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Public Sector Outsourcing to a Subsidiary Company from a Principal-agent Perspective: Efficiency or Challenges?

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ABSTRACT

Using the lens of principal-agent theory, this study examines the efficiency paradox and governance challenges in outsourcing facilities management (FM) services to a subsidiary company within the public sector. A case study approach was employed to investigate a higher learning institution's FM outsourcing arrangement. Data were collected through semi-structured interviews and focus group discussions involving key stakeholders, including representatives of the parent institution, end users, FM staff, and finance officers. Relevant documents, including contracts and performance reports, were also reviewed. The qualitative data were analysed thematically. The findings reveal critical agency-related tensions arising from internal outsourcing. Goal incongruence emerged as the subsidiary prioritised cost reduction over service quality, leading to staff shortages and heavier workloads. Information asymmetry manifested through incomplete and inaccurate reporting, which constrained the principal's capacity to monitor performance effectively. The subsidiary's excessive reliance on the principal for supervision blurred the accountability boundaries, undermining the intended efficiency gains. Moreover, weak contract enforcement and monitoring mechanisms enabled opportunistic behaviour, false reporting, and diminished accountability. This study is among the few to explore public sector outsourcing to a subsidiary company, a hybrid arrangement that combines elements of both internal and external contracting. It advances the outsourcing literature by exposing the unique agency risks, governance gaps, and accountability dilemmas inherent in such quasi-market relationships.

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INTRODUCTION

Since the early 1990s, outsourcing has become a widely adopted business strategy across industries, primarily aimed at reducing costs through the delegation of peripheral or non-core activities such as cleaning, maintenance, information technology, payroll, and logistics to external service providers (Lonsdale, 1999; Ghodeswar & Vaidyanathan, 2008). This approach, rooted in the classic "make-or-buy" decision, enables organisations to lower fixed costs by downsizing staff or replacing them with more flexible and less costly labour, while optimising infrastructure and operational resources (Jacques, 2006; Ghodeswar & Vaidyanathan, 2008; Breunig & Bakhtiari, 2013). Over time, outsourcing has evolved beyond a cost-minimisation strategy to become a strategic management tool that enhances service quality, drives innovation, and shortens operational cycles through partnerships with specialised external providers (Lonsdale, 1999; Gilley & Abdul Rasheed, 2000; Aksin & Masini, 2008; Bustinza et al., 2010).

This trend has also permeated the public sector, where outsourcing is viewed as part of broader administrative reform initiatives aimed at enhancing efficiency, reducing government expenditure, and improving public service delivery (Prager, 1994; Hood & Young, 2003; Breunig & Bakhtiari, 2013; Haugen & Klungseth, 2017). For instance, in healthcare, hospitals outsource cleaning, food catering, laundry, and laboratory testing to manage operational costs and improve service quality (Moschuris & Kondylis, 2006; Roberts et al., 2013; Osman et al., 2022; Ab Rahim et al., 2023; Kadir et al., 2025). Similarly, in higher education institutions (HEIs), outsourcing, particularly in facilities management (FM), has become increasingly prevalent. FM outsourcing in HEIs typically encompasses maintenance, cleaning, security, landscaping, and catering services, allowing universities to focus on their core missions of teaching and research (Lok & Baldry, 2015; Wekullo, 2017; Ikediashi & Aigbavboa, 2018). Beyond cost reduction, outsourcing in HEIs is now regarded as a means to enhance service quality, promote flexibility, and improve stakeholder satisfaction (Kok et al., 2011; Wekullo, 2017).

While a vast body of literature focuses on outsourcing to independent external providers, less attention has been given to "internal" outsourcing, where services are contracted to a subsidiary or wholly owned company of the same parent organisation. Such arrangements, though administratively convenient, introduce a complex dynamic of governance and accountability that differs from conventional outsourcing relationships. This study investigates one (1) such case in a Malaysian higher education institution (hereafter Institution A), where FM services are outsourced to a subsidiary company (hereafter Company X) under a wholly owned holding structure. Although this arrangement ostensibly aims to achieve cost efficiency and service specialisation, it simultaneously raises critical concerns about role ambiguity, performance accountability, and governance control.

Guided by principal-agent theory, this study contends that effective outsourcing depends on mechanisms ensuring that the agent (subsidiary) acts in the best interests of the principal (parent institution) (Marvel & Marvel, 2007). However, when outsourcing occurs within the same organisational family, trust-based assumptions may replace formal monitoring mechanisms, potentially weakening control and accountability. This raises an important question: Can internal outsourcing to a subsidiary company deliver efficiency and service quality without compromising governance integrity?

Accordingly, this study explores the agency challenges and governance issues arising from Institution A's outsourcing of FM services to Company X. It makes three (3) key contributions. First, it extends principal-agent theory by applying it to the context of internal outsourcing, demonstrating how information asymmetry, trust-based governance, and weakened monitoring interact within related-party arrangements. Second, it contributes empirically to the FM outsourcing literature by revealing how subsidiary relationships shape service delivery outcomes in HEIs. Third, it advances public sector reform discourse by identifying the practical risks of blurred accountability and governance vulnerabilities when outsourcing occurs within interlinked organisational structures.

The remainder of this paper is organised as follows. Section 2 discusses the theoretical background and reviews the relevant literature. Section 3 outlines the methodology. Section 4 presents the results and discussion. Section 5 concludes with implications and directions for future research.

THEORETICAL FRAMEWORK AND LITERATURE REVIEW

This study is anchored in Principal-Agent Theory (PAT), which is situated within the broader framework of new institutional economics (NIE). The theory emphasises the role of formal institutional arrangements such as governance structures, regulations, incentive systems, and contractual mechanisms in mitigating problems inherent in principal-agent relationships (Braun & Guston, 2003; Joha & Janssen, 2010). In this framework, the principal delegates authority or specific tasks to the agent. However, because both parties are assumed to act in pursuit of their own self-interest, conflicts such as goal divergence, opportunism, moral hazard, and inefficiency may arise (Eisenhardt, 1989; Wright et al., 2001; Lepori et al., 2013; Gailmard, 2014). In the context of public sector outsourcing, these agency problems commonly manifest as moral hazard (hidden action), adverse selection (hidden information), and goal incongruence arising from contract incompleteness. These constructs provide a structured lens for examining how outsourcing arrangements may lead to performance shortfalls despite formal governance mechanisms. Accordingly, this study adopts these core PAT constructs as the primary analytical framework.

When principals are unable to exercise effective control, agents may prioritise their own preferences at the expense of the principal's objectives (Braun & Guston, 2003; Lepori et al., 2013). Therefore, robust contractual design, incentive alignment, and performance monitoring mechanisms become critical to reduce information asymmetry and ensure that agents act in accordance with the principal's goals (Cigolini et al., 2009; Joha & Janssen, 2010; Gailmard, 2014). Equally important is the establishment of transparent and verifiable reporting systems that link outputs and outcomes to measurable performance indicators, thereby allowing the principal to assess the agent's performance more objectively and consistently (Cigolini et al., 2009). From a PAT perspective, such challenges reflect moral hazard, whereby agents engage in hidden actions or reduce effort when their behaviour is not fully observable by the principal.

These theoretical insights are particularly relevant to public sector outsourcing, where principals (government agencies or public institutions) delegate non-core activities to external service providers (agents). Under the New Public Management (NPM) paradigm, outsourcing has become a central reform instrument aimed at achieving cost efficiency, improved service delivery, and the reallocation of resources toward core functions (Hood, 1991; Domberger & Jensen, 1997; Ismail et al., 2022). It involves the transfer of non-core or support functions to external providers with specialised expertise and economies of scale (Wekullo, 2017). Unlike the private sector, however, public sector outsourcing is shaped not only by efficiency considerations but also by political accountability, fiscal discipline, social legitimacy, and public value imperatives (Kremic et al., 2006; Hakansson & Axelsson, 2020). However, PAT highlights the risk of goal incongruence when agents prioritise cost minimisation over service quality. This risk is further exacerbated by contract incompleteness, as not all service quality dimensions and contingencies can be fully specified or enforced ex ante.

Within this broader reform movement, FM outsourcing has emerged as a particularly significant area of application. Originating in the 1960s (Wiggins, 2021), FM has evolved from a technical support activity to a strategic enabler of organisational performance (Ikediashi & Odesola, 2016; Haugen & Klungseth,

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2017). In the public sector, outsourcing FM allows organisations to focus on their core competencies and service mandates while specialised providers handle support operations (Kakabadse & Kakabadse, 2001; Kurdia et al., 2011; Hakansson & Axelsson, 2020; Modu et al., 2024). In higher education institutions (HEIs), the pressure to manage financial constraints and rising stakeholder expectations has further accelerated the adoption of FM outsourcing. Commonly outsourced services include building maintenance, cleaning, catering, landscaping, and security, which enable universities to allocate more resources to teaching, research, and student engagement (Palm, 2001; Kamaruzzaman & Ahmad Zawawi, 2010; Ikediashi et al., 2012; Palm, 2021).

The extant literature identifies both benefits and inherent risks associated with outsourcing. The reported advantages include cost reduction, efficiency gains, flexibility, and access to specialised knowledge and technology (Adegoke & Adegoke, 2013; Ellram & Tate, 2015). However, persistent challenges remain, particularly regarding quality assurance, contract enforcement, and monitoring capacity (Hefetz & Warner, 2004; Marvel & Marvel, 2007; Ali & Akhtar, 2015; Pilbeam, 2024; Kadir et al., 2025). Principal-agent theory provides a valuable explanatory lens for these challenges: when information asymmetry and weak oversight exist, agents may act opportunistically, thereby compromising service quality and accountability (Braun & Guston, 2003; Hui & Tsang, 2004; Marvel & Marvel, 2007). Prior studies reveal that outsourcing transfers accountability from hierarchical internal control systems to contractual arrangements, which may blur lines of responsibility and make the attribution of service failures ambiguous (Marvel & Marvel, 2007).

Empirical evidence on outsourcing outcomes is inconclusive. While some studies report significant efficiency gains, others document cost overruns, diminished service quality, and accountability deficits (Domberger & Hall, 1996). For instance, Johnston and Girth (2012) observed that thin markets, limited competition, and information asymmetries in local government outsourcing often undermined intended efficiency outcomes. In a U.S. context, Marvel and Marvel (2007) found that oversight and contract management capacity in public outsourcing were generally weaker than in in-house delivery, leading to fundamental accountability challenges. In public healthcare services, a number of studies have examined the role of Key Performance Indicators (KPIs) in improving service quality of outsourced FM (Ikediashi et al., 2015; Amankwah et al., 2019; Amos et al., 2021).

These agency-related risks are exacerbated when outsourcing involves related-party providers, such as subsidiaries or affiliated entities, rather than independent contractors. It is a common practice to outsource FM services to familiar service providers with whom established relationship exists (Pilbeam, 2024). In such internalised arrangements, formal governance mechanisms are often relaxed, and principals may depend more on relational trust and perceived alignment of interests, exposing themselves to moral hazard and performance risks (Liu & Ooi, 2018; Pilbeam, 2024). Evidence from Australian superannuation funds shows that outsourcing to related providers is frequently associated with underperformance and weak oversight due to vertical integration and overlapping directorships (Liu & Ooi, 2018). Similar risks are likely to manifest in the public sector, where organisational proximity and familiarity may erode the objectivity required for effective contract enforcement.

Despite the extensive scholarship on outsourcing, several important gaps remain. First, most existing studies are grounded in developed-country contexts, limiting generalizability to emerging economies where governance systems and institutional capacities differ significantly. Second, the dominant conceptualisation of outsourcing assumes arm's-length relationships with independent third-party providers, while relatively little attention has been devoted to internal outsourcing arrangements involving subsidiaries or affiliated entities. Third, even though outsourcing has become a common strategy in higher education institutions, empirical research on FM outsourcing in universities, particularly within developing nations, remains sparse.

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These gaps highlight the need for context-specific and theoretically grounded investigations into the governance and accountability implications of outsourcing to related entities in HEIs. By adopting a principal-agent theoretical lens, this study contributes to filling these gaps by exploring how information asymmetry, weakened monitoring, and relational governance influence the effectiveness and integrity of internal outsourcing arrangements within the public sector.

RESEARCH METHOD

Research Design

This study adopted a case study approach, which is appropriate for exploratory research aimed at describing and examining contemporary phenomena within their real-life context (Yin, 1994). The case study design is particularly suitable when the boundaries between the phenomenon and its context are not clearly evident and when "how" and "why" questions are central to the inquiry (Darke & Shanks, 2002). This approach allows for an in-depth exploration of organisational dynamics and contextual factors that influence outcomes, providing rich, holistic insights that would be difficult to obtain through purely quantitative methods.

The case study approach is also consistent with the application of PAT, as agency problems such as moral hazard, adverse selection, and goal incongruence often manifest through processes, behaviours, and outcomes that require rich qualitative evidence rather than purely quantitative measurement.

Case Organisation and Outsourced Service

The selected case, referred to as Institution A, is a higher education institution in Malaysia with more than 4,000 academic and administrative staff. It serves a student population of approximately 23,000 across several campuses. Given its continuous seven-day operational schedule, the management and maintenance of its facilities represent a critical organisational function requiring efficient coordination and service reliability. Institution A was chosen as a representative case due to its long-term outsourcing arrangement, organisational complexity, and relevance to public sector reform initiatives in Malaysia.

Since 2002, Institution A has outsourced its FM services for all campuses to Company X, a wholly owned subsidiary of its holding company. Company X employs over 2,000 staff and provides FM services to several HEIs, private firms, and government agencies. Within Institution A, the Infrastructure Division is responsible for overseeing the performance of Company X. The division conducts monthly performance review meetings to evaluate service delivery using Key Performance Indicators (KPIs) and Key Deduction Indicators (KDIs). These performance metrics are used not only for compliance monitoring but also as a basis for continuous service improvement and accountability. The regular engagement between Institution A and Company X ensures alignment with institutional objectives and provides a feedback mechanism for problem resolution and innovation in service delivery.

Data Collection Strategy

To enhance credibility and analytical depth, the study employed methodological and stakeholder triangulation (Yin, 1994). Data were collected through focus group discussions (FGDs), semi-structured interviews, and document analysis, involving multiple stakeholder groups with distinct roles in the outsourcing arrangement. Data collection took place between May and July 2025.

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A total of six (6) FGDs and four (4) individual interviews were conducted. Participants were purposively selected based on their involvement in, or exposure to, the outsourced FM services. As summarised in Table 1, the stakeholder groups included representatives from the Infrastructure Division, Finance Division, end-user divisions, and Company X (cleaners and supervisors).

Table 1. Participants of Focus Group Discussions and Interviews

Focus Group Discussion Session	**Total Number of Participants**	**Duration**
FGD1 – Finance Division (May)	4	90 minutes
FGD2 – End user Division 1 (May)	7	108 minutes
FGD3 – Infrastructure Division (May)	9	84 minutes
FGD4 – Infrastructure Division (June)	28	131 minutes
FDG5 – Cleaners from Company X - Residential (July)	3	13 minutes
FGD6 – Cleaners from Company X - Faculty (July)	4	63 minutes
Interview session	**Gender**	**Duration**
Interviewee 1 – End user Division 2 (May)	Male	50 minutes
Interviewee2 – Ex-staff of Infrastructure Division (May)	Female	35 minutes
Interviewee 3 – Top Management (June)	Male	45 minutes
Interviewee 4 – Supervisor of Company X (July)	Female	29 minutes

Source: Authors (2025)

The inclusion of these diverse stakeholders was theoretically driven, rather than merely descriptive. Guided by PAT, the study recognises that agency problems cannot be fully captured from the principal's perspective alone. Instead, different manifestations of agency problems emerge at different organisational interfaces. Accordingly, each stakeholder group contributed evidence relevant to specific PAT constructs.

The Infrastructure Division represented the formal principal in the outsourcing relationship and provided insights into contract governance, monitoring mechanisms, performance evaluation, and reporting practices. Their perspectives were essential for understanding how accountability was formally designed and exercised. The Finance Division was deliberately included to capture financial and budgeting perspectives that shape outsourcing decisions and operational priorities. From a PAT perspective, Finance Division data are critical for identifying goal incongruence, as financial controls, budget constraints, and cost rationalisation decisions directly influence staffing levels, wage structures, and resource allocation by the subsidiary. Evidence from this group helped explain how cost minimisation pressures contributed to the divergence between the principal's service quality objectives and the agent's operational priorities.

End users, including faculty representatives and residential service units, were included to capture service delivery outcomes and user experiences. Their role is particularly important for identifying moral hazard (hidden action), as end users directly experience the consequences of reduced effort, weak supervision, and declining service quality. Unlike contractual reports or managerial assessments, end-user accounts provide outcome-based evidence of how agent behaviour translates into service deficiencies. In addition, cleaners and supervisors from Company X were included to provide operational-level insights into workload distribution, staffing adequacy, and internal supervision practices. These perspectives allowed the researchers to contextualise agent behaviour and cross-validate claims made by the principal and end users.

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Collectively, these stakeholder perspectives enabled theoretical triangulation, whereby evidence of agency problems was corroborated across financial decision-making (goal incongruence), operational behaviour (moral hazard), and service outcomes (experienced quality). This multi-perspective approach reduced single-source bias and strengthened the robustness and validity of the findings.

Data Analysis

All FGDs and interviews were audio-recorded with participants' consent and conducted in English and Malay, depending on participants' preferences. The recordings were transcribed verbatim, and Malay transcripts were translated into English. To enhance reliability, selected participants were engaged in member checking to verify the accuracy of key interpretations.

The data were analysed using thematic analysis, following an iterative coding process. Initial coding was conducted inductively to allow themes to emerge from the data, after which themes were refined and interpreted through the lens of PAT. This analytical approach enabled the systematic identification of patterns related to moral hazard, adverse selection, goal incongruence, and contract incompleteness.

To further strengthen validity, qualitative findings were triangulated with documentary evidence, including service contracts, KPI reports, and internal audit documents. This integration of multiple data sources enhanced the credibility of the analysis and ensured consistency between reported practices and documented evidence.

FINDINGS AND DISCUSSION

Guided by PAT, this section discusses the findings using the core agency constructs of moral hazard (hidden action), adverse selection (hidden information), and goal incongruence and contract incompleteness as the primary analytical structure. This theoretically grounded approach allows the empirical evidence to be systematically interpreted in terms of agency risks that emerge when FM services are outsourced to a wholly owned subsidiary. The findings demonstrate that, rather than mitigating agency problems through organisational proximity, internal outsourcing intensified information asymmetry, weakened accountability, and diluted governance discipline.

Moral Hazard (Hidden Action): Poor Monitoring and Declining Service Quality

Moral hazard arises when agents engage in opportunistic behaviour because their actions are difficult or costly for the principal to observe (Jensen & Meckling, 1976; Eisenhardt, 1989). In the present case, moral hazard manifested most clearly through weak supervision, delayed maintenance actions, and declining service quality, particularly in cleaning and preventive maintenance activities.

Evidence from cleaners and infrastructure officers revealed systematic reductions in staffing levels that were not transparently communicated or adequately justified:

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"Originally, one (1) residential block had eight (8) cleaners. To save costs, now we only have five (5)." (Cleaner 1)

"In the past, we had 10 cleaners for this Faculty. Now there are only seven (7)." (Cleaner 2)

These staffing reductions increased workload intensity and compromised service outcomes, yet Company X continued to report compliance with contractual obligations. This reflects classic moral hazard behaviour, where the agent reduces effort or quality after the contract is awarded, knowing that direct monitoring by the principal is weak.

Further evidence of moral hazard emerged from the agent's failure to actively monitor site works and contractors, as highlighted by Infrastructure Division staff:

"Company X failed to proactively monitor site works." (FGD 4)

"There is over-dependence on the Infrastructure Division for supervision." (FGD 4)

From a PAT perspective, this behaviour contradicts the fundamental purpose of outsourcing, which is to transfer operational responsibility to the agent. Instead, Institution A was forced to engage in what Lonsdale (1999) terms "in-sourcing by supervision," where the principal absorbs additional monitoring burdens due to agent shirking. The reliance on trust and organisational affiliation reduced incentives for Company X to exercise rigorous internal control, thereby enabling hidden action and eroding service quality.

These findings are consistent with prior public-sector outsourcing studies showing that weak monitoring capacity allows agents to underperform without immediate consequences (Marvel & Marvel, 2007; Johnston & Girth, 2012). Importantly, this study extends the literature by demonstrating that internal outsourcing to a subsidiary does not eliminate moral hazard; instead, it may exacerbate it by weakening formal oversight mechanisms.

Adverse Selection (Hidden Information): False Reporting and Information Asymmetry

Adverse selection occurs when agents possess superior information that principals cannot easily verify, allowing agents to misrepresent capabilities or performance (Eisenhardt, 1989). In this study, adverse selection was evident through incomplete, delayed, and inaccurate reporting, particularly in relation to staffing levels, preventive maintenance, and work completion claims.

Internal audit findings explicitly highlighted discrepancies between reported and actual performance:

"There's a mismatch between Company X's KPI reports and the actual work done." (Internal Audit Report)

Similarly, Infrastructure Division officers noted persistent reporting deficiencies:

"Preventive maintenance (PPM) reports are often delayed and sometimes missing details." (FGD 3)

These reporting gaps constrained Institution A's ability to assess performance objectively, reinforcing information asymmetry in favour of the agent. From a PAT standpoint, such hidden information enables agents to conceal underperformance, overstate compliance, or shift blame for service failures. This is consistent with incomplete contracts theory, which predicts that agents exploit monitoring gaps when performance quality is difficult to specify and verify ex ante (Hart et al., 1997).

The problem of adverse selection was further amplified by the related-party nature of the outsourcing arrangement. Because Company X was a wholly owned subsidiary, reporting was treated as a formality rather than a governance safeguard. Assumptions of shared interests and organisational loyalty reduced pressure for strict verification, allowing Company X to control operational data while limiting the principal's access to independent information sources. This dynamic is reflected in the following remark:

"Company X acts like they are our employer." (Infrastructure Division staff)

Such statements suggest a reversal of power asymmetry, where the agent leveraged informational advantage to dominate the relationship. This finding aligns with Aman and Maelah (2010) and Liu and Ooi (2018), who argue that outsourcing to related entities creates governance blind spots by masking agency conflicts under relational trust. In this case, adverse selection was not merely a technical reporting issue but a structural outcome of blurred organisational boundaries.

Goal Incongruence and Contract Incompleteness: Cost Prioritisation over Quality

Goal incongruence is a central assumption of PAT, arising when principals and agents pursue divergent objectives (Eisenhardt, 1989). In Institution A's outsourcing arrangement, goal divergence was most apparent in the subsidiary's prioritisation of cost minimisation over service quality, directly conflicting with the principal's objective of maintaining a conducive academic and residential environment.

This misalignment was evident in workforce management practices, wage disparities, and service coverage decisions:

"Our salaries are not the same..." (Cleaner 3)

Such cost-driven decisions weakened staff morale and service reliability, reinforcing the agent's focus on financial efficiency rather than performance outcomes valued by the principal. From a PAT perspective, this reflects incomplete contracting: although KPIs and KDIs formally existed, they were insufficiently detailed, weakly enforced, and rarely linked to meaningful sanctions.

The long-term nature of the contractual relationship further intensified this problem. As Domberger and Hall (1996) and Prager (1994) note, extended relational contracts often reduce competitive pressure and encourage complacency. In this case, Company X's secure position as a subsidiary reduced incentives to align behaviour with the principal's evolving quality expectations.

Moreover, contract incompleteness was evident in Company X's supervision of third-party contractors. Audit evidence revealed that contractors were paid for work recorded as completed despite inadequate verification:

"...contractors were paid for works recorded as completed even though site inspections showed otherwise." (Internal Audit Report)

This demonstrates a cascading agency problem, where weak incentives and incomplete contracts at the first-tier agent level translated into opportunism at the subcontractor level. As Jensen and Meckling (1976)

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argue, agency problems multiply when monitoring responsibilities are delegated without corresponding control mechanisms.

In summary, the findings demonstrate that outsourcing FM services to a wholly owned subsidiary did not mitigate agency problems as theoretically assumed. Instead, moral hazard (hidden action), adverse selection (hidden information), and goal incongruence reinforced by contract incompleteness collectively undermined efficiency, service quality, and accountability. This study shows how internal outsourcing arrangements may reproduce rather than resolve the governance failures outsourcing is intended to address.

IMPLICATIONS OF THE STUDY, LIMITATIONS AND SUGGESTIONS FOR FUTURE RESEARCH

Using the lens of PAT, this study explores the challenges of outsourcing FM services to a service provider closely affiliated with the principal institution. Drawing on a case study of HEI (Institution A), the research employed interviews, focus group discussions, and document reviews to uncover three (3) critical issues. First, goal misalignment emerged as the service provider prioritised cost minimisation over the principal's quality objectives. Second, weak contract governance diluted accountability, with incomplete reporting and information asymmetry limiting effective oversight. Third, ineffective contractor monitoring by the service provider compromised service quality.

There are several important implications from the findings of the present study. As declining service quality was found to be linked to the close relationship with the current service provider, it is timely for the institution to initiate an open and competitive tendering process. Such an approach will enable the exploration of alternative providers, allowing for a fair assessment of service quality, reliability, and cost efficiency. This not only increases the likelihood of engaging a more capable and accountable service provider but also ensures that any reappointment of the existing provider is based on merit and performance rather than personal or institutional relationships. In doing so, the institution can strengthen governance, transparency, and accountability in its outsourcing practices.

For service providers, especially those closely related to the principal institution, the findings highlight the importance of ensuring that service delivery is not compromised by relational proximity. Service quality must be anchored in professionalism, with clear alignment to the client's goals and expectations rather than being driven by cost minimisation alone. Providers should also uphold contractual accountability by strictly adhering to agreed terms, conditions, and performance indicators. In addition, robust monitoring and reporting mechanisms should be established to enhance transparency and demonstrate compliance with service standards.

Beyond the current study context, the study also carries important strategic implications for service providers. An outsourcing arrangement with a related institution should be viewed as an opportunity to showcase reliability and establish a reputation that extends beyond relational contracts. By delivering consistently efficient and high-quality services, providers can strengthen their credibility and position themselves as model performers. This reputation, built on demonstrated service excellence rather than institutional ties, is crucial for long-term strategic growth. Moreover, superior service delivery to the holding institution can enable the principal to confidently promote the provider's capabilities to other organisations, opening new avenues for business expansion and market recognition.

Despite the significant findings, this study is not without limitations. It specifically examined the challenges of outsourcing to a related company for a service that does not constitute the core business of

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the principal institution. While outsourcing is often applied to non-core activities, the dynamics may differ substantially when the outsourced service involves core business functions. Therefore, future research could extend the scope of investigation to outsourcing arrangements that involve core activities, in order to provide a more comprehensive understanding of the implications and challenges across different outsourcing contexts. In addition, future studies may also wish to explore outsourcing in different sectors, examining principal and agent companies operating in diverse industries and institutional settings. Such comparative evidence would provide richer insights into how sector-specific factors shape outsourcing outcomes and governance practices.

The study was guided by principal-agent theory, which offered valuable insights into issues of goal misalignment, weak governance, and ineffective monitoring. However, principal-agent theory may not fully capture other dynamics such as trust, power relations, or institutional pressures that could influence outsourcing relationships. Future studies could therefore integrate complementary perspectives, such as institutional theory, resource dependency theory, or relational governance approaches, to provide a more holistic understanding of outsourcing arrangements.

Despite its limitations, this study provides valuable insights into the challenges of outsourcing to a related company. The findings highlight the need to strengthen outsourcing arrangements in the public sector, particularly to ensure that non-core activities are managed efficiently. Achieving positive outcomes from such arrangements can ultimately enhance public sector performance and reinforce accountability to society at large.

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This study adheres to all applicable ethical standards and guidelines throughout the research process. Participants of the focus group discussions and interviews were provided with comprehensive information about the study's purpose and procedures. They were fully informed of their rights as respondents, including the right to decline participation or withdraw from the study at any time. No participants were coerced or subjected to any undue influence in obtaining their consent or participation. Measures were taken to ensure the confidentiality and anonymity of all participants. Furthermore, the data collected were used solely for the purposes stated in the study.

CONFLICT OF INTEREST STATEMENT

The authors agree that this research was conducted in the absence of any self-benefits, commercial or financial conflicts and declare the absence of conflicting interests with the funder.

AUTHORS' CONTRIBUTIONS

Suhaiza Ismail, Hawa Ahmad and Norsyahida Mokhtar jointly conducted the research and contributed to the writing of the manuscript. The central research idea was conceptualised by Suhaiza Ismail, with Mohamed Aslam Mohamed Haneef providing professional guidance and oversight throughout the research.

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