June 2004

Why Outsourcing Deals Fail

Throughout the years, as outsourcing has become part of the mainstream of business, more and more organizations, from major old-line blue chip organizations to high tech to start-ups, are outsourcing parts of their critical business processes. The business processes that are being outsourced ranged across a number of business functions including information technology, logistics, facilities, back office processing, manufacturing, warehouse and storage, human resources, legal and accounting.

With the spectacular growth and acceptance of the outsourcing industry, business has seen a number of spectacular failures. These failures are more and more catching the eye of the corporate decision makers that are responsible for making the outsourcing decisions and subsequently charged with the accountability for their success. A failure is defined as one party prematurely cancelling the contract prior to its completion.

Failures cost everyone, the clients through their start-up costs and the further costs to either repatriate the business processes or through finding a new supplier; the outsourcing services providers through their loss of the upfront costs, the loss of the revenue stream, wind down costs, litigation, loss of reputation and loss of further business from other clients.

According to a 2000 survey by Dunn & Bradstreet, over 90% of all North American companies were expected to outsource some business processes in 2001. As more companies embrace the concept of outsourcing, we will continue to see more spectacular failures.

Outsourcing deals rarely fail due to lack of agreed upon delivery, or the inability of either party to live up to their rights and obligations under the contract. A contract is an objective document that details the terms and conditions of the business relationship. The very essence of a good contract is to take the emotion and subjectivity out of the outsourcing deal. It is not unusual to find an acrimonious cancelling of an outsourcing contract where both parties have lived up to their rights and met their obligations under the contract, where the fees paid are within the contractual scope and where the service levels were being met.

Most outsourcing deals fail, and are subsequently cancelled, because the person-to-person relationships, the trust, breaks down between the client and the outsourcing services provider. The fundamental level of trust required to maintain a healthy relationship no longer exists. When the trust relationship is broken, and the trust no longer exists, the tendency is to bring out the contract.

We have an old saying in the outsourcing services delivery business:

"THE MOMENT THE CONTRACT IS BROUGHT OUT THE DEAL IS DEAD!"

All outsourcing agreements, to be successful, require a high level of trust between the client and the outsourcing services provider. Trust by its very nature can be very subjective. At the start of the relationship the level of trust between the client and the outsourcing services provider is typically very high; "***the classic honeymoon period"***. Most outsourcing deals would not be consummated were there not a great deal of trust between the parties.

Once the trust relationship is broken, and the contract comes out, it is extremely difficult to get the relationship back on a positive footing. All the flexibility to make changes to the fundamentals of the relationship is not longer there. Either or potentially both parties start to develop inflexible positions that can only exacerbate the problem.

The most difficult area to monitor and report on ***"objectively"*** is the ***"trust component"*** of the relationship. How do we keep the relationship sound and the trust intact? Before we answer that question we need to delve into the issue of trust further.

We commonly think of trust in terms of a relationship between parties. When trust exists we feel comfortable that the information being conveyed to us by the source of the information is accurate, relevant, complete and current, and that we can rely on it to take appropriate, often consequential action that can put us at risk. For example, when we have a trusted relationship with an investment advisor, we are inclined to accept her financial planning advice and purchase the recommended products. So the purpose of trusting the source of the information (i.e. the investment advisor) is essentially to allow us to more easily rely on the information being conveyed by that person.

The relationship trust model works very well in situations where a good relationship can be established and maintained. But what happens when circumstances are not conducive to building and maintaining relationships, or where the consequences of a broken relationship are too significant to rely solely on the relationship for critical information? Is an ironclad contract a sufficient substitute for a trusted relationship? Does a contract allow parties who no longer trust each other to continue to rely and act on each other's business information? Unfortunately, a contract does not help to establish trust in the absence of a trusted relationship. It only protects the parties from damages related to business underperformance. An absence of trust always results in unrealized business opportunities and a contract cannot help.

It is therefore insufficient to rely solely on relationships to establish trust and contracts to protect from a loss of trust. Fortunately, it is possible to attain sufficient levels of confidence in information even in the absence of trusted relationships.

"Now, we can trust the information despite its source."

Trust Enablement™ is a discipline that allows relying parties to establish and ensure sufficiently high levels of trust, with or without trusted relationships. It redirects their focus away from trusting each other to building confidence in their information by employing alternative or complementary Trust Enabling™ mechanisms – thereby also making trust a more objective process.

There are only two ways to establish trust, from: authoritative sources; and experiential sources of trust. Authoritative sources of trust serve to establish trust quickly, while experiential sources of trust help to establish higher levels of trust. The former is often very useful for providing a base level of confidence in the information, while the latter is required for deep business collaboration. Personal relationships are an example of the experiential sources of trust, since they are based on our personal experiences. Audit logs, video surveillance and customer feedback are examples of other common experiential sources of trust. The most appropriate mechanisms for establishing required levels of trust in information depend largely on the nature of the information being relied upon. Also, the most effective sources of trust are those that the relying party has chosen, rather than those imposed by the information supplier.

Similarly, there are only three ways to ensure trust, by: motivation, ability and risk transfer. Contracts are a highly effective type of risk transfer mechanism that can accelerate information reliance even without sufficient trust. Guarantees, warranties and insurance help achieve similar Trust Enablement™ objectives. Motivation and ability represent the entire business environment that governs business conduct and its ability to deliver expected value. Many of these mechanisms are often invisible to the relying party, unless something goes wrong in the business dynamic to bring attention to specific business practices.

All aspects of Trust Enablement™ need to be addressed in order to achieve a balanced and effective trust environment that is not overly dependent on only a few fragile mechanisms, such as relationships and contracts. An independent trust steward can further contribute to business sustainability by proactively managing information reliance systems.

Outsourcing best practices generally do address most of these trust-enabling elements. For example, the following are some best practices for outsourcing software development to offshore suppliers:

Best Trust Enabling™ Practices for Offshore Software Development

Trust Establishing Mechanisms

- Trust Management
  - Manage and monitor changes in scope
- Experiential Sources
  - Start with a pilot project
  - Local interface is key
- Authoritative Sources
  - Have realistic cost saving expectations
  - Consider Russian developers for technologically complicated projects

Trust Ensuring Mechanisms

- Motivation
  - Trustworthy partner
  - Define your requirements well
- Ability
  - Strong project management and communications procedures are key
- Risk Transfer
  - Start with a pilot project
  - Build systems in multiple small releases
  - Prototyping

What more could you do to establish trust faster? How could you establish even higher levels of trust? What additional things should you consider to protect you if something goes wrong and trust is broken? A trust-enabling framework allows us to focus on specific types of mechanisms in order to achieve explicit trust objectives and empowers us to look beyond the obvious solutions. The same approach can be applied with equal effectiveness to smooth all phases of a traditional business cycle, from discovery to negotiation and order, to fulfillment, to settlement, compliance and renewal.

During the fulfillment/delivery phase of the outsourcing contract an independent trust steward can independently provide an information delivery infrastructure, performance metrics and monitoring services, third party warranties and insurance, and dispute resolution services that reduce reliance on personal relationships between the client and the outsourcer and their inclinations to "***bring out the contract***". The effect can be a dramatic improvement outsourcing business, as measured by improved business retention, larger contracts and higher profitability.

To enable a Trust Enabled™ relationship, the client and outsourcing services provider would need to objectively work the trust model prior to consummating the outsourcing deal and would subsequently need to monitor the Trust Enabled™ relationship on a regular basis, at a minimum quarterly, to insure the Trust Enabled™ relationship is holding strong and that there is never a need to ***"bring out the contract".***

Through the effective use of the trust model, and its accompanying processes, both the clients and outsourcing services providers will find that they have fewer failures in their relationships and a healthier long-term partnerships in the effective delivery of their business processes as required. This can only make for a more satisfying and profitable business climate for all involved.

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