Remediation and Relaunch: Putting an Outsourcing Deal Back on Track

A White Paper

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You've read the many and varied statistics about the numbers of outsourcing deals that fail, have to be renegotiated, or simply leave the customers dissatisfied and the providers losing money. We won't repeat them here, but suffice it to say that while it is not all bad news and outsourcing will continue to be a standard tool in management's repertoire, there are enough problems with these relationships and it is hard enough to get them back on track when they run into trouble, that senior management must take notice and must take action to remediate damaged relationships as early as possible.

It's not just how often there is trouble. All available research, from analysts, advisors, and academics confirms what many of us experience in practice: there is a lot of value at stake in how outsourcing relationships are managed. The difference in results between a deal that is humming along well in which the parties are solving problems together effectively, and one in which they are constantly pulling out the contract, fighting over who's at fault, and making threats is somewhere between 20 and 40% of contract value.[1]

When these deals get into trouble and the parties decide to call for help, they often contemplate litigation or arbitration. While arbitration is often faster and cheaper than litigation, whichever of those you embark on, you can bet there will be a tremendous amount of value that gets destroyed in the process. While the process is going on, and even after it concludes, you can also expect it to become even harder to work effectively together.

How the problems manifest

In our experience, problems between buyers and providers take on a variety of forms. They sometimes seem to be focused on the contract; other times they seem to be about results; and in others still the symptoms seem more related to personality clashes. When we ask a few questions about what's going on, we typically hear a laundry list of concerns from both sides such as those in Figure 1.

Whichever combination of these and other complaints are present, you can bet that there are a few things that can also be said about the situation:

Both buyer and provider are unhappy: While not impossible, it is highly unlikely that one side in the relationship could be experiencing these sorts of problems and the other side would be unaware and not

Typical Concerns In Outsourcing Deals

Buyer Concerns	Provider Concerns
■ Provider not meeting SLAs ■ Provider not fixing problems fast enough ■ Excessive staff turnover at provider is leading to loss of knowledge and efficiency ■ ARCs and change orders are eating up all the savings ■ Transition is taking too long ■ Internal stakeholders are angry ■ Where's the innovation? ■ The only way to get them to pay attention is to send a letter from Legal	■ We're meeting SLAs, but the buyer is still complaining ■ They don't give us clear priorities ■ We're not getting what we need from the buyer ■ Volumes are completely different from what we expected ■ We can't get reasonable forecasts from them ■ Their users are not following the new process ■ Their retained organization is micro-managing us: wastes our time and sends mixed messages

Figure 1

impacted. Invariably, a dissatisfied customer is more expensive to serve, and a provider who is losing money on every interaction is less likely to go above and beyond to make the customer happy.

The problems tend to get worse, rather than better, if ignored: Unlike the weather, which can clear up on its own, problems in the relationship between buyer and provider have a tendency to get worse the longer they run. Consider the typical doom loop shown in Figure 2. Many relationships spiral downwards as technical or business problems erode trust; which as it breaks down makes it harder to solve problems creatively; which in turn lead the parties to feel frustrated, disrespected, or ignored; and around and around it goes.

Doom Loop

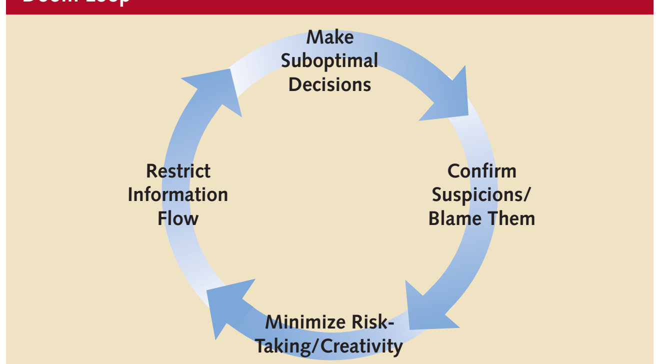

Figure 2

[1] D. Ertel, S. Enlow, and K. Barr *Managing Outsourcing Relationships: Essential Practices for Buyers and Providers*, Vantage Partners, LLC (2006).
L. P. Willcocks and S. Cullen *The Outsourcing Enterprise: The power of relationships*, LogicaCMG, UK (2005).
Corporate Executive Board, *Maximizing Return on HR Outsourcing Investment* (2004)

Typical customer-vendor communications don't help: The outsourcing relationship is somewhat different from a classic customer-vendor situation. Switching costs are high. The services delivered are complex and require a great deal of interaction between the parties. There is also usually a fair bit of baggage around the decision to outsource, the scope of the deal, the selection of the provider, and the way in which the initial transition was handled.

In such a context, many parties bounce between two extremes in how they communicate and deal with conflict: they either tend to shut down communication and avoid talking about the problems, or they come out guns blazing making demands and imposing (or deflecting) blame, (often trying the former until their level of frustration leads to the latter.) Either approach tends to aggravate the problem and reduce the likelihood that the parties will, on their own, resolve the situation.

Getting to the roots of the problem

Although the problems listed in the chart above may sound like they are quite different from one another, in our experience, there are a few common dynamics that typically drive many of the problems. Understanding what combination of these or other root causes, are creating the problem in your outsourcing relationship is the key to developing a workable and durable solution.

1. **Lack of clear decision making roles and responsibilities:** Many buyer and provider teams find themselves frustrated, or worse, by disappointed expectations about how decisions will be made. That is because we often get stuck in an either/ or sort of paradigm — either I am a "decision maker" with the right to determine whether something gets done or not, or I am in the dark and things "happen to me." Faced with those choices, most people want to be the ones to call the shots. But when we all want that, it can difficult to get things done efficiently. Sometimes, to avoid involving "everyone" we choose to consult very narrowly, for fear of creating broader expectations we cannot meet. But when we consult too narrowly, we tend to make more mistakes, and we tend to disappoint expectations about how stakeholders' views would be taken into account (and in the process make them feel disrespected, distrusted, overburdened, and all the more committed to make sure they get a seat at the table.)
2. **Mismanaged expectations about how each side needs to contribute to realizing the value of the deal:** Buyers ask providers to deliver value, but rarely ask how the provider intends to do so and with what trade-offs or implications. Providers in turn, listen to the buyer's stated priorities and mandate, and march off to cut costs, or accelerate transformation, or improve quality, or implement variable delivery models — *without checking whether buyers are on board with how they are going to do it and what it will take from the buyer.* Many times, this is the result of implementation teams on both sides not being involved in the initial negotiation process and having to live with a deal that does not match business reality or expectations. The results are as predictable as they are sad. Providers try to apply economies of scale and find that buyers want highly customized solutions that break those economies. Or they prepare to reengineer processes and find buyers unprepared for change. Or they create highly elastic delivery systems and find buyers who lack the ability to forecast demand accurately enough for the model to work. Who is at fault then? Does it really matter for purposes of coming up with a good solution?
3. **Ineffective communication between the parties about performance and scope:** Both buyers and providers tend to approach these conversations as if the goal were to prove that their interpretation of the contract is the only plausible one. Exaggerating only a little for effect, Figure 3 shows what some of performance discussions sound like.

Typical Concerns In Outsourcing Deals

Buyer:	You are failing to meet your SLA obligations.
Provider:	Well, it wasn't our fault
Buyer:	The contract is very clear that you have to do X, and Y, with less than Z% errors!
Provider:	Yes, but we ran into some problems we didn't anticipate, and your people were slow in getting back to us, and …
Buyer:	Oh, so you are going to try to shift the blame to us now …No way!
Provider:	We're not miracle workers, you know!

Figure 3

Scope discussions follow similar patterns, except that buyers tend to have little patience for what feels like being "nickel and dimed" over things that the provider should have known would be necessary. Providers on the other hand, having had to cut their fee to the bone, have little patience for what feels like buyers trying to squeeze yet more out of an already unprofitable relationship. The resulting conversation is about each side trying to convince the other to "give in" with predictable consequences for the working relationship.

4. **Lack of alignment and buy-in among stakeholders:** On the provider side, it often takes multiple business units and functions to deliver a significant outsourcing program. On the buyer side, there are typically stakeholders throughout the organization, including end users, business unit leaders, functional specialists, finance, and more. When there is lack of alignment among buyer stakeholders around the decision to outsource at all, or to whom, or with what scope, or with what service level expectations, then both providers and their day-to-day counterparts in the retained organization pay the price. Similarly, when there is lack of alignment on the provider side with respect to the make up of the solution, the facilities that will support it, how the deal was priced, what commitments were made during the negotiation, or how the relationship should be managed, both sides of that relationship suffer from inconsistent performance, slow decision making, and lack of follow through.

What to do when problems arise

When problems arise that are "relationship affecting," it is important to determine the scope and cause of the problem before deciding that the outsourcing relationship cannot be put back on track. While some problems may have been ignored or "swept under the carpet" previously, and others simply festered without full resolution, the entire relationship needs to be reviewed so that a party can understand, from all stakeholders, what went wrong and what the parties did to address the problems as they arose. For all of the governance procedures that were negotiated in the outsourcing agreement, it is common to find out that these procedures were never followed, problems were never raised with the other party, (or were raised but never addressed through the governance procedures), so that senior management, perhaps of both parties, are in the dark about the significance of the problems in the relationship.

Indeed, that was the case in one of the troubled relationships where our firms teamed up to help deal with the problem. Buyer and provider operational teams were busily documenting who had done what to whom, and doing so wholly outside of the contractual governance processes. Why? Well, it turns out that even though they had a rather nice multi-tiered governance model written into the contract, along with wonderful aspirational language about the collaborative nature of their partnership, the Steering Committee had never met, the Management Committee had never been fully staffed, and their shared scorecard had never been populated. They simply weren't using the contract's governance provisions. When we asked about that, what we heard was the governance provisions had never really been discussed in the negotiation, they were just cut and pasted from another contract (where perhaps they had never been implemented either!).

Vantage's research shows that indeed, even though they know better, many providers fail to implement, or insist that buyers implement, governance best practices.

So, when an outsourcing relationship is in trouble, a party has some homework to conduct a thorough relationship review to determine what went wrong and why, before it can engage in an effective dialogue with the other party and develop a strategy to address these problems.

Governance Processes Deemed Critical but Not Regularly Implemented

Category	% Providers who said Provision was Critical*	% Providers who Always Implemented
Communication Processes	95%	43%
Conflict management/problem-solving processes	86%	35%
Guidelines/methods for hand-ing off between negotiation and implementation teams	75%	35%
Joint training for buyer and provider	73%	8%
Change management processes/tools	71%	49%
Scope management protocols/tools	71%	43%
Escalation paths	65%	54%
Demand management processes/guidelines	60%	28%
Relationship audit/adjustment processes and structures	52%	30%

Initially, a team needs to be assembled to address these issues and conduct the relationship review. The team should consist of representatives for all affected parts of the enterprise, including operations, finance, management and others necessary so that a comprehensive review can occur. Consider whether members of the team that negotiated the deal should be involved as well, to better understand the deal that was struck.

Once assembled, the team needs to understand the nature of the problems as well as all communications between the parties on these issues. This will require discussions with various parts of an enterprise, since multiple interactions may have occurred between the parties regarding the very same issues. This review also requires collection of all documents, including electronic documents such as presentations, meeting agendas/notes and emails, to get a full picture of what was known and what was communicated. This is not an easy task, and will occur over time, with the most readily-available documents coming to light first, with others (particularly electronic documents) taking more effort and longer to collect. Clearly, this process needs to be well managed and organized to be useful. Participation by the law department or outside counsel should be involved, and can assist in document collection, contract review, and strategy discussions.

The results of this review typically include one or more of the following:

- Problems were not clearly identified to the other side or there was never confirmation that the proposed resolution had worked.
- The parties departed from the negotiated contract in some manner, typically with respect to scope or responsibilities, service levels or charges.
  - Sometimes these variances were intended, but were not documented; other times, the variances just happened over time and were not addressed.
  - Often the variances are a mixed bag, some favorable to one side, some to the other.
- There are numerous emails between different individuals that need to be collated and included into an analysis of the timeline of events, in order better to understand who might have had what information and when.
- There are communications between the parties that reveal a different set of facts than originally thought, including:
  - Agreement to modify operational or financial aspect of the deal
  - Knowledge of problems, including scope of the problems
  - Revealing a failure to understand what was negotiated in the outsourcing agreement

Senior management need to be involved in this process to ensure that the relationship review is conducted in a proper and timely manner. Once completed, senior management can then be involved in the process of determining the appropriate strategy and communication with the other party. Since it is important for communications to be clear between the parties, a party should consider establishing a single point of contact within the organization to avoid multiple, sometimes conflicting, messages being sent to the other party.

Addressing the problem

The solutions to these problems can vary substantially from situation to situation. In some cases, key elements of the contract, including scope, pricing, or service levels need to be revisited. In others, the problems have to do with things that may not have been fully spelled out, like the way certain data is handled or how third parties are managed. In yet others, the challenges are less about what is in the contract than about how the parties work together. Whether specific contractual provisions change or not, when we help buyers and providers work to redefine, restructure, or just relaunch their relationships, we usually work with the parties to make sure the following critical components of an effective governance system are in place and working well.

1. **Decision roles and responsibilities:** One way to deal with the problem of people feeling left out of critical decisions, or feeling like decisions can never get finalized and implemented for lack of buy in, is to recognize that there are a variety of different roles that individuals can play with respect to decisions, and that those roles each come with paired rights and responsibilities. The choices are not all or nothing, and indeed, the roles that individuals play can vary by issue. One approach to doing so that has gained significant traction in outsourcing is the D-I-C-N decision rights matrix.

   To create a decision rights matrix, such as D-I-C-N, start by delineating the roles that different individuals can play on any given decision. Instead of giving someone veto power or none at all, consider the range of decision-making powers you could assign: who should be **informed** (I) of a decision before it is broadly announced, so they are not surprised or embarrassed by first hearing about the decision from the other side or even from a competitor; who should be **consulted** (C) before a decision is made, so that they may provide input or share relevant information or expertise; and who must be part of a **negotiation** (N) before a decision can be made. The person framing up the decision and taking responsibility for making sure some decision is made, is the **driver** (D).

Each of these roles not only implies a right—to be consulted, to be informed, and so on—but it also has a corresponding obligation, or responsibility. If you are in the consultation role for a particular decision, for example, that means the driver has to get your input and take it into account before a decision is made. It also means, however, that you have an obligation to provide the driver with timely and informed feedback when consulted. Similarly, if your role entitles you to be informed and you will have privileged access to information, you might reasonably be expected to maintain that information in confidence for some period of time.

The value of creating such a matrix is often in the creation process itself. It helps clarify expectations for how decisions will be made — internally as well as between buyer and provider — and makes decision making more transparent, more effective, and as the parties get used to it, more efficient.

2. **Joint contributions to value creation:** Although the service provider is certainly the one on the hook for the deliverables in the contract and the service levels in the SLAs, if the buyer wants to receive real value (rather than just collect on penalties) they need to engage the service provider in a robust conversation about what the service provider needs and expects from the customer in order to properly perform. When a buyer's expectations are disappointed and internal stakeholders are upset, part of the solution usually lies in identifying not only what the service provider needs to change, but also those things that *the buyer* can or needs to change, influence, or deliver that would make a difference.

   It's likely that many of the things a buyer can do to enable a service provider to deliver value are not contractually required of the buyer. But if by making themselves easier to serve, a customer can make it more likely that the service provider can deliver real value, then those things should be put on the table, considered, analyzed, and discussed. What is on that list? What are the costs of doing them? What are the impacts on the service provider's ability to deliver?

   One very useful way to make both parties feel responsible for contributing to value creation is to create a shared scorecard that focuses on measuring outcomes that really matter as well as the key activities that enable those outcomes. Whether the parties choose to assign consequences to meeting or not meeting their respective obligations tracked on such a scorecard can be a separate question. But when they at least start monitoring and shining a light on whether they are each doing what they can to create value together, they begin to produce the kinds of positive results that are self-reinforcing and that lead them to work better together on all fronts.

3. **Managing difficult conversations:** In most situations we have seen, both sides tend to be at least adequately covered, if not over supplied, with subject matter experts. Unfortunately, one or both sides usually tend to be under supplied with individuals who have the requisite relationship management skills.

   Whatever else is required to right the relationship, part of the solution likely involves "reskilling" some of the individuals on both sides of the relationship. There is no need to get rid of subject matter experts or replace them with more "diplomatic" individuals. Their expertise is important. But it is also important to expand their repertoire, with effective communication skills, the ability handle difficult conversations about performance and scope, the ability to engage collaboratively in joint problem solving, and the ability to build alignment across diverse stakeholders.

Taking action

One thing should be clear to anyone who has experienced a troubled outsourcing deal: it doesn't just get better by itself. You can sit back and hope that replacing some individuals on the interface, throwing a bit more resources at the problem or making threats will solve the problem. When that ultimately fails (as it often does, if you haven't addressed the root causes of the problem) many just try the same thing again, bringing to mind the old definition of insanity: doing the same thing over and over again and expecting different results.

The longer these problems go unresolved the more likely it is that the end result will be painful and expensive for all concerned. Lack of effective governance and relationship management mechanisms, which are actually being used in appropriate ways, is often at the heart of the problem. Remediating and relaunching a troubled outsourcing relationship requires strong leadership and a willingness to look at the problem broadly and objectively.

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