and Thursday. Good. Tuesday and Thursday then. Some weeks I couldn’t on Tuesday, so I called and said, can I come on Monday? The client said yes. Sometimes the client called me and said don’t come this week at all. Come four times next week. In*

*general contracts entail a kind of flexibility, but obviously you look at the terms, which are particular and quantifiable so that you can satisfy them.”*

(Interviewee No.5, Associate)

The contract in this case enrolls all actors that are relevant to the scope of work so that the delivery of the service can be made, but also mobilizes potentially additional actors in cases where additional workforce is needed for a project to be delivered efficiently.

To ensure delivery of the service control methods are used and are implemented based on occasions. In the contract, unless a very specific client with very specific needs demands it, there are not hard control measures included. The contract enables both sides to act accordingly, so the service can be delivered. In addition, it enables both sides and gives them freedom to develop and shape their relationship. Control mechanisms to ensure delivery of service include setting time schedules, providing drafts of the work, cross checking the documents and reports between client and outsourcer, obtaining KPIs. Apart from standard controls and depending on the client, other types of controls may be imposed. In some cases clients wanted to interview the employees of the outsourcer so they can accept the cooperation. To ensure quality of service and customer satisfaction also the outsourcer occasionally asks for feedback and the client's opinion so they can get a clearer view of the client's perception of the service and how they can improve. The interestment and enrolment phases again of the actors from both parties can be seen. With interestment both parties understand that each party has a role and contribution so that the service can be delivered and that both parties need to be enrolled successfully for that to be done. In other case problems in delivering the service can occur.

The relationship with the clients usually are considered very good in all cases and the outsourcers also strive for relationship building. Because of the cooperation, the relationship between employees of the two firms evolves. Of course in the context of professionalism the outsourcer tries to develop the relationship because in that way the outsourcer can get a better understanding of the client and it's needs, thus providing an even better service. In that sense, relationships can help so that the service is delivered in a better and more efficient way thus honoring the contract. Therefore good

relationships and trust begin from the contract and later they return back to it by making sure it's terms are met, like a circular procedure. The contract in this case engages the actors to act not only on duty and respect, but also motives them to create social relationships to strengthen and expand the foundations of the relationship. In other words, the interestment and enrollment levels of actors increase beyond the scope of the contract.

### 5.3 Phase 3: The role of contract during overflows

In this section the results regarding how the contract operates during problems in the delivery of the service are discussed.

According to the outsourcers, problems (e.g. delays) in the delivery of the service occur due to two factors. The first factor has to do with the fact that the client has not provided the necessary data/documents/reports in time, hindering as a result the whole delivery of the service. The second factor has to do with the outsourcer's wrong estimation of the project, thus leading to a delay of the project. In any of the two factors, the most important thing stated is again communication and cooperation to solve the problems.

If the problem occurs because of the client, the outsourcer takes action to remind the client that the cooperation needs the effort of both parts. If the problem occurs because of the outsourcer, the outsourcer puts more effort or resources to meet the deadline or in other case the project is postponed. In that case the outsourcer in order to make sure not to ruin the relationship and the client satisfaction, he may resort to discounts or providing an extra service free of charge. But the most important and meaningful action is to show effort and good will to meet the demands of the client with also the aim to strengthen the relationship.

*“For example there was a person from our firm that quit. The project did not go well and we were late on the deadline. And I went to the client. Because I was very formal and I had accountability and ownership. We worked many hours, we met the demands of the project and the client appreciated so much my effort and my willingness to help. This contributed in renewing the contract and continue the cooperation. And for example the client asked for me personally the next time.”*

(Interviewee No.5, Associate)

Relationship building is extremely important in these cases since it can help solving the problems more efficiently. In cases where the relationships were good, the clients showed understanding and supported the outsourcer. Trust and relationships that are built through the cooperation makes the contract more “elastic” so that the delivery of the service will be provided eventually. From this example it is understood that the contract loses its durability in the cooperation and the notions of trust and controls take over to manage the relationships.

Overflows can occur not only when performance issues arise but also when a party from the agreement does not necessarily honor the agreement or has excessive demands beyond the terms of the contract. During a project one client demanded more services than written in the contract because the client expected that the additional service is included in the contract. That raised issues and debate because the client had other comprehension of the scope of the contract. The outsourcer in that case did not want to ruin the relationship that was built and because the additional effort was not much, decided to provide the service. In cases the workload is a lot more, the outsourcer proceeds to suggest amendments to the contract. From this case it is observed that although the contract may seem “clear”, it can still become an issue of debate between the parties. Because of the problems that occur, negotiations can take place so that the relationship does not deteriorate. The contract can still affect how the service can be perceived by the parties and again the problematization process begins once more even after the contract is being completed so each party identifies what are the problems and what is needed for the cooperation to succeed.

In another case the outsourcer provided to his client an employee as a secondment. The employee received direct orders from the client. When the employee asked the client for vacation that was not mentioned in the agreement, the client gave oral permission. When the employee returned from the vacation, the client demanded a reduction in fees appealing to the contract terms due to less working hours. The outsourcer could not contest this issue because the vacation permission was an oral agreement without solid evidence. From this incident it is observed that trust is lost from

the client, who used the contract terms to manage this issue and the relationship. The outsourcer on the other hand demanded from its employee to be formal in any way and not to give rights to the client. In this case trust is lost and the contract is followed strictly so that the outsourcing relationship and service can be managed. The contract in this case enrolls directly the actors to their work and trust loses power in managing the relationship.

In all cases the outsourcer tries to manage the relationship as discreetly and as smart as possible not to ruin the relationship. Even if the problem is attributed to the client the outsourcer tries in his way to show the error of the client and discuss the problems that occur. The outsourcers avoid appealing to the contract.

*“Surely when a problem occurs, the thing that will make wiser both sides is that when the project is finished, we will sit down and talk with the client what went good and what went wrong.”*

(Interviewee no.2, Project Manager)

This retreat from the side of the outsourcer not only keeps the relationships in a good place, but also acts as good will for a possible next cooperation with the client or making the client having a longer term cooperation with the outsourcer. So the contract engages the outsourcer and makes him honor the agreement in any way he can (as long as it is beneficial to the firm) so that the client is satisfied and so that the client can be retained.

In addition, the last insight can have a broader scope. The outsourcer does whatever he can in his power even when the client is not right because of other implications a good service could have. These implications are the reputation of the outsourcer in the market. With the concern of the reputation, the goals of outsourcer to find new clients, the “fear” of the outsourcer of losing clients to other firms the contract acts again as a strong control on the outsourcer and as a promise. By honoring the contracts in any way the outsourcer can, he maintains a good reputation in the market, he provides assurance of the quality of the service and the safety of the client. In that way the outsourcer can attract more clients and increase its market expansion and value. From



the last two examples it is understood that the contract is a cause and a strong motivating force to mobilize new allies in the sense that the outsourcer will engage any resource he can to make sure that the contract will be honored, thus creating a good name and reputation in the market that will lead to the attraction of new potential clients.

## 6. Conclusion

This section summarizes the results, experiences and the insights gained from the interviews and gives answers to the research question that was formulated in the introduction.

In this thesis, the role of contracts in outsourcing relationships is investigated. Using ANT and its insights, the opportunity to observe a non-human actor like the contract and how it acts in a network of organizations is given. The contract is seen as a black-box. When it is formulated, everyone accepts it and follows it “blindly”. In this thesis the aim was to observe and map the actions of actors surrounding the contract. With the process of translation an effort was made to deconstruct the contract into phases and to observe and to understand how in each phase the contract affects the actors and how it affects their actions in an outsourcing relationship.

To better map the interactions the effects of the contract were divided into three phases. Interactions that occurred before its completion, interactions after it was implemented and interactions when problems occurred in the outsourcing relationships.

In the beginning the contract is a product of careful debate. In outsourcing relationships where the client is dependent upon the outsourcer the definition of the exact services that will be delivered is of great importance. From the outsourcer’s perspective, to understand the needs of the client and to estimate with accuracy the workload is also crucial. The contract in general is flexible allowing both parties and giving them freedom to act accordingly so that the contract terms are honored. The main goal is to establish a strong foundation for the relationship to be developed. In that sense it sets a frame in which the actors work, but they also may deviate from that frame when needed for the delivery of the service. For that to be achieved the scope of work must be defined as best as possible and then the parties take action for the service to be delivered.

The implementation of the contract signals the beginning of the relationship. It is observed that not all employees are aware completely of the contract. That means that the contract does not have the same magnitude or importance for all employees. Employees in the higher positions take into account its full content and are responsible

to convey and translate the contract terms into actions so that the service is delivered. In outsourcing relationships regarding accounting and finance services where the cooperation is needed, the relationships are governed mainly through social controls and formal controls.

During overflows and problems in the delivery of the service the usual reaction of both parties is understanding and common effort to overcome the obstacles. As a general rule unless extreme conditions no one desires to appeal to the contract or to legal issues as these actions ruin the relationship of the firms but also may affect their image in the market. Although different insights and cases were experienced. The contract can set the foundation for trust and therefore trust takes over to govern the relationship and therefore the problems are solved by common effort. In another case the contract was recalled to govern the relationship and trust was lost. The contract took action with its power and its formal controls. Finally it is observed from all the outsourcing firms that in any case of overflows, they took action to solve the problems as orderly as possible. Even though the contract did not oblige them with its terms or legally, the outsourcers try to honor the contract in any way they can. So the contract enrolls them beyond the boundaries and rules that it sets.

## 7. Discussion

From the research it is observed that a perfect contract does not exist. A contract sets the foundations for the cooperation and then controls and trust interact and adapt to the cooperation so that the contract will be honored. While Baiman and Rajan (2012) provide a definition of a complete contract, this definition could be characterized as a guideline or tutorial on how to efficiently design contracts. In the thesis even though “complete” and well thought contracts were made, later it was observed in cases that new needs emerged or that in the end the parties in the cooperation did not understand fully the needs of the cooperation. In that sense the contract depicts the current understanding both parties have of each other at the specific time of the completion of the contract. That is why the contract must provide a level of flexibility. To adapt to situations and to allow unexpected problems to be solved. The contract is an obligatory passage point. Although everything must come through it to meet its terms, all actors and elements that operate under it have a freedom in their actions. This freedom contributes to the main goal which is the satisfaction of the contract terms. The thesis also adds to studies researching outsourcing relationships and issues of trust and control. While most focus is given on trust and control in regard to managing outsourcing relationships, in this thesis the contract emerges from the background role it has. It is observed through the examples and cases of the research how control and trust are shaped so that the terms of the contract are satisfied. Controls and trust are complementary in managing relationships but they are also the translated actions that the contract demands. The contract signals the beginning of a process. That process includes the process of the delivery of the service and all the actions that will achieve that. And because a process is something dynamic and changes in time, the contract drives and demands from its actors to also be dynamic and to adapt to the circumstances.

## 8. Limitations and suggestions for further research

The thesis tried to investigate how the contract affects the actions of actors in outsourcing relationships. To do that, interviews were conducted from several firms to gain insights. Although the results between the firms seem coherent and the results complement each other in the sense that the outsourcers act in general in a similar way, a better sample could provide better results. Research on specific outsourcing departments of a firm as a whole is suggested, in order to try to understand how the whole firm is affected by the contracts and what the philosophy of the firm regarding this matter is. Another limitation of the research due to confidentiality issues is the examination of the research question only from the perspective of the outsourcer. Therefore a full picture could be given if the research can investigate the relationship meticulously from both sides. Finally another suggestion that could give even better insights for the role of contracts is to trace an outsourcing relationship before it even begins. That means to observe from the contact process of the cooperation all the actions of both sides until the completion of the contract. In that way the researcher could have a complete view of how the contract acts even before the start of the relationship and also investigate the effects of the contract after the cooperation begins.

## Appendix:

Guideline questionnaire for the research:

### 1. Introductory questions:

- Overview of the firm, Job position of interviewee, Duration of employment, Obligations, What is the exact service provided

### 2. Questions regarding initial contract process:

- How do you choose your outsourcing partner?
- How is the contract developed?
- Do you actively participate in the contracting process?
- How do you convey the contract terms/ rules to the colleagues/department?
- (For managers) Why do you not convey the whole content of the contract to all the employees?
- Are you fully aware of all the contract terms?
- Does the department understand the goals of the cooperation and contracts? How do they find/evaluate the terms? (I would like to ask this because I would like to understand whether the employees from the beginning do not “like” the contract. For example in other studies the employees had a starting negative attitude towards the contract that led to problems).

### 3. Questions regarding working process:

- How do the terms of the contract affect your work? How do you perceive the contract in your work? (Do you have its terms on the backside of your mind while working to achieve the deadlines/quality of service?)
- Do you consider the contract terms strict? How do you find/perceive the terms of contract?
- How is the relationship with the clients?
- How is the monitoring of your service achieved by the client?
- Does the contract include ways of monitoring your work and progress?
- How do the clients perceive your service?
- What are your general actions/plans in order to assure timely and responsible delivery of service? How are they connected to the contract?

### 4. Questions regarding problems in delivering services or problematic relationships:

- Do problems occur in the delivery of the service? What happens in case of delay?
- When they do how are they solved? Do you solve them yourselves? Do you inform the client?
- How does the client evaluate the delivery service problems? How does he respond? (New controls maybe?)
- Do you call upon/evoke the contract terms in cases of serious problems?

- How does the client then perceive your services?
- Does your relationship change? How?
- How do both parties face unexpected events (that could not be at any way be predicted) that affect the delivery of service?
- What happens in the scenario that the client does not honor the agreement? (I would like to ask that because I believe that the outsourcer has the biggest pressure in this kind of relationship and I would like to see if the opposite happens, that the client doesn't behave ethically or maybe has irrational demands).

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