The 3 Es of Effective Outsourcing Governance

CORE Research - 2011/2012
The 3 Es of Effective Outsourcing Governance is a joint research initiative by:

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CORE

Deloitte.

TED Rogers School of Management, Ryerson University

CORE Research - 2011/2012
Foreword

The Centre for Outsourcing Research and Education (CORE) is committed to helping its members optimize the value of outsourcing by providing education and performing independent research on matters that are of importance to the three constituencies – buyers, providers and advisors – that comprise CORE’s membership. The subject of this research initiative, outsourcing governance, reflects a top priority communicated to CORE in a recent member survey. With almost $25 billion worth of outsourcing contracts in Canada to be renewed or renegotiated over the next three years, effective governance promises to be an increasingly important priority.

This project was made possible through a collaborative effort involving CORE, Deloitte Inc., and the Ted Rogers School of Management at Ryerson University. We extend a special thanks to the 15 buyers of outsourced services who agreed to be interviewed and to provide their insights and experiences with respect to governance. Deloitte’s experience as an advisor to outsourcing buyers and service providers, coupled with the intellectual capital (Deloitte’s proprietary outsourcing maturity model) provided the team with a solid foundation and a quantifiable basis for assessing governance maturity on one common, objective scale. The Ted Rogers School of Management, through its commitment to learning and to seeking new insights in the outsourcing practitioner space, contributed research capabilities and resources which enabled the research to be conducted quickly and effectively.

It should also be noted that partial funding for this research initiative was provided through MITACS-Accelerate, Canada’s premiere research internship program. We are excited to make this research available to you and we are confident you will find value in the results.

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Executive Summary

The parties to outsourcing transactions have identified effective governance as a fundamental requirement for successful outsourcing arrangements. There is, in fact, a growing body of anecdotal and experiential evidence that points to effective governance as a key contributor to value realization. But while previous research by both CORE and Deloitte has revealed a growing awareness of the importance of active management of service provider relationships, organizations continue to demonstrate varying degrees of success in the execution of effective governance and the realization of business value. The on-going challenge of enabling effective sourcing governance served as the catalyst for this latest CORE research initiative.

Using a Deloitte-authored outsourcing maturity model and an understanding of governance practices and capabilities, the research team focused on assessing the maturity and effectiveness of governance functions in ‘buy-side’ organizations. The key findings of the research initiative can be summarized in three simple, but content-rich, themes. Specifically:

1. Experience matters;
2. Essentials matter; and
3. Empathy matters.

The 3 Es of Effective Outsourcing Governance

Experience Matters

The research determined – perhaps not surprisingly – that organizations that were experienced in defining and managing outsourcing relationships had more mature and more effective governance models than those organizations that were in the ‘first generation’ of their outsourcing relationships. While academic literature and analysts’ how-to guidance on effective outsourcing governance controls have improved significantly over the past decade, they are not a substitute for actual hands-on experience in managing a service provider on a day-to-day operational basis. This research suggests that organizations embarking on a major outsourcing initiative for the first time would be well served to seek advice from experienced peers within or outside of their organization, or from external advisors, when developing and implementing governance capabilities within their outsourcing contracts.

Essentials Matter

A fact-based and easily understood set of business-oriented metrics, i.e., the essentials, is key to enabling an objective assessment of service provider performance and to developing performance improvement plans when required. Buyer organizations are often challenged to extract meaningful
insights from an overabundance of component-based service levels, as opposed to navigating a concise collection of ‘essential’ metrics that accurately reflect business priorities. And, while concise business-oriented metrics should be established up front, flexibility within the contract is essential such that the metrics can be adjusted and remain relevant throughout the life of the outsourcing contract.

**Empathy Matters**

The third and perhaps most interesting research finding is the importance of understanding between buyers and providers, which we label as empathy. More and more, the mature user of outsourced services is coming to appreciate that a higher level of openness, trust and collaboration are critical to the success of complex outsourcing arrangements. While many buyer organizations rely heavily on the traditional notion of managing ‘outcomes only’ and treating the service provider operations as a ‘black box’, the more mature organizations have begun to appreciate the value of a better understanding of, and empathy for, the provider’s business model and challenges. This, of course, demands a higher level of openness on the part of the provider as well. ‘Empathy’ does not have to imply complete bilateral transparency, but a proactive commitment to more openness, cohesion, and collaboration between buyer / provider resources is shown to lead to higher levels of trust and to more value creation from the outsourcing arrangement. While this does necessitate a certain level of investment on the buyer side, the magnitude of this spend can be expected to be significantly lower than the traditional internal HR spend prior to outsourcing transition.

On the following page we elaborate on these three key findings, with more key insights provided from the Deloitte outsourcing maturity model. The insights on the following page provide a structure for the rest of the report. The full maturity model and research methodology are described in the Appendix I and Appendix II.

We invite your comments and feedback on this research. We can be reached at the email addresses in the foreword. We hope you enjoy this report.
Key Insights

Experience Matters

VMO Effectiveness
- Governance maturity scores of clients with dedicated vendor management organizations (VMOs) or centralized sourcing governance functions were on average 30% higher than those without. While some contracts were not material enough to justify a formal VMO, clear roles and responsibilities need to be defined for all resources involved in managing the provider.

Contract Flexibility
- While all respondents identified contract flexibility as a key determinant of outsourcing success, over 30% felt they lacked the capabilities to structure contracts to accommodate changes in business needs.

Essentials Matter

Optimize Metrics
- Only 50% of respondents felt that they had a relevant, compact set of metrics to measure alignment of outsourcing performance with business priorities. Additionally, there was minimal evidence of any continuous improvement programs to ensure currency and relevance of the respective metrics. Key performance indicators / metrics should be focused, simple and aligned with end-to-end business needs.

Business Alignment
- While outsourcing objectives at contract initiation were generally aligned to business goals, only 60% of respondents had metrics in place which reflected these objectives. Non-financial objectives were all but ignored once the contract was signed and often organizations lacked the discipline to update and align outsourcing objectives with changing business goals over the term of the contract.

Maintain / Refine Strategy
- Outsourcing strategies were typically well-defined at the onset of most contracts. However, over the contract life cycle the outsourcing strategy often drifted away from the business strategy. Outsourcing strategy and provider selection tools should be periodically reviewed and updated to stay current with business priorities.

Empathy Matters

Build Trust
- Only 60% of respondents expressed having a good / satisfactory level of trust with their service provider. Encouraging greater levels of cohesion, openness and collaboration between clients and provider resources can increase trust, leading to higher value from the outsourcing relationship.

Provider Employee Loyalty
- A mere 30% of respondents have established mechanisms to recognize and reward provider’s employees for performance. Simple mechanisms to reward and engage provider employees, understand their motivations and make them feel connected to the client organization can unlock significant value.

Transparency
- Information sharing between clients and providers was low with less than 40% reporting visibility into pricing models and strategic plans. Linked to the issue of trust, few clients were willing to take the first step towards the free exchange of relevant information with sourcing providers.
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1. Introduction

Due to the increasing complexity and scale of modern outsourcing arrangements, implementing effective governance controls has become a fundamental requirement. Outsourcing managers are constantly searching for better ways to engage with their providers to ensure a collaborative working relationship and ultimately a successful outsourcing arrangement throughout the contract lifecycle. While both academic and industry literature consistently highlight the importance of good governance as a key to outsourcing success, many organizations still struggle with the implementation and execution of governance capabilities.

A 2010 research study by CORE in partnership with IDC Canada\(^1\) highlighted governance as a key priority for achieving outsourcing success, however some organizations lacked effective governance controls even though they understood it to be a critical element. The following year, Deloitte published the results of an outsourcing industry survey\(^2\), which showed that while many respondents had established vendor management offices (VMOs) as a mechanism for enabling consistent sourcing governance, just over half of respondents felt these offices to be effective and delivering value. This misalignment between an organization knowing what needs to be done and actually implementing and executing it effectively was the foundation of this research initiative. The objective was to provide a perspective on the current state of outsourcing governance within Canadian ‘outsourcer’ client organizations by looking at outsourcing governance maturity levels within different industries and the identification of current challenges, strengths, weaknesses and best practices. The research revealed eight fundamental insights falling into a framework of three primary themes, each having recommended best practices and processes adopted by mature organizations to improve the effectiveness of outsourcing governance.

Deloitte and Ryerson University co-sponsored the research and provided a team of researchers and the methodology for the study. Using Deloitte’s proprietary outsourcing maturity model, 15 deal teams from 10 client organizations across Canada were interviewed, representing 10-12% of the total annual contract spend within the Canadian outsourcing market. Interviews were conducted with senior-level managers of outsourcing arrangements to speak about governance and their organization’s capabilities. The research framework allowed for a quantitative, objective evaluation of each organization’s

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governance maturity across 10 major dimensions pertaining to outsourcing governance. In addition, the interview format allowed the research team flexibility to collect anecdotal evidence, resulting in the development of qualitative insights that add significant value beyond the quantitative maturity scores.

When interpreting the maturity scores it is important to note that a low maturity score should not be directly interpreted as an organization’s inability to effectively manage its sourcing relationship. Rather, the respective maturity score should be viewed from the larger organizational context and strategy (e.g., the organization may have consciously decided to reduce the investment within a particular dimension due to the reduced need and / or anticipated business operational value).

Please refer to the Appendix II at the end of the report for a summary and overview of the Deloitte outsourcing maturity model,\(^3\) the framework used for the research as well as a description of the dimensions explored with the research participants.

2. Findings

By analyzing both quantitative and qualitative data from the interviews, trends were identified regarding the state of sourcing governance across the Canadian sourcing landscape. Some of these insights are rooted in numerical data, while others stem from discussions and anecdotal evidence from respondents and help illuminate the important issues that are affecting the outsourcing community.

The research findings clearly highlight increasing levels of awareness and activity within the Canadian outsourcing community with regards to implementing effective governance controls across their strategic provider relationships. All organizations surveyed unilaterally understood the value of effective governance and have initiated mechanisms to improve governance processes. While some organizations were clearly ahead of the game and working on second and third-generation contracts, newer or first-generation contracts were well down the path of standardizing and developing repeatable governance processes, as evidenced by the average maturity score of 3.58 across all research participants and depicted in Figure 1 on page 9.

\(^3\) Please note that the framework is proprietary to Deloitte, Inc. While usage for academic research purposes and for organizations seeking to conduct a self-assessment of their governance effectiveness are allowed, any other use will require written approval from Deloitte and the Center for Outsourcing Research and Education.
The research also revealed a significant variability in level of outsourcing governance maturity across different dimensions. While operational relationship management processes, financial management, contract management and service management were generally strong across the industry, organizations were consistently challenged in establishing mature performance management capabilities and improving levels of trust and engagement with the service provider organization. Figure 2 depicts the range and average scores on the ten dimensions of the outsourcing maturity model.

Qualitative insights from the survey fall into three major themes. The first theme, Experience, speaks to the undeniable improvements seen in the success of managing sourcing providers in organizations that
had prior sourcing management experience. While research and current literature on outsourcing models and frameworks, and best practices have evolved significantly in the last few years, it is evident that a theoretical understanding alone is often not enough in deriving maximum value from the relationship.

The second theme, Essentials, highlights the sub-optimal performance-management seen across the Canadian outsourcing market and the importance of tracking a simple, focused set of indicators that are frequently reviewed to maintain alignment with business goals and priorities.

The third theme, Empathy, deals with the issues seen when clients employ a ‘black box’ approach towards outsourcing by focusing only on managing outcomes and taking minimal interest in service provider operations. While this may seem contrary to established notions, our results indicate client organizations and service providers who engage in developing strong, collaborative, mutually beneficial relationships based on empathy and a deep understanding of respective needs enjoy higher levels of trust, transparency, collaboration and ultimately greater value from their outsourcing arrangements.

2.1. Experience Matters

While perhaps an obvious insight, the value of experience in managing providers cannot be overstated as a key pre-requisite towards achieving increased levels of governance maturity. As seen in Figure 1, those organizations involved in first-generation contracts were, on average, a full point below more experienced clients in their overall maturity scores.

Although academic literature and our understanding of theoretical models and frameworks regarding outsourcing governance has matured significantly over the past few years, it was evident that theoretical understanding of governance models and practices alone was not enough to achieve sustainable results. While understanding ‘what needs to be done’ is critical, the experience that comes from implementing it within day-to-day operations is critical towards understanding the nuances of outsourcing governance and extracting greater value from the relationship. Hiring veteran relationship managers and outsourcing experts is a good start for client organizations embarking on the outsourcing path. However, outsourcing represents a transformational shift in the way an organization operates and the governance of this new operating structure requires the definition of processes, structures, roles and responsibilities which often require years to optimize and implement even with an experienced team at the helm.
This leads to two important conclusions relevant to clients. First, clients embarking on an outsourcing journey should be cognizant of this initial learning period and be flexible to adapt or realign their processes and methods during early stages of the contract. This may require building additional flexibility within the contract to accommodate these changes even if this requires a slightly higher investment during the initial years. Second, clients should not be reluctant to seek outside help. Numerous respondents favoured using external legal teams to augment internal counsel when drafting new contracts, yet significantly fewer used external advisors or subject matter experts to help with issues such as outsourcing strategy, relationship management and performance monitoring. Knowledge and guidance from experienced peers can often help bridge this gap if hiring external advisors or consultants is not the preferred approach.

Within this theme, two insights were common among respondents. These pertained to the effectiveness of VMOs and the importance of flexibility in new contracts to adjust the arrangement as the organization’s needs change over time.

**2.1.1. Insight: VMO Effectiveness**

Organizations that have established a VMO or centralized governance function (to support individual deal teams) and have defined formal roles and responsibilities for provider management demonstrate significantly stronger governance capabilities when compared to organizations that do not have a dedicated VMO.

![Figure 3: Maturity scores for dimension 'outsourcing organization structure and capabilities'](image-url)
Close to 90% of organizations that were into second (or third) generation outsourcing arrangements had established VMOs with a clear mandate and well-defined roles and responsibilities, while only 20% of first generation outsourcing organizations had done so. In addition to effects of time and experience, this factor helps account for some of the discrepancy in first generation maturity scores.

Setting up a formal VMO or centralized governance group has substantial costs that may not always seem justifiable. Many survey respondents agreed that a dedicated VMO would help extract more value from their outsourcing relationships, but indicated their contract volumes were not large enough to warrant the creation of a formal VMO function. Still, the benefits are clear in the maturity scores and, in the absence of a full VMO, organizations should strive to recreate as many of the roles and responsibilities as possible.

Regardless of whether a dedicated VMO or centralized group is established, clear roles and responsibilities should be defined for all individuals involved with provider management and efforts should be made to continuously train and develop team members. There should be a clear delineation of the accountabilities and responsibilities between the lines of business and the VMO to reduce any ambiguity in roles and responsibilities. Central contact points on both the client and provider sides should be defined. Additionally, individuals from the VMO (or involved with provider management) should be engaged early in the initial stages of the outsourcing process, especially during the sourcing strategy definition and deal origination stage to ensure continuity of knowledge throughout the life of the outsourcing arrangement.
2.1.2. **Insight: Contract Flexibility**

As seen in Figure 5 below, most organizations have strong contractual capabilities in the form of highly competent in-house legal teams or access to external legal counsel. However, even with strong legal support, 30% of organizations still felt that they did not have the flexibility needed to either align the service provisioning efforts within the existing contract or to easily modify and update the contract to better represent the requirements of the deal.

![Figure 5: Flexibility and clarity are critical attributes of contracts](image)

Some organizations found themselves buried beneath change orders, often a natural outcome of an unclear or ambiguous contract, which negatively affected the relationship: “We feel we’re seeing too many change orders . . . this is a sore point [in the relationship]”. Even those who had flexibility built into their contract identified the contract as a large, unwieldy document that was open to interpretation: “I think we have a very strong contract with the right flexibility but it is this thick and . . . I don’t think it’s easily digestible and always transparent.”

This evidence indicates that there is a disconnection between the capabilities of the legal teams and the requirements of the outsourcing governance teams. Whereas most buy-side managers expressed the desire to have short, simple, and easily interpreted contracts with clearly defined accountability, legal teams were traditionally more comfortable with lengthy contracts with legal controls that cover a wide range of potential risks. Some managers stated that their perfect contract would be never looked at, even though the details were often followed to the letter by the provider: “Ideally, once every contract is..."
done, put it in the drawer and never look at it again, but unfortunately, [the provider] would clearly train people on what the contract is: where every comma and period is.”

Mature and experienced organizations tended to have stronger contract management capabilities, as depicted in Figure 6, with a good balance between legal controls and operational clarity coupled with a mature change management process for handling changes to contract provisions.

![Figure 6: Maturity scores for dimension ‘contract management’](image)

Contracts should be drafted with sufficient flexibility to allow the scaling up or down of services within certain thresholds without penalty or the need for detailed change order provisions. When change orders are required, the process should be simple and straightforward to ensure that the contract is kept current and aligned with actual service delivery. The use of model contracts (or client terms and conditions requiring individual response and attestation from the vendor) within the request for proposal process help drive clarity of contract requirements upfront and reduce the need for lengthy negotiations later on during the contract process. Lastly, as a reality check, organizations should create a document (often called a ‘will document’) that highlights all instances of ‘vendor will’ and ‘client shall’ statements within the contract. This document helps drive a high degree of clarity and awareness among both the sourcing and operational management resources as well as vendor staff, and distils the contract down to its basic deliverables to help reduce ambiguity within the contract.

### 2.2. Essentials Matter

With current technologies, the option exists for clients to track hundreds, if not thousands of metrics pertaining to the performance of the outsourcing arrangement. Many providers offer a full,
comprehensive dashboard with more detail and depth than the average organization would ever need. At the end of the day, clients must ask themselves what is truly important for ensuring the sourcing arrangement addresses the needs of the business.

Almost uniformly, respondents admitted that while many had a plethora of metrics being reported, only a handful (usually 5-10) actually mattered and reflected the end-to-end service delivery needs of the business. Unfortunately, even more concerning than this handful being lost in a sea of useless data, some clients reported that their most important goals were not being tracked or monitored on a regular basis. Largely due to inexperience, new contracts were often signed with metrics that had no bearing on the true objectives laid out by the client’s business priorities or outsourcing strategies. Worse yet, many clients could not (or refused to) update their metrics due to the complexity and difficulty of changing reporting standards with their provider.

There is a distinct need for clients to balance comprehensiveness with simplicity in defining metrics to measure overall outsourcing performance. Furthermore, it must be understood that even if the core / focused set of metrics are being tracked, over the life of a contract, a client’s strategy and, in turn, outsourcing goals can change. If the contract and reporting standards cannot be easily updated to reflect that change in objective, performance monitoring can become a misaligned and futile effort.

Within this theme of Essentials there are three insights that we recommend organizations have: a compact set of optimised metrics; outsourcing metrics are closely aligned to the business case objectives; and ensure the outsourcing strategy is regularly updated to reflect their business strategy.

2.2.1. Insight: Optimise Metrics

One of the largest weaknesses found by the research was that almost half of the organizations struggled to identify a compact set of metrics that aligned with business priorities. Over-abundance of metrics often obscured the core set and made it challenging for clients to aggregate relevant information and derive intelligent insights. Others recognized the issue not as a problem of quantity but of quality; stating that metrics were being tracked, but did not link to the organization’s ultimate goals. Many organizations were unable or even unwilling to attempt to change the metrics being reported due to the hassle and time needed to review and update metrics given contract inflexibility and / or the effort required to update existing metric tracking and reporting solutions. In addition, very few organizations attempted to benchmark their metrics alongside industry standards, even in an informal fashion.
Most distinctly noted in first generation outsourcing arrangements, identifying the correct set of performance metrics is no easy task and often requires the flexibility to adapt these metrics as the sourcing requirements evolve through the contract lifecycle. Through the life of the outsourcing arrangement, some performance metrics may lose relevance and should be replaced with those that are more fitting to the current needs of the organization. In failing to keep metrics current, a classic issue can arise of having a ‘green’ dashboard with an unhappy client organization. Without taking the time to identify the right metrics, “there is a lot of energy [organizations] spent at [performance metrics] but [they] will still not be happy with it.”

![Figure 7: Performance management was a distinct weak area within most contracts](image)

![Figure 8: Maturity scores for dimension ‘performance management’](image)
Organizations should attempt to define a compact set of metrics that enable simple, focused monitoring of the most relevant, ‘essential’ outsourcing objectives. Contracts should be kept flexible enough to accommodate changes and updates to the set of metrics on a regular basis with minimal hassle or time commitment to ensure that metrics are reflecting the most pressing issues of the organization. When updating these metrics, organizations should look to peers and industry practices to ensure that they are tracking the most effective measures of success for their outsourcing venture.

Linked to performance management, challenges in management of recurring performance issues were often cited by respondents as an area of concern. One option of handling recurring performance issues is to define a non-repeat root cause analysis (RCA) clause within the contract to encourage the resolution of chronic performance issues. This non-repeat RCA clause would state that a service failure, once identified and linked to a root cause, should never recur once the root cause is understood and a fix has been implemented. This clause, when appropriately linked with penalties and exclusion conditions, would help ensure that the provider proactively monitors and reduces probability of recurrence of the same service failure.

### 2.2.2. Insight: Align to Business Goals

Ninety-two per cent of organizations stated that they had a strong alignment between their outsourcing objectives and the overall business strategy. However the research shows that only 60% of organizations displayed an effective understanding of how to define and track the metrics that measure these outsourcing objectives. In particular, many organizations often had limited means of tracking less tangible, non-financial objectives, such as improving customer or employee satisfaction, over the contract lifecycle and subsequently holding their provider accountable for any deviations.

![Figure 9: Strong alignment with business strategy at contract initiation was common](image-url)
The primary reason for not being able to track outsourcing benefits was that many organizations lost sight of the outsourcing business case over the life of the contract. While they had embarked upon their outsourcing journey with defined goals and clear objectives aligned with the business strategy, many organizations became entrenched in day-to-day operational management and over time allowed the objectives to drift away from those established within the business case. In addition, as business priorities and objectives changed over time, the outsourcing objectives were not always reviewed and updated to reflect the current state of the organization. As such, the goals that were arguably the most important to the client organization at the onset of the deal, over time, became either neglected or irrelevant.

To ensure that the most imperative outsourcing goals are attained, a compact set of high-level KPIs (key performance indicators) that directly reflect the strategic objectives should be established with the provider. Furthermore, non-financial objectives such as customer satisfaction or employee turnover should also be tracked with the same rigour as financial savings. These compact KPIs should be reviewed regularly (annually or more frequently) to ensure that they continuously align with overall business strategy and, in the event that they do not, are adjusted to better reflect the needs of the client organization. Lastly, when the benefits of these objectives are seen, the client should communicate and celebrate successes and quick wins to increase the visibility of the outsourcing accomplishments and promote the benefits across the organization.

![Figure 10: Maturity scores for dimension ‘outsourcing objectives alignment’](image)

**Figure 10: Maturity scores for dimension ‘outsourcing objectives alignment’**
2.2.3. Insight: Maintain Strategy

Client organizations unilaterally displayed strong capabilities when creating new strategies around outsourcing. Outsourcing strategies were well defined, well documented and typically outlined a multi-variable business case (e.g., including costs, improved service delivery and better responsiveness) for the justification of an outsourced service. The drafting of new deals occurred with a good understanding of the internal organization and which functions were best suited to outsourcing. New providers were selected with rigorous, thorough processes to ensure the selection of a suitable provider who could meet both service delivery needs as well as align with the culture of the client organization. Many of the client organizations surveyed adopted a formal ‘vendor tier’ approach to separate strategic vendors and contracts, often based on business criticality and deal size, from transactional or commodity services, and accordingly aligned levels of investment on governance and relationship management.

![Graph showing maturity scores for outsourcing model]

Figure 11: Maturity scores for dimension ‘outsourcing model’
However, over the contract lifecycle, the outsourcing strategies of some organizations fell behind the direction and overall strategy of the business. Outsourcing a service creates a paradigm shift in the way organizations function. As such, in addition to the creation of a well-defined outsourcing strategy, organizations must ensure that this strategy is aligned to the overall business strategy and continually updated. Outsourcing provides such a drastic change within an organization that it can even dictate that the outsourcing strategy feeds back to propose adjustments to the overall business strategy. Given the breadth and impact of moving a function outside of the organization, all internal (e.g., executive, legal, HR) and external (e.g., customers, partners) stakeholders should be consulted with before the service is moved out, and should be well informed as to the changes to expect under the new operating model. This will both ensure an outsourcing strategy that reflects the needs of all necessary stakeholders as well as a thorough understanding of the strategy and how it affects each stakeholder.

However, the creation of this strategy alone is not enough. A process should be established to periodically review and refresh the outsourcing strategy to ensure its alignment with the overall business strategy. In addition, the criteria for the selection of providers should be reviewed and updated to match the culture, objectives and strategy of the client organization.

2.3. Empathy Matters

While many clients strategically choose to have their outsourcing be transactional, more and more are realizing the benefits of developing open, collaborative relationships with their providers. Yet as often as the outsourcing community uses terms such as ‘strategic partnership’, the actions of this community do
not reflect the same enthusiasm for openness. Respondents scored the ‘relationship management’ dimension higher than any other in the survey. However, these scores were somewhat of a misnomer, as they measured the organization’s governance structure for relationship management when considering communication protocol and processes for interaction. While operational processes around relationship management were strong, organizations were often found lacking in establishing a satisfactory level of ‘trust’ with their providers.

Of those that did indicate a good level of trust in their relationship, the differentiator was often a mutual sense of empathy, a deep understanding of respective challenges and constraints, and the willingness of either party to understand the relationship from the other’s perspective. More mature organizations tended to possess a certain outsourcing ‘emotional quotient’, an understanding of how to gauge the intent and needs of their provider and knowing when to be aggressive versus when to be considerate. While requiring more effort than a hands-off approach, and often contrary to the established notion of managing only outcomes, an empathetic approach towards the relationship from both providers and clients can help build a strong and sustainable foundation and help both parties derive greater value from the arrangement.

Three main insights fell under the ‘empathy’ theme. Already mentioned is the issue of trust and the cautious state of client-provider relationships. Partially connected to this are efforts taken by client organizations to engage with provider’s employees to ensure an optimal level of moral and commitment. Lastly, is the concept of visibility and how, with a sufficient level of trust or insight into each other’s organization can help a client and provider better understand each other’s needs and work towards a more harmonious relationship.

2.3.1. Insight: Lacking Trust

Most organizations reported a strong rapport and cooperative relationship with their providers. Collaboration was high between most clients and providers with defined operational processes to manage day-to-day interactions and periodic strategic reviews.
That being said, few organizations identified the relationship with their provider as a ‘partnership’ or having a spirit of partnership. Trust was continually raised as a barrier preventing true, open and complete collaboration. Most organizations identified the provider’s intent to continually expand the contract revenue as a factor preventing the client organization from sharing their complete strategy and service delivery needs and plans.

While understandably not appropriate for all outsourcing deals, a relationship built on trust and openness can provide a better understanding of needs and priorities to both sides and help to improve the efficiency of the deal by removing redundancies, sharing best practices, collaborating on new initiatives, and generally aligning the needs of both organizations. This type of relationship building is...
most suitable for sourcing arrangements that are considered strategic partnerships. As one organization with a high level of trust with their provider stated, there had been “some contractual misinterpretations, but at the end of the day, no one wants to look bad in front of the other. We try to create a spirit of partnership so it’s very rare that things go very wrong.” Achieving this type of relationship can greatly reduce the effort and difficulty encountered by both organizations when initiating or adapting new services and helps both sides of the deal meet their underlying needs. The survey showed evidence of evolving trust in most outsourcing relationships, indicating that the development of this client-provider relationship may take an extended period.

To improve trust within an outsourcing relationship, the general consensus was to start at the top. First, establish a strong rapport and trusting, informal relationship between top management that is founded upon a mutual understanding of each other’s organization and priorities. Next, ensure that this approach is pushed by top management down to the delivery centres and VMOs to encourage a strategic outsourcing partnership. Be aware that as indicated by one participant, the trust may need to be continually enforced: “At the senior level, trust remains pretty constant, but I have a feeling that things can ebb and flow month to month at the operational level. It takes constant rebuilding, shoring up or addressing; it’s not something that just stays.” Client organizations should establish relationship manager roles that act as the primary contact point for the deal and set the tone with the provider as to how the relationship will function. Informal communication and relationships should be strengthened by building risk / benefit sharing into the contract to incentivize the provider to offer greater innovation and operational efficiencies, thus aligning them to the client’s objectives. In addition, greater collaboration, including joint establishment of long-term objectives and risk / benefit sharing can help reinforce the importance of a strong, trusting relationship.

2.3.2. Provider Employee Loyalty

The lowest of all maturity scores, provider employee engagement, was all but neglected by some organizations. Only a handful of the most mature organizations acknowledged and actively improved their involvement within provider operations. Mature organizations dealing with outsourcing high-attribution functions (e.g., offshoring call centre operations) have realized “that we have a lot to do with attrition. If you’re too hard on the supplier, if you treat them too much like a supplier and not enough like part of the family, you drive them away.”

The majority of clients surveyed adhere strictly to the traditional notion of managing ‘outcomes only’ with respect to their outsourcing relationships and considered provider operations as a ‘black box’ with limited involvement and engagement with provider staff. However, a few mature organizations are
increasingly trying to eliminate the same boundaries for strategic contracts and create awareness that vendor employees were intrinsically tied to the organization and should be treated as an extension of the organization itself. Programs to increase bi-directional engagement between client and provider employees, joint retention programs, performance-based rewards and recognition for provider staff are being explored, and options to foster collaborative, open mindset towards the relationship are becoming key items on the executive agenda. While this remains a progressive area in the current outsourcing industry, initial results suggest a significant increase in value through improvement in service quality, greater employee retention levels and reciprocal benefits by way of improved overall trust levels.

Many of the traditional organizations with a ‘hands-off’ approach stated that part of their reason for outsourcing was to not have to deal with employee engagement. While this may be true for transactional deals, for larger strategic and business critical engagements client managers must interact with provider employees to be able to define the vision of the organization and set expectations for delivery. Otherwise, the ‘black box’ exists on both sides of the deal; provider employees will not be able to understand the underlying needs and requirements of the client organization either, and therefore the degree of commitment and dedication may decrease throughout the life of the contract.

Another reason cited for a ‘hands-off’ approach was the additional investment on the part of the outsourcer to implement such levels of engagement and whether the incremental benefits justify the cost. Our recommendation for outsourcers is to start with small, simple actions such as involving provider employees in company events, business unit publications, recognition programs and in-house social meetings which can do a great deal to improve provider employee engagement and in turn, service delivery quality.
2.3.3. Transparency

Organizations surveyed unilaterally possessed strong financial management capabilities. Invoice reconciliation and financial audits were performed regularly to ensure that financial reporting was accurate and appropriate. However, less than 40% of the organizations surveyed had visibility into the provider’s pricing models and competitiveness of the contract pricing offered to them. Few organizations had an initial understanding of the provider’s margins during contract negotiation; however, none claimed to have ongoing discussions with providers regarding alternate service pricing options and steps to improve clarity of pricing structures by working together with the provider. This lack of transparency also affects the ability to perform routine price benchmarking with industry to ensure competitiveness.

One reason for the lack of visibility into pricing models is that relationships have not yet achieved the necessary level of trust for such an open interaction. For providers to share pricing models, they must have the assurance that the client organization is invested in the relationship for the long term and in turn, willing to share strategic objectives and future sourcing plans. Open sharing of pricing models will help clients get a clearer understanding of the key cost drivers and work with the provider to optimize service delivery process and / or make necessary adjustments. On the other hand, sharing of long-term strategic plans will help providers collaboratively plan resources, tools and technologies appropriately to ensure profitability over the longer term.
Understandably, this is a difficult state to achieve. However, this ability to forge a deep client-provider relationship based on a mutually beneficial degree of trust from both an operational and strategic perspective provides a solid foundation for ensuring long-term sustainability of the sourcing partnership.
3. Conclusion

While successful governance of sourcing arrangements require numerous tactical and strategic management capabilities and a practical knowledge of the sourcing industry and provider capabilities, this report has focused on a subset of issues that were found to be common among some of Canada’s largest outsourcing deals. Outsourcing, being a significant transformational endeavour, requires not only simply knowledge, but the practised experience of managing a provider, whether in-house or with third-party guidance. Effective performance monitoring can become lost in an over-abundance of data and clients must strive to focus on essentials and consistently and regularly track and monitor a core set of metrics that are most relevant to their organization’s business objectives. Lastly, as providers become more critical within the client’s operations, empathy is a crucial mindset to allow greater trust, collaboration, cohesion and openness within both the client and the service provider organization.

Effective governance of an outsourcing relationship can mean the difference between success and failure. As outsourced services become more complex and of greater strategic importance towards retaining competitiveness, governance will only continue to grow in significance. Not only clients, but providers and advisors must accept this evolution of the sourcing industry and be prepared to adapt their approach. The table on the next page shows high-level recommendations for clients, providers and advisors to improve their focus on the elements of governance that matter: Experience, Essentials and Empathy.
<table>
<thead>
<tr>
<th>Experience</th>
<th>Providers</th>
<th>Advisors</th>
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<tbody>
<tr>
<td>• Identify governance functions lacking in maturity</td>
<td>• Lower client maturity in governance may negatively affect the relationship quality and contract longevity</td>
<td>• Aid clients not just with strategy, provider selection and contract creation but continue to function as trusted advisors throughout the contract lifecycle to ensure alignment with operational and strategic goals</td>
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<tr>
<td>• Aim to improve maturity by engaging external advisors or augmenting internal staff with seasoned sourcing resources</td>
<td>• Assist new clients with governance setup and work as a true partner</td>
<td>• Provide recurring guidance on improving the relationship quality, increased collaboration, and the degree of trust</td>
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<tr>
<td>• Focus on keeping contracts flexible enough to adapt during learning period</td>
<td>• Discover underlying needs and adapt service delivery to improve alignment with client business objectives</td>
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<tr>
<th>Essentials</th>
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<td>• Identify, track &amp; hold accountable a handful of the most important performance metrics, which reflect the end-to-end service needs from a business perspective</td>
<td>• Understand that the client will not be satisfied if service is routinely reported as functioning in a “green” status but not delivering value</td>
<td>• Function as the intermediary between the client and provider to identify performance metrics that ensure a high degree of correlation between both the client’s business objectives and the provider’s capabilities</td>
</tr>
<tr>
<td>• Ensure the respective metrics are reviewed &amp; updated regularly to ensure sustained alignment</td>
<td>• Work collaboratively with the client to ensure the metrics are manageable and reflect the evolving needs of the client</td>
<td>• Assist clients with developing flexible, simple contracts and implementing controls to effectively track and measure value</td>
</tr>
<tr>
<td>• Keep contracts, KPIs and governance structures simple and flexible</td>
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<tr>
<th>Empathy</th>
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<td>• Recognize value of trust &amp; empathy with the service provider towards advancing the quality of the sourcing relationship</td>
<td>• Recognize the value of trust &amp; empathy with client resources; understand their needs and constraints</td>
<td>• Provide innovative guidance on alternate approaches towards increasing the level of empathy within the sourcing relationship</td>
</tr>
<tr>
<td>• Treat service provider team not as a ‘black box’, but as an extension of own resources and potentially as a strategic partner to support growth</td>
<td>• Evaluate opportunities to improve the integration between provider and client resources</td>
<td>• Force outsourcers and providers to understand implications of their actions on the other</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Demonstrate persistent thought leadership towards increasing the degree of trust, flexibility, guidance and alignment of interests</td>
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Appendix I. Research Methodology

This research was prompted by a 2010 CORE study, in partnership with IDC Canada, which highlighted outsourcing governance as a key priority towards achieving outsourcing success\(^4\). A 2011 Deloitte report\(^5\) also revealed that while many client organizations had established dedicated VMOs, just over half of them felt these offices were effective or delivering promised value.

These reports highlighted a discrepancy between the governance maturity of client (buy-side) and service providers (sell-side) organizations. To further investigate the challenges and issues faced by client organizations, interviews were conducted solely with the buy-side of outsourcing arrangements. This research focused on understanding:

- maturity of outsourcing governance within buy-side organizations; and
- trends and best practices with respect to outsourcing governance.

In total, 15 outsourcing deal teams from 10 organizations were interviewed from June to October 2011. Using Deloitte’s proprietary outsourcing maturity assessment model, questions were asked about governance and the client-provider relationship. Respondents, typically high-level management staff responsible for the operational management of outsourcing contracts, provided insights into their organization’s governance capabilities and the state of their provider relationship. Interviews were conducted in-person at the client’s office with some members of the research team on conference call. Both quantitative and qualitative results were analyzed to discover common trends in the Canadian market and to highlight industry best practices.


Appendix II. The Deloitte Outsourcing Maturity Model

The research team leveraged the Deloitte-proprietary outsourcing maturity model for assessing the maturity of the governance functions within the organizations surveyed as part of this research. Deloitte’s outsourcing maturity model reviews end-to-end outsourcing relationships across the following major areas:

1. **Business Alignment and Relationship**: Assesses the effectiveness of the organization’s outsourcing decisions and evaluates the strategic imperatives of outsourcing. It evaluates the outsourcing model, the drivers behind outsourcing, the organizations outsourcing readiness, its outsourcing decision process and relationship with strategic providers. Dimensions assessed for this research include outsourcing model, outsourcing objectives and business alignment; outsourcing preparation and relationship management.

2. **Process and Tools**: Analyses key processes and tools required for establishing and managing a successful outsourcing relationship. Dimensions assessed as part of this research include performance management, service management, financial management and contract management.

3. **Organization and Capabilities**: Assesses the structure and capabilities within the outsourcing organizations for both the client and provider, the existence of an enterprise change management strategy and capabilities to manage and reduce vendor turnover and increase engagement with the provider organization. Dimensions assessed as part of this research include outsourcing organization structure and capabilities and people and change.

Organizations were assessed based on their maturity across 10 dimensions aligned within these three areas. A maturity scale of ‘1’ to ‘5’ was used based on the definitions in the table below. Detailed descriptions of the assessment dimensions and maturity indicators are provided on the following page.
<table>
<thead>
<tr>
<th>Assessment Dimension</th>
<th>Key Question</th>
<th>Maturity Indicators</th>
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</table>
| Outsourcing Model                    | • Is there a formally defined outsourcing strategy in place? Does the strategy enable collaborative / mutually beneficial relationship with key service providers? | • Formal outsourcing strategy exists  
• Strategic and collaborative partnerships with key service provider(s)  
• Strong supplier selection and contract negotiation capabilities |
| Outsourcing Objectives and Business Alignment | • Are the outsourcing objectives aligned to the needs of the business and the overall business strategy? | • Definition, communication and measurement of outsourcing objectives  
• Alignment with business priorities  
• Ability to correlate outsourcing savings / benefits with business case targets |
| Outsourcing Preparation              | • Are there capabilities in place to define scope, structure target state, understand current state impacts and coordinate transition plan? | • Evaluation of services for alternate sourcing fit  
• Balanced business case  
• Process standardization prior to sourcing  
• Organizational change readiness plan |
| Relationship Management              | • Are there formal processes to proactively manage relationships / interactions between service providers and internal stakeholders? | • 3-Tier relationship management process  
• Routine evaluation of relationship  
• Proactive communication, open rapport between leadership teams  
• Evidence of trust and collaboration |
| Performance Management               | • Are there capabilities to focus on the identification, reporting, and benchmarking of performance attributes to assess the effectiveness of in-flight outsourcing contracts? | • Metrics defined, measured and enforced  
• Alignment to end-to-end business need  
• Mature reporting capabilities  
• Periodic industry benchmarking of metrics |
| Service Management                   | • Are best practice service delivery and support processes (e.g., ITIL) leveraged to ensure consistent provisioning and management of outsourcing activities? | • Alignment with industry best practices  
• Routine review of service delivery  
• Knowledge sharing  
• Service level monitoring, continuous improvement |
| Financial Management                 | • Are there formal mechanisms to manage invoicing and payments? Are financial audits, benchmarking activities conducted to ensure costs are reflective of fair market prices? | • Strong invoicing and order reconciliation  
• Execution of financial audits  
• Visibility into provider pricing model  
• Industry benchmarking of costs / spend |
| Contract Management                  | • Do key capabilities exist to proactively manage the contract lifecycle (e.g., creation, mobilization, change & renewal, termination, dispute management, etc.)? | • Clarity of contract scope / activities  
• Effective dispute resolution mechanisms  
• Termination clauses and penalties  
• Flexibility to accommodate changes  
• CSAT monitoring capability |
| Outsourcing Organization Structure and Capabilities | • Is there a well defined / structured internal organization to oversee the outsourcing relationship? Are roles, responsibilities and accountabilities clearly established to maintain vendor oversight? | • Communication of vision and mandate  
• Well defined roles and responsibilities  
• Optimal structure and size for VM team  
• Key capabilities exist for managing governance / operational practices |
| People and Change                    | • Is there a capability to oversee client and provider organizational change activities throughout the contract lifecycle? | • Org. change management strategy  
• Management of vendor turnover  
• Engagement with provider organization  
• Performance-linked compensation for contract manager  
• Resource / knowledge transfer processes |
Appendix III. Research Team

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