As companies consider their choice of outsourcing service providers, they tend to examine a number of factors, from cost, to delivery capability, to cultural fit. Of course, there are important contractual terms to consider as well — like IP protection, compliance, and indemnification — all of which can be deal-breakers. But customers don’t choose providers based on their IP protection terms. They tend to focus on the answers to three key questions:

• What’s it going to cost?
• How well will the provider be able to deliver?
• What’s it going to be like to work with them?

Regarding the first question, most experienced providers know what it’s like to compete based on cost, whether that’s through multiple “apples-to-apples”
cost comparisons or learning how far you can cut before your profit margin is gone (and you know that generally your customer will be dissatisfied well before then).

Regarding the second question, you’re likely already working to build and improve your delivery capability. You also know that sometimes you have to make commitments in the sales process that are hard to keep in implementation, especially in a world where many of your capabilities are constantly being pushed into a “commodity” box.

Research has demonstrated just how important the way you manage the relationship is – various studies have shown it can mean a swing of 30% or more in annual contract value (For example, see Cullen & Willcocks, Corporate Executive Board). Experienced outsourcing service providers have known for years that effective relationship management is critical to delivering value (not to mention customer satisfaction and deal profitability). Many experienced buyers have learned the hard way that how they work together with their provider can make all the difference to results they can achieve.

Often with the help of their advisors, even less experienced customers are getting more sophisticated about assessing potential providers’ relationship management capability — the structures, processes, tools, skills, and mindset needed to manage the day-to-day work and govern the business relationship.

In response to such customer demand, some providers have invested in building their relationship management capability; others, however, haven’t built relationship management capability so much as they’ve created “vaporware” – charts and process maps without real substance – so that they can have something to insert into an RFP response. These days, however, customers want to see more than just generic models and fluff about corporate culture and partnering mindset as they consider what it’ll be like to work with you; the price of entry for any significant deal is much higher.

Increasingly, customers want to work with a provider with a proven track record of governing similar deals and managing those relationships effectively so that both sides realize the value anticipated in the original contract. To set yourself apart from the competition, you’ll need true capability and a differentiated way to demonstrate it.

Based on our experience working with both customers and providers, this article identifies what service providers need to do to build and demonstrate an appropriate governance structure and a model for delineating roles and responsibilities – both ‘the basics’ that are now the price of entry for most significant deals, and “beyond” – to differentiate themselves in the sales process.

Of course, there are other important aspects to governance, and in the next installment of this two-part series, we will discuss key governance processes, performance monitoring, and governance implementation.

GOVERNANCE STRUCTURE

### The Basics

- A governance structure that describes:
  - Key groups and individuals responsible for governing the relationship
  - The authority and responsibilities of each governing body
  - Basic definition of how each governing body will accomplish its mandate (e.g., meeting frequency, basic agendas, etc.)

### Beyond

- An articulation of how the governance structure should differ based on each deal’s unique purposes and complexity
- A proven track record of adapting and customizing governance structures (or using different models) based on the customer’s needs and input

Most buyers have heard and bought into the importance of having a governance structure for buyer and provider to steer and guide their arrangements jointly. At a minimum, they want to see an exhibit or summary of your approach to governance – various decision-making bodies and key individuals, and how they align across organizations. They also want some idea of the responsibilities or mandates of different key groups and committees, along with some sense of meeting cadence and working-together protocols.

Less experienced customers, particularly those without advisors, will look to you to educate them on what governance is required – they are hungry for different models and approaches and will want to learn from an experienced provider what works and what doesn’t, and how they need to staff their side. More experienced customers, and those with advisors, often don’t need an education so much as they need reassurance.

An articulation of a working governance structure is just the basics; however – it’s often the price of admission for any significant deal. Setting yourself apart requires recognition that different relationships have different needs. Governance structure isn’t “one size fits all” – your basic three-tiered model with operating, managing, and steering committees may be sufficient for some types of relationships but entirely inappropriate for others.

When considering different types of relationships, customers and providers often imagine a spectrum from transactional relationships to partnership
arrangements, based on the degree of transformation, innovation, or value added called for by the deal. Providers tend to think of and push for arrangements closer to the “partnership” end of the spectrum, out of a desire to more deeply root themselves and their services, to get a greater share of spend, while buyers often try to keep providers at arm’s length to minimize their reliance on outside parties and squeeze potentially more value in “commodity” purchases.

Unfortunately, when only this dimension is considered, most deals end up somewhere in the muddy middle, and both parties have a hard time articulating the implications of being in the middle on how they manage their relationships. We find it helpful to consider at least one more dimension when thinking about how governance structures should differ for different arrangements (see Figure 1).

The first dimension is the goal or objective – the customer’s key drivers for outsourcing in the first place. Are they looking for more operational types of value (for example: cost savings or productivity gains), or are they looking for more strategic or transformational benefits (for example: access to new markets or a radical change to their IT infrastructure to take advantage of new technologies)?

The second dimension is complexity – the complexity inherent in the deal, which is often a function of the number of processes outsourced, the number of sites or geographies, and/or the complexity of the organizational structure underlying those processes. It can also relate to the previous outsourcing or insourcing of the function (since having outsourced before should simplify the management of the function to some degree).

These dimensions together create four different types of relationships, none better or worse than another, but each bringing distinct types of value (and also inherent challenges to be managed). For example, consider a more “focused” relationship, such as a basic IT infrastructure deal in one geography (for example: a narrowly-defined scope). A customer might outsource benefits administration in anticipation of moving to online self-service benefits in the space of a year; in IT, they might be moving from a large mainframe environment to a more distributed, mid-range environment; and in Finance, they might be looking to dramatically reduce the time required to close the books. The key is scope and complexity could be somewhat limited, but the focus is innovation and transformation.

When governing transformational relationships, the focus should be on change. Because the customer is looking to achieve rapid transformation or dramatic innovation, managing that change effectively will be the key to unlocking the value anticipated. A key role of governance is to help the organization welcome that change. Rather than focusing on efficiency, then, the focus should be much more on effectiveness. It’s possible to get somewhere fast, but ultimately, that place might not be where the customer wants to go.

Your governance structure therefore needs to be designed to enable good change management, possibly by including a “Change Council” that is responsible for helping the customer to embrace anticipated change, with representation from across the organization (see Figure 2b). Naturally, you should also be sure that your governance team includes people skilled in change management, so they can help steer and support the Change Council.

Contrast that relationship with a “transformational” one. These relationships are often about changing the way the customer operates internally – instead of going up the learning curve and making the investment to get there themselves, they look to you to get them there. As with “focused” relationships, the scope of these deals is pretty limited, and only one or a few geographies are involved. However, some big transformation or innovation is a key part of the deal.

For example, in HR, a customer might outsource benefits administration in anticipation of moving to online self-service benefits in the space of a year; in IT, they might be moving from a large mainframe environment to a more distributed, mid-range environment; and in Finance, they might be looking to dramatically reduce the time required to close the books. The key is scope and complexity could be somewhat limited, but the focus is innovation and transformation.

When governing transformational relationships, the focus should be on change. Because the customer is looking to achieve rapid transformation or dramatic innovation, managing that change
All outsourcing deals involve some transfer of roles, responsibilities, and decision-making authority from buyer to provider. Often customers and providers alike struggle with how to define roles and responsibilities for governing the relationship after go-live – who makes what decisions? On what timeline? Who needs to be consulted for their input before a decision can be made?

At a basic level, providers need to bring some approach to defining governance roles and responsibilities between buyer and provider that articulates the key decisions to be made, and how various individuals and groups can and should be involved in making them. Some providers use models popular in Six Sigma, such as RACI (Responsible, Accountable, Consult, Inform); others have different models. The point is that the parties need some means for defining the scope of each side’s authority in the new, outsourced world, and how they will work together to steer and guide the relationship.

When the rubber meets the road, however, some buyers and providers find that they’ve focused so much on splitting up authority and accountability for action that they’ve neglected to think carefully about the relationship as a system. In any complex arrangement, the actions one party takes (or doesn’t) inevitably have an impact on the other party. There are almost always things that one side can do (sometimes with minimal cost or effort) to make it easier – or harder – for the other side to perform their responsibilities. For example, consider moving work to offshore resources to generate cost savings through labor arbitrage.

In an IT application support deal, a very clear cutover date for when the provider’s offshore resources will be responsible for maintaining applications may have been agreed upon, but if the parties haven’t also put in place the appropriate knowledge transfer and means for communicating issues and changes, the provider’s ability to successfully take on that maintenance responsibility is likely to be seriously compromised.

Going beyond the basics when it comes to defining roles and responsibilities means thinking beyond “here’s our authority, here’s yours” to thinking about how the parties can enable one another’s success. At the outset of any arrangement, and as it evolves over time, you need to be able to articulate to your customers how you intend to deliver value to them (e.g., via labor arbitrage or application of best practice) and define clearly what you’ll need from them in order to effectively perform your roles and responsibilities (and thereby deliver value).

All too often, we see providers make assumptions (for example, about how quickly their customers will be able to turn around requirements or come to a decision about an approach) that they know are not likely to hold true. And while providers don’t necessarily hide those assumptions, they don’t clearly articulate them for their customers, either. Then when the work isn’t delivered on time, or the customer isn’t pleased with quality or some other outcome, the provider can point to some fine print about what they needed from the customer to get the work done, and it devolves into a finger-pointing game about whose fault it is.

Customers should be wary of providers that claim they can do it all without their help. The clearer you are on the risks and dependencies inherent in your business case, and the better you can clarify how you intend to carry out your defined roles and responsibilities, and what you will need from your customer in order to be successful, the better you set customer expectations, and the more likely you are to earn their respect and trust in implementation.

As the market continues to recognize the importance of governance and relationship management, outsourcing providers need to speak to their importance to differentiate themselves in the buyer’s eyes. You need to describe how your governance structure with the customer will fit the deal’s unique purposes and complexity, and you need to articulate how you intend to carry out your defined roles and responsibilities, and what you will need from your customer in order to be successful.

In the SECOND part of this two-part series, to be published in the upcoming issue of Outsourcing magazine, Danny Ertel and Sara Enlow will continue to share insights on relationship management capability for service providers — with a focus on governance processes, performance monitoring, and the ability to implement governance.

DANNY ERTEL is a founding partner and Sara Enlow is a principal of Vantage Partners — a spinoff of the Harvard Negotiation Project.
The hard work of realising an outsourcing business case lies in effective execution. While service delivery processes (e.g., QA processes in application development or quarter-end close procedures in finance) are critical, so too are processes for governing and managing the relationship between the parties. In order to manage a complex, long-term relationship, some basic governance processes and procedures are required:

- Contract management (e.g., monitoring milestones and other contractual obligations, reviewing and approving contract amendments and changes, indexing and storing pieces of the ongoing agreement, managing third-party contracts)
- Demand/consumption management (e.g., forecasting demand, balancing demand/cost, prioritising projects/initiatives)
- Request for service (e.g., documenting new service needs, assessing those against contractual obligations, quoting prices/rates, obtaining approvals)
- Financial management (e.g., forecasting, financial reporting, invoicing, asset management)
- Issue management (e.g., issue identification, escalation, dispute resolution)

And these are just a few. All providers need to begin each new relationship with at least an outline of the key processes required and set target deadlines with their customers for defining and implementing them. Then customer and provider transition teams can work together to modify or further define the specifics of such processes in ways that make the most sense for their deal. Emphasising the need for governance processes will not only demonstrate the provider’s focus on managing the relationship during the sales process, but it will also help set customer expectations about what processes need to be implemented for the parties to work together effectively.

But those are just the basics. Having the right governance processes in place offers no guarantee that those processes will be executed effectively, nor does it mean the parties will be able to create the kind of day-to-day relationship they need to make the relationship a success. In actuality, it’s often less about the specifics of the process itself and more about how individuals go about executing against the process that will make a significant difference in the time and effort required and the satisfaction of your customer.

To get beyond the basics and truly generate value for providers and customers, a degree of relationship management skill is required for all of these processes on top of the functional skill (e.g., financial acumen to effectively manage the finances of the deal) required for any of these processes to be executed effectively.

For example, consider the request for service process. One way to go about requesting service is to have the customer document their need in as great detail as possible; the provider will then scope and price the request and, should it be approved, execute against it. Providers with significant relationship management skills, however, look at the request for service process as an opportunity to learn...
more about their client and generate greater value for them. Rather than simply pricing against a set of requirements and ultimately executing, provider relationship managers, skilled in identifying “underlying interests” rather than “stated positions” (i.e., demands or requests) will try to understand what is behind their customer’s request. He or she will ask, “What are they trying to achieve? How can we get creative about meeting that need in a way that is most efficient, effective, and value-generating for both of us?”

As another example, consider processes for scope management. A robust process might include steps for the parties to jointly review and make decisions when there is a lack of clarity or disagreement over scope. However, such processes quickly fall apart when every time there is a disagreement, each side comes to the table seeking to prove that something is in or out of scope (i.e., that the other party is wrong). Such forums quickly become a frustrating “battle of the wills”, where the party that is more stubborn or willing to push harder will “win” and get their way, rather than the parties coming to an agreement about what is the best decision. And you can bet that if your customer feels beaten once, they’ll come back fighting even harder on a later point.

Individuals skilled in seeking to understand different interests and perceptions, however, will take a different approach to the same scope management process. Rather than seeking to prove something, they’ll ask how the other side sees the situation and then share their own perspective. Instead of arguing over who is right and who is wrong, they’ll seek to learn about the different perspectives that exist and make decisions with their customer based on the merits of a particular issue, rather than on who has more leverage. Rather than making the entire discussion about convincing them to pay for these activities, they will look for ways to refocus resources towards their best use.

Relationship management skills, such as the ability to look behind positions for interests and get creative about different options, or the ability to understand the other side’s perspective/perceptions set providers apart. They are the skills that make for true consultative, advisory relationships, as opposed to “order taker” or “vendor” types of relationships. They are skills that move beyond the letter of the process to define a higher-level way of executing and managing the relationship to generate even greater value for all parties.

**Performance Monitoring**

<table>
<thead>
<tr>
<th>The Basics</th>
<th>Beyond</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Service-level agreements against which to measure performance, and a process that provides a means to monitor operational service quality</td>
<td>• A balanced scorecard that measures what matters most to the buyer’s business, including strategic, financial, operational, and relationship metrics</td>
</tr>
</tbody>
</table>

Effective service delivery is critical to the success of any outsourcing deal, and measuring and monitoring delivery is a tricky, yet important, process. Most arrangements today include a set of service level agreements (SLAs) or key performance indicators (KPIs) against which to measure service delivery performance, some of which are holdovers from when the buyer managed the function on their own, and others which were provider- or consultant-recommended or developed jointly.

While many customers have created their own sets of (sometimes extensive) SLAs as part of their standard contracting procedure, they are likely to look to the provider to ensure that those SLAs can be measured and tracked and are sensible for the arrangement. Other customers, particularly those with less outsourcing experience, will look to the provider for guidance on how best to assess service delivery.

Most measures like SLAs tend to focus on operational service delivery performance; some operational performance measures (such as transaction volumes, defect rates, and speed of execution) are indeed critical for managing a function. Every arrangement will need them to some degree. It also makes sense that, because SLAs or other types of metrics often come with penalties or financial incentives, providers tend to focus their attention and resources against meeting these metrics (if the customer didn’t care about them, why would they spend so much time measuring and monitoring them?).

Unfortunately, SLAs have some shortcomings; in particular, they often don’t say much about the impact of delivery performance on the customer’s business. For example, how much does it matter that your help desk picked up calls in two rings instead of three? How was the customer really impacted when their planned network outage had to be extended by an hour? In one survey, less than half of IT providers need to begin each new relationship with at least an outline of the key processes required and set target deadlines with their customers for defining and implementing them.”
outsourcing customers said that there is a “significant business impact” when their provider does not perform to a specified service level.

In our experience, when the metrics used in an outsourcing arrangement don’t correlate directly to business impact, an operation may be running efficiently, but the customer can still be dissatisfied. (You may recall times when your dashboard is “green” but your customer is still complaining.)

To go beyond monitoring operational performance to assess true business impact, providers need to bring a more balanced set of measurements that look at additional factors, such as strategic, financial, and relationship value (see Figure 1). Such an approach should begin with the value the customer is seeking in the deal. For example, if the customer has outsourced to focus on their core capabilities, metrics related to number of resources freed for other activities make sense; if they want innovation, an entirely different set of metrics is in order.

Figure 1

In considering different metrics, you should also help the buyer balance more tangible measures (such as costs, volume, and turnaround time) with less tangible measures (such as responsiveness and employee or customer satisfaction). You can also build in means to look at both outcomes (measuring the results of an activity, such as money saved or issues resolved) and leading indicators that measure things that might signal an upcoming problem or opportunity (such as efficiency of decision making or quality of communication).

### Ability to Implement Governance

<table>
<thead>
<tr>
<th>The Basics</th>
<th>Beyond</th>
</tr>
</thead>
<tbody>
<tr>
<td>• A solid transition plan with defined milestones for implementing governance</td>
<td>A systematic approach for operationalizing governance and getting the relationship off on the right foot</td>
</tr>
</tbody>
</table>

While many customers and providers have recognised the importance of governance and relationship management, a disappointingly small number of providers have consistently and effectively implemented the governance-related provisions outlined in their contracts (see Figure 2).

Figure 2

Complex charts and persuasive whitepapers are not the same as good governance. The deals that fall apart are often those that have governance committees that are left unstaffed or haven’t met (even well into transition), or those that never put into place its issue management process. At a basic level, providers need to do more than “talk the talk”— they have to be able to implement governance. Demonstrating your
capability to implement often means that, in the selection process, you need customer references who can speak to the quality of their relationship with you and how your approach to relationship management enables that.

You can go well beyond customer references, however. Some providers have begun to build a more systematic approach to implementing governance and getting the relationship off to a strong start, which we call a formal relationship “launch.” A launch consists of a series of joint working sessions between buyer and provider to:

1. Brief transition and delivery teams on the important terms and scope of the deal
2. Align on a specific governance model customised to suit the goals and complexity of the relationship
3. Identify and plan for mitigating or avoiding potential pitfalls
4. Determine specific decision rights, roles, and responsibilities
5. Agree on a process for tracking and resolving issues, and managing scope
6. Plan for how to communicate with key stakeholders and actively manage change

Participants in these sessions should vary; a broad group of individuals will need to be briefed on the deal, and a much smaller core group (such as governance team leads) is more appropriate for planning communication and change management activities. The format and facilitation of the sessions can vary as well; the key is, however, to bring a structured approach to conducting these key governance activities early in the deal to ensure rapid and effective governance implementation.

SETTING YOURSELF APART
More and more players in the outsourcing market are recognising the important role governance and relationship management play in ensuring that the value sought in outsourcing deals is realised. In an increasingly competitive outsourcing market, providers need to do more than speak about the importance of governance to differentiate your organisation from the competition. As buyers grow increasingly sophisticated in their assessment of providers’ relationship management capabilities, you, as the service provider, need to:

- Describe how your governance structure will fit the deal’s unique purposes and complexity
- Articulate how you intend to carry out your defined roles and responsibilities (i.e., deliver value) and what you will need from your customer in order to be successful
- Ensure your delivery team leaders and client managers have both strong functional skills and relationship management skills
- Help the customer understand how they can measure the aspects of performance that really matter to their business
- Bring a systematic approach for making governance operational and getting the relationship off on the right foot.

Danny Ertel is a founding partner and Sara Enlow a principal of Vantage Partners – a spinoff of the Harvard Negotiation Project.