

Managing the Outsourcing Relationship

A Step by Step Guide

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Successful outsourcing depends on three main factors: it should be the right strategic decision; the match needs to suit both parties; and the relationship needs to be well managed. Although the formal association between buyer and provider starts when the contract is signed, successful relationships begin much earlier. Exploratory conversations can provide the foundation of a good match if parties are candid about factors crucial to a sourcing relationship.

Setting Goals and Expectations

Each party should discuss short and long-term goals and expectations. These influence how performance will be measured. Discuss cultural and geopolitical differences. Talk about what a mutually beneficial relationship might look like and whether the scenario is feasible.

Partners foster successful outsourcing relationships when they explore their respective expectations, capabilities, and cultures, appreciate one another's goals and requirements, and understand what deficiencies must be overcome and what differences must be reconciled. These conversations, together with due diligence, reduce the likelihood of failure.

If the conversations suggest that a mutually beneficial relationship can be forged, use the outcomes of these conversations to develop and document a vision of a relationship that suits each party. Documenting this shared vision provides clarity and a reference point to which the parties can return.

Measure Performance

Focus performance measurements on outcomes, value, and accomplishments. To be meaningful, the measurements must benefit the buyer and be achievable by and motivate the provider. Performance measures should be clear and manageable and readily evaluated with data easily collectible at a reasonable cost.

Measure of Accomplishments:

- Quality
- Timeliness
- Innovation
- Exception handling
- Reliability
- Improvement
- Quantity
- Customer satisfaction

Periodic cost benefit analysis can help assess progress. A balanced scorecard, with a quadrant for degree of alignment with the buyer's strategic goals or value contributed by the provider, will also further this assessment. Benchmark performance at the commencement of the contract to establish a baseline for ongoing performance measures.

Although consistent performance measurement is crucial, circumstances change over time and metrics may need to be modified. Increasing volume or complexity in the service, growing ambiguity in targeted outcomes, a new buyer initiative, or an increased need for collaboration may necessitate a review of performance measurements.

Partners who understand how their respective businesses work and what each can realistically expect from the other, are more likely to work through such changes. If the buyer and provider have built a flexible relationship, one that can bend without breaking, they will be better able to work as partners to redefine the service. They will be able to recast how performance will be evaluated – and rewarded or penalized – in light of their respective goals and capabilities. Such communication and collaboration are the best hedges against failure due to a growing misalignment of the parties. Begin discussions early so if new requirements cannot be satisfied or do not fit the provider's objectives, an orderly transition can occur.

Develop Incentives

Incentives based on the quality and value of the transaction should be established. Managers' incentives may be tied to the value they add to the outsourcing relationship, performance achieved, and problems resolved. Incentives for executives may be

based on the added value they drive out of the outsourcing arrangements.

Consider sharing cost savings with the provider and rewarding the provider's volume, quality, and customer/end-user satisfaction improvements. Base provider incentives on realistic, diverse metrics that encompass overall satisfaction. Measure and track results. Ensure that rewards bear some relationship to the benefits gained. Consider recognizing costs incurred by the provider to achieve improvements. Assess penalties for deficiencies in the provider's performance. Apply incentives and penalties in the first case they are relevant and consistently thereafter.

While establishing and modifying metrics and instituting well-crafted incentives and appropriate penalties in this manner will not avert a provider's failure to meet requirements, they do build a foundation conducive to success.

Establish Governance

Good governance furthers the relationship and the respective business objectives of the parties. Governance is the agreed upon set of roles, rights, accountabilities, principles, procedures, and escalation processes that guide decision making, issue resolution, and changes in the outsourcing arrangement. Poor governance structure was one of the most frequently cited reason for failure. Suitable governance, however, sustains relationships by providing standard procedures that reduce the confusion, inconsistency, and inefficiency associated with ad hoc responses of different individuals with different skills and ways of operating.

Governance should be sufficiently clear and detailed to avoid uncertainty, yet flexible enough to allow for quick, innovative responses to issues and changes that inevitably occur over the life of the contract. To establish a governance model, assign a cross-functional team with provider and buyer representation to:

- Identify the types of issues and changes that may arise during the relationship;
- Design a governance model that describes each role required for governance;
- Define the rights of the buyer and provider;
- List the accountabilities of the buyer and provider;
- Principles to guide decisions and actions;
- Set procedures for handling issues and changes;
- Create a process for escalation if initial steps are unsuccessful;
- Vet the model with other representatives of the parties;
- Revise the governance model, as necessary, based on feedback.

Designing and documenting appropriate governance prior to entering the contract builds the relationship. When used consistently, good governance strengthens trust and eases issue resolution.

The Management Team

Management of an outsourcing relationship requires certain key skills and actions, including strong communications capabilities that are regularly exercised. Inadequate communication ranks high on the list of causes of outsourcing relationship failures. Open and continuous communication, both ad hoc and structured, between management teams, is critical.

Select managers with tactical and strategic general management capabilities. Look for strong communication and negotiation skills. A good understanding of the buyer's business and each party's objectives are vital to a manager's success.

The outsourcing relationship manager must effectively communicate with the provider daily to ensure consistent and reliable service that meets the buyer's requirements across all departments. Communication will increase as the service grows more complex. Slippage in alignment between the buyer's and the provider's objectives, or between performance and requirements can be costly. Therefore, the manager must be firm, yet capable of negotiating solutions and brokering accords to maintain alignment and a positive relationship.

In order to negotiate solutions feasible for both the provider and the various buyer groups served, the manager must understand the human resource, financial, and IT implications of these solutions. Day to day decisions in connection with the outsourcing relationship must be based on a clear understanding of both parties' strategic goals and of the service and performance metrics, and awareness of continually changing business needs and goals. The manager should be open to, and even welcome such changes.

The executive who heads the buyer's outsourcing relationship management team must exhibit the same qualities and capabilities but have a deeper understanding of the provider's strategic objectives and how to best leverage the outsourcing relationship. This individual bears responsibility for maintaining alignment, ensuring proper direction and health of the relationship, accomplishing business objectives, and ongoing contract performance. Success in these areas requires frequent telephone and e-mail communication, and face-to-face communication as necessary, with the provider counterpart.

Structured meetings are necessary to properly manage and fully benefit from the outsourcing partnership. Meetings should be in-person as often as is practicable, but make full use of telephone and video conferencing on other occasions.

A strategic sourcing partner can bring great depth and breadth of experience to developing and executing an organization's strategy. Frequent informal communication and periodic joint strategy sessions allow the buyer to gain the provider's insights and foster continuing alignment of the parties.

These sessions provide an established forum in which the provider and buyer can share their respective visions, reassess priorities and metrics, and adapt the relationship to changing business conditions.

Establish a schedule for action-oriented meetings of buyer and provider representatives. Guide these meetings with a standard agenda and press for decisions and assigned action items. Agenda items for managers' meetings, usually at least weekly, should address operational and tactical aspects of matters.

Agenda Items:

- Performance metrics and issues;
- Provider issues;
- Buyer issues;
- Upcoming changes in service;
- Upcoming changes in buyer needs;
- Improvement recommendations;
- Strategic and major operating plans;
- Relationship issues;
- Major operating issues and changes;
- Major personnel issues;
- Unsatisfactory performance metrics and issues;
- Contract issues.

Senior management often must meet monthly in the early stages of the contract, changing to bimonthly or quarterly when the relationship and service stabilize.

Establish the expectation of regular attendance, active participation, and timely and thorough follow-through on action items for all meeting participants. Replace any member who is unable to meet these expectations.

Evaluating and Repairing the Relationship

Despite their best intentions, individuals sometimes let a concern fester. Deteriorating relationships are inefficient and costly. If not improved, dissolution of the relationship, with its attendant costs, may result. Take a proactive approach by assessing the state of the outsourcing relationship, mending a faltering relationship whenever possible.

Periodically conduct joint buyer and provider relationship reviews. Reviews should cover:

- Quality of the relationship, including communications and issue resolution;
- How the relationship might be improved to better achieve goals;

- Solicitation of examples of particularly good issue resolution or communication episodes;
- Identification of unresolved issues or misunderstandings.

Share audit results with members of management. Repeat positive approaches identified, and remedy noted problems.

In the event established issue-resolution practices do not work, consider replacing one or more of the buyer or provider team members. Modifying the mix of personalities and introducing at least one individual with little to no history with the team may open an opportunity for resumption of a productive relationship.

It may be necessary to call a meeting to work through outstanding issues. In such a case, the buyer and provider might each identify their top five issues, exchange lists, and come to the meeting prepared to propose reasonable solutions. Third party facilitation may improve the efficacy of such a meeting.

Alternatively, one party may develop a list of the top five to ten issues. The other party is then given a period of time to research and validate the issues, and to develop a reasonable resolution for each valid issue. The provider and buyer then implement each proposed resolution within their area of responsibility, reporting progress to each other.

Develop Exit Plan

Not all outsourcing relationships work well indefinitely, despite the parties' best intentions and efforts. Prepare a well-defined contingency plan early in the relationship and update this plan periodically. People, the experts who perform and manage the service, are key to the plan. Be sure to address all legal, human resource, responsibility transfer, and change management requirements in the plan.

For an outsourcing relationship to flourish, the parties must begin with a shared vision. Regularly ensuring continued alignment of their respective expectations, goals, and requirements helps sustain the relationship. Establishing appropriate governance and strong management teams that communicate frequently and openly bolsters chances for success. Performance measures satisfactory to both the provider and the buyer keep the relationship on track. Underlying all these actions must be a commitment to of the buyer and the provider to work as partners to achieve their respective goals. ■

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