

## **IT Outsourcing Contracts and Performance Measurement**

David Fitoussi (davef@uci.edu)  
Vijay Gurbaxani (vgurbaxa@uci.edu)

Center for Research on IT and Organizations  
The Paul Merage School of Business  
University of California  
Irvine, CA 92697-3125

November 2008

### **Abstract**

Companies that outsource IT services usually focus on achieving multiple objectives and outsourcing contracts typically specify a variety of metrics to measure and reward (or penalize) vendor performance. The specific types of performance metrics included in a contract strongly affect its incentive content and ultimately its outcome. One specific challenge is the measurement of performance when an outsourcing arrangement has a mix of objectives, some that are highly measurable and others that are not. Recent advances in contract theory suggest that the design of incentives for a given objective is affected by the characteristics of other objectives. However, there is little empirical work that demonstrates how relevant these “multi-task” concerns are in real-world contracts. We apply contract theory to examine how objectives and incentives are related in IT outsourcing contracts that include multiple objectives. We establish empirical results about performance measurement in IT outsourcing contracts that are consistent with recent theoretical propositions. We find that the use of strong direct incentives for a given measurable objective is negatively correlated with the presence of less-measurable objectives in the contract. We show that outsourcing contracts that emphasize goals with high measurement costs employ more performance metrics than initiatives whose objectives have a lower measurement-cost profile. Surprisingly, as the number of performance metrics increase, satisfactory outcomes decrease, which we explain within a multi-task theory framework. Overall, our results provide empirical support for multi-task principal-agent theory and important guidance in designing outsourcing contracts for complex IT services.