Building
Tomorrow's Enterprise

White Paper

Building Trust in Strategic Relationships

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Given the importance of effective outsourcing relationships to the growth and profitability of large enterprises, it is important to revisit the essential nature of these relationships and consider those elements that are essential to their success. In this context the word "relationship" is key. Customers who have had unsatisfactory experiences with outsourcing don't describe these experiences as "contractual failures"; instead, these experiences are described as failures in developing effective relationships with outsourcing partners.

A true outsourcing relationship is best seen as a long term process in which the parties develop increasing levels of trust and understanding of the customer's business goals and the value that the service provider can bring to overall business proposition of the customer. A true outsourcing partner is a strategic advisor and thought leader, not just a reliable provider of services. However, many outsourcing arrangements fall short of this ideal.

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One reason why parties do not develop successful relationships is that they start off on the wrong foot. Contract negotiations leading up to an outsourcing agreement often do not foster relationship building because they are unduly adversarial. First, the parties do not actually talk enough about what each expects of the other; and second, the parties try too hard to negotiate a transfer of normal business risk on an unfair basis. The negotiations are structured on a model better suited to the sale of goods than to the creation of a long term mutually beneficial relationship. In either event, we should look to the contracting process to identify the problems and the solutions.

We submit that there are two essential elements to any successful long term outsourcing relationship. First is the element of clearly articulated and defined expectations. No business relationship will work in the long run if one or both parties are consistently disappointed in the behavior or output of the other. Second is the element of fundamental fairness. Customers and service providers work through problems and find solutions and create value through their relationships as long as each party perceives that it is being treated fairly by the other. Occasional disputes and disagreements are inevitable, but rarely fatal to a long term relationship. Fundamentally unfair terms, on the other hand, cannot be the foundation of an enduring outsourcing agreement.

Defining and Aligning Expectations

The key to aligning expectations is creating a process that permits the parties to discuss and clearly describe in contract documents "what" each party expects of the other, "how" the parties plan to work together to meet those expectations, and "how well" each party must perform its responsibilities. Frequently, the process of negotiation is flawed.

Sometimes the problem arises from a lack of process. Parties may have a previous positive experience with one another, or for some other reason they may decide to abbreviate the contracting process and settle on a brief contract describing in broad (and usually ambiguous) terms what they expect of one another. The negotiations are short and uneventful and both parties believe they have done a great job in a short time. Only later, after the contract has been signed, do they discover that they never really talked about, much less agreed on, what each expected of the other. Conflicts arise. The customer is disappointed that he is not getting the service he thought he would get, and the service supplier is disappointed that he his being asked to do more than he thought he was being paid to do. And to make matters worse, the contract does not even address how the parties are to go about managing the contract and their relationship to resolve these issues.

More often, however, the problem arises in the context of rigidly applied contracting processes that do not allow free and open discussion of the "what" "how" and "how well." This is particularly true in competitive procurements where the customer, often working with a deal consultant, drafts a contract, including statements of work and service level agreements, and requires bidders to simply agree or disagree with the contract language, tacitly threatening to disqualify any bidder who attempts to engage in a dialogue. Where the parties have little or no opportunity to actually talk about how each is reading the contract language and their real expectations it is no wonder they fail to understand each other.

Global sourcing contracting is a challenge. By their very nature, these contracts are between entities covering various nationalities, legal systems and cultures. Further, contracting parties that appear identical on paper often turn out to have widely divergent infrastructure, processes and capabilities on the ground. Time spent getting to know each other is crucial to the contract and to the long term relationship. Considering the disparities in culture and communication styles, inherent in global sourcing negotiations, it is not enough to have negotiation discussions take place among lawyers and procurement specialists. Technical and account management teams that understand the day to day realities of providing and receiving outsourced services have to be given a chance to work together to help to create unambiguous statements of work, performance standards, and contract management rules at the outset. Too often, however, these key teams are excluded altogether from the negotiation process.

At the end, both parties must know what exactly it is they can and cannot do and what they expect of one another and how they will work together. Over reliance on lawyers, procurement specialists, deal consultants and negotiators in the negotiation of contract documents too often leads to contracts that look good but just do not work. The parties involved directly need to spend more time talking to one another and understanding each other's requirements fully. Only then will the involved organizations gain the necessary insight for a successful contract.

Fair Allocation of Risk

Arriving at a fair and reasonable assignment of risk is the second key element in creating sound strategic outsourcing relationships. The long term sustainability of an outsourcing engagement is dependent on both parties believing that the contract has fairly allocated commercial and legal risks between the parties. As a general rule, each party should assume the responsibility for risk of not achieving outcomes over which that party has all or at least a predominant control. For example, a service provider who agrees to provide equipment to support a critical customer function should agree to assume the responsibility for assuring that that equipment functions as it should. Similarly, a customer controls its internal security requirements and thus should assume the risk that changes in those policies that affect the performance of a service provider may alter the cost of performance. Risk and responsibility (or control) go hand in hand and the party that is responsible for an outcome, or at least controls a good part of the risk that it will or will not occur, should bear the risk of cost increases should a potential risk materialize.

Often, however, such cut and dried allocation of risk is not feasible. Negotiations become difficult where both parties share in the responsibility for producing a defined outcome. In such cases, it is appropriate to share risk based on a mutually fair allocation, with each party being responsible for the portion under their respective control. For example, the transition of services from the customer's own internal team to a service provider is a critical and time sensitive undertaking. It requires time and resources from both parties, as set out in a detailed transition plan, for all to go as it should. Either party has the potential to cause delays in the achievement of a transition deadline and thus, neither party can fairly be held to assume all of the risks (e.g. costs) associated with delay, without regard to fault.

Finally, there are situations where neither party can control the risk (for example changes in law or acts of God). Nevertheless, there still exist fair standards that can be applied to assign such risk to one party or the other, or to share the risk. For example, a customer in a regulated industry cannot fairly be said to "control" government imposed changes in the way he must conduct his business. Despite this lack of control, it makes sense from a perspective of fairness and cost to have the customer retain the risk of regulatory changes. This is because the customer is by choice engaged in a regulated environment and its charges to its customers reflect that fact, the risk of regulatory change is borne by the customer before outsourcing and neither increases nor decreases just because services are outsourced, and there is no way to quantify such risk and include it in the price of the outsourcing. The same analysis applies to laws addressed to the service provider, but not the customer. It probably makes more sense to address these uncontrollable risks by agreeing that whenever an uncontrollable risk substantially diminishes or destroys the economic value of the relationship to either party, the relationship should be dissolved on a no fault basis.

Conclusion

Global sourcing negotiations need to reflect an underlying trust and commitment to building a relationship on the part of both the contracting parties. Seen as such, these negotiations should endeavor towards increasing interaction and comfort between the contracting parties. A successful relationship depends first on clarity of roles and expectations as established not only through contract negotiation but also through a mutual alignment of expectations. It depends second on each party being mindful of the other's legitimate business, financial and technical concerns and a concerted effort to allocate risk in such a way that the parties can work together in a spirit of good faith and fair dealing.

About the Author

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