

Contracting for Information System Outsourcing with Multiple Bidders^{*}

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ABSTRACT: Outsourcing of information systems (IS) is becoming an increasingly popular phenomenon. However, most problems that arise in outsourcing arrangements can be traced to the contract between the company and the IS vendor. Of particular concern are the types of information available for contracting and the observability of that information. This paper examines the form of such outsourcing contracts by casting the problem in a principal-agent setting using the theory of mechanism design. The analysis we provide helps to (1) define the optimal contract for IS outsourcing, (2) understand the effect of unobservability on the form of the contract, and (3) examine the effect of multiple bidders. In summary, our analysis finds support for the growing trend toward equity-based contracts and partnership agreements in outsourcing relationships.

Key words: Outsourcing, Contracting, Agency, Information economics, System performance, System Effectiveness

Data availability: Not Applicable.

^{*} Accepted for publication by Uday Murthy and Casper Wiggins.