**Jim Hemmington**, Director of Procurement, BBC / NOA Council Member

# Do we need more transparency in outsourcing relationships?

Anyone will tell you that the most successful contracting relationships are built on that well-used five letter word “TRUST”.  In the outsourcing world those proud of their work will also talk about “collaboration”, “win/win” and “partnering”, all flowing from the same source - a trusting and constructive relationship.  They may also tell you that openness, honesty and in particular transparency are essential to building trust. Trust brings success, increased value, efficiencies, faster decision making and much more.

So why do contracting parties still heavily resist being open and transparent to support a trusting relationship? Or is it more fundamental than that, and the notion of transparency and real trust in outsourcing is really just the expected thing to say? Not least perhaps because ultimately the aims of the buying organisation (reducing cost is king) and service providers (maximising revenue is king) are so diametrically opposed.

In pursuit of answers to these and other questions, I’ve consulted with a broad range of stakeholders on both the buyer and service provider side, to really test whether more transparency in contracting relationships is worth considering as a route to even greater value.

### But first - is it really worth the effort to be more transparent?

Everyone I’ve spoken to advocates that some improvement in transparency will spark further value opportunities, though how far this can go and what tangible benefits can be achieved depends on several factors, explored later. What is clear is that a lack of transparency is starting to lead to questions about whether continuing to outsource is right for some. Indeed we have seen some major reversals recently. Cornwall Council terminated and back-sourced a huge contract with BT for IT services less than two years into the contract, and the Ministry of Defence decided to back-source a significant contract with Serco for corporate services, covering activities such as human resources, finance, information and vetting.  It is not clear if a lack of transparency/trust influenced these decisions, but we should not dismiss the possibility that they did.

The NOA’s recent research shows that the overarching trend towards 2020 is to continue to outsource and outsource more. However, if complacency sets in, and service providers in particular maintain a “black box” approach to commercial issues, there is a strong possibility that back-sourcing could emerge more prominently for some services and some industry sectors.

Two issues seem to be prime drivers for back-sourcing. An in-house model brings no margin and ultimate cost flexibility; the organisation can alter its own cost base more readily than having to rely on negotiations with a service provider. Cost flexibility certainly appears to be becoming increasingly important to buying organisations. Since the economic downturn many organisations have needed to make tougher financial decisions. Limited influence and control of cost drivers that reside with service providers have been seen as a big disadvantage. Certainly the “core” versus “non-core” debate seems to have less weight now, when organisations consider outsourcing. They increasingly look more widely at their overall cost bases to optimise efficiencies.

So the hypothesis is: yes, it is worth looking to increase transparency, not just to identify new ways to generate value but to show that outsourcing can compete with the financial flexibility that organisations may now find tempting with the self-provide model.

### So what is actually meant by greater transparency?

If we first go back to the "black box" concept where if I'm the buyer, provided I get my expected cost savings, service performance improvements and so on, I shouldn't really be worried about the costs that sit behind the value I'm getting, especially if I've transferred a bunch of risk too. That's been the base approach in several industry sectors for many years. But expectations are changing and while we have seen innovation, technology and people arbitrage reduce costs dramatically, buyers want to know more about cost drivers, supply chain issues and the cost of risk management, so they can make more informed decisions.

Equally service providers, in trying to respond to increasing cost pressures both internally and from their clients, want to know more about what's influencing client's decisions, priorities and future plans.

From discussions with a broad mix of buyers and service providers, the practical things they would like to see that could demonstrate and support real and tangible transparency are given below. This is of course a wish list, much of which will not be a surprise. There are also some common topics (highlighted) across buyers and services providers.

### THE BUYER'S WISH LIST

- Knowing all service provider costs
- Better understanding of service providers' cost drivers (like volumes and people)
- Knowing margin
- **Costing risk and allocating risk in a more informed way**
- **Honest conversations**
- Full open book
- **Understanding service providers' business priorities**
- Investing more time in driving efficiency
- **Sharing benefits**
- Service providers not sitting back until re-procurement to drive more value

### THE SERVICE PROVIDER'S WISH LIST

- Clients to share internal inefficiencies
- Realistic about expectations on both sides
- Clients sharing business plans
- **Clients being open to taking more risk**
- Better planning by clients
- **Engaging more openly**
- Taking time to understand service providers' issues
- Less formal governance
- Less use of contractual levers by clients
- **Being open to incentives to drive good behaviours**
- Clients taking more responsibility for success, rather than expecting service providers to shoulder everything

Interestingly there were two areas of contrasting views from the buyer perspective.

Firstly, some buyers saw no real benefit to knowing margin. If value for money could be clearly shown and service providers were overtly competitive, then that was seen as enough. Other buyers, and in fairness the majority, wanted to know about margin too, not to attack it but to understand how service providers were managing their cost base, achieving profitability and offering assurance to clients that any growth in margin was proportional and compatible with clients' objectives.

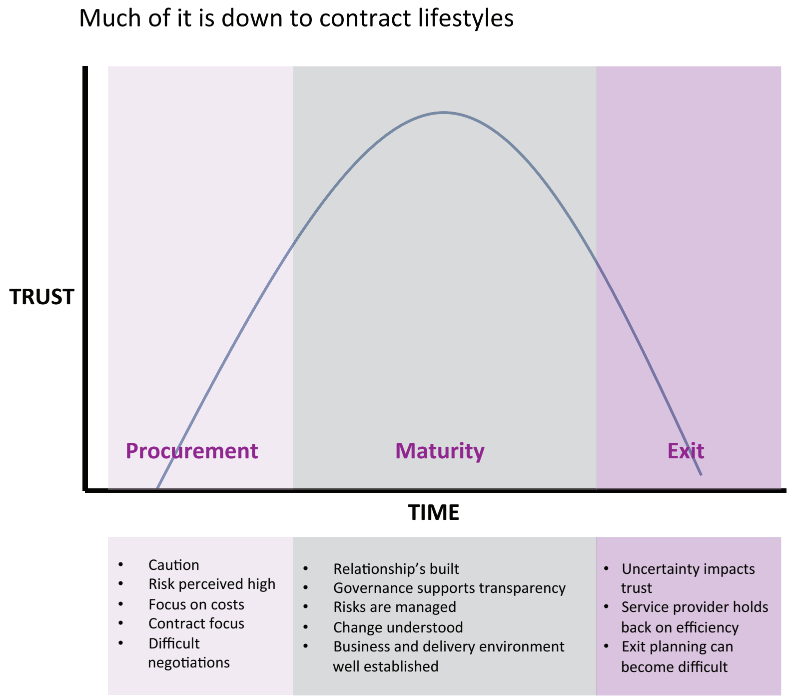
Secondly, there were differing views on how effective open book was as a means to evidence the spend profile. Some thought it was difficult to get a true view; others saw open book as a means to force transparency and subsequent conversations that focus on driving good behaviours and discipline. Certainly for the public service contracts there is a strong desire for service providers to adopt a more cooperative stance in supporting regular open book reviews.

### But what stops greater transparency?

There are a number of barriers to achieving the level of transparency that on the face of it look wholly sensible but remain elusive. These vary and, even though they can be challenging, it is possible to overcome them all and create a highly transparent and mutually beneficial relationship:

**1. The maturity of the relationship**

The procurement process can leave an air of mistrust. Building trust and ongoing transparency can therefore take longer, not least on the service provider side where there may be fear that more transparency on their part to engender trust will simply be used against them, and undermine the viability of their commercial goals. The graph below shows how trust builds and transparency grows, but then declines as the uncertainty of exit looms.




***Hints to avoid the problems:*** *It's important to recognise this cycle. During the procurement stage the buyer must challenge and scrutinise, but positively and with context in order to start the basis of a good relationship. Equally the service provider should respond to buyer challenges practically and not overly wrap difficult issues in sales speak.*

*Once the relationship is mature, that's when transparency will underpin success, but as it approaches exit, unless it is possible to extend, there needs to be acceptance that the level of transparency will start to wane and expectations must be reset.*

**2. Importance of the relationship to both parties**

A number of my sample contributors have invested much in positioning the importance of their outsourced relationship. Several have taken measures such as including service provider staff in their own staff surveys, there have been joint bonus schemes, and service providers investing time and resource in seeking to anticipate the next big thing that might impact the client's longer-term strategy. Here transparency is as pure as it can be. The service provider is effectively an extension of the client organisation and the client regards the service provider as a valued partner supporting its long term business aims.

Such relationships only thrive though where business imperatives are aligned. Alas, while they may appear so, often they are not. One contributor to this study gave me an example where the service provider of marketing services was seen as a key strategic supplier, intuitive to the needs of the buyer and generally responsive. However, when a major strategic change was required by the buyer in their marketing strategy, the service provider was unable to adjust their service model accordingly. At this point the buying organisation realised the relationship was not as aligned as they had thought and that, in reality, they were followers of a successful formula that the service provider delivered to all clients.

In another example a complex service contract for support services had included very detailed transparency provisions in the contract, established to support the highly collaborative principles that the relationship was set to deliver. A few years in and the service provider bought out the transparency provisions (for a significant rebate back to their client), all cost transparency then disappeared within a set service charge. Yet as time passed further and staff changed, there was again the desire from the client organisation to establish more transparency.

***Hints to avoid the problems:*** *It's important to understand the real perception of the relationship on both sides and set the transparency agenda according to these expectations. A key supplier may be important to you, but be clear about the limitations of the relationship. Equally if there is a danger transparency starts to expose real commercial issues for the other side, you may need to agree adjustments to protect the relationship without going to extremes.*

**3. The people involved on both sides**

Once in a while senior executives get excited. They see opportunity for mutual gain, they like each other, and they want to do business and achieve great things together. When these senior executives are counterparts in buying and service provider organisations, this can lead to great collaborative outsourced relationships. Complete transparency prevails, trust is unquestionable and both organisations reap the benefits, and the great "win/win" is achieved. In most cases these relationships only prevail because of the connection between individuals at the right level in both organisations.

However, when one of these individuals leaves and is replaced by someone new, the whole relationship can change. In fact in the worst case it can begin to decline, leading to mistrust, disputes and eventually a complete breakdown. Very often the contract underpinning the relationship includes few of the principles creating the trust and transparency from the individuals involved.

***Hints to avoid the problems:*** *It is important to capture what the expected outputs are from a collaborative relationship and incorporate them into the contract, as far as is practicable and within the governance process for managing the relationship. This needs to be quickly followed by efforts to ensure the teams on both sides work effectively together, so that the impact of any change in key people can be minimised.*

**4. When times are strained**

That first major dispute in a relationship can be a huge test. Often the contract management team/service provider account team dig in and the other side becomes the enemy. That atmosphere may then prevail, and what first seemed to be a good open and transparent relationship starts to become confrontational, wholly contractual and worst of all of limited strategic value to either party.

Disputes happen, and if these are allowed to unduly influence the behaviours of both the buyer and service provider, then the whole basis of transparency and trust was probably just a pipe dream.

***Hints to avoid the problems:*** *Strong governance is required and clear levels of escalation. It is important to present escalation as a means to objectively resolve disputes and not as acknowledgement that someone lower down the organisation has failed. Otherwise escalation is avoided until it's too late and the relationship is damaged. A good mix of people within the team on both sides can help manage disputes effectively and keep the relationship on an even keel.*

## Getting the balance right

So if contracting parties agree that greater transparency is a prize worth going for and can see a joint approach to addressing the perceived barriers, then the foundations ought to be in place to create more value and less hassle, for both parties.

Absolute transparency is unlikely to be achieved; there will be issues on both sides that simply cannot be shared. That said, when we look at those relationships that are highly successful from a collaboration and transparency point of view, both parties are sharing operational and commercial information at a very detailed level. Buyers are sharing forward plans and business road maps. Service providers are operating highly flexibly, where the cost of change is minimised by agile operating models that can adapt quickly to the client's changing priorities.

But there needs to be incentives on both sides and these differ. Going back to the introduction of this study, the aims of the buying organisation (reducing cost is king) and service providers (maximising revenue is king) can be so diametrically opposed. Transparency that promotes financial incentives for the service provider against cost savings for the buyer can be a highly successful formula for most contracting relationships.

Imagine a service provider able to openly increase margin and a buying organisation reducing their costs and creating significant savings opportunities, by just being more open about what they are trying to achieve with their service provider.

## Making long term transparency happen

Let's assume we all think greater transparency is not perhaps the Holy Grail, but worth pursuing as it will bring value, so how do we deliver it?

There seems to be three things that when applied in concert, make transparency work effectively:

| THE CONTRACT | THE RELATIONSHIP | AGREED PRINCIPLES |
|---|---|---|
| This preserves the practical mechanisms that enable transparency to continue through the contract lifecycle, regardless of change to people. | This creates the opportunity, boundaries and behaviours that support transparency and trust. | This creates the framework for sustaining the relationship, the basis of engagement, standards that apply and rules supporting ongoing transparency. |
| This includes (but not limited to):<br>• Detailed cost models, refreshed as appropriate<br>• Margin set, but with parameters for review<br>• Process prescribed for expected change - with "automated" commercial adjustments if feasible<br>• Quantified costs associated with commercial risks and a process to allow the parties to review<br>• Inclusion of an annual commercial review – KPIs, service credits, trends and a process to reset outdated commercial parameters<br>• Options to relax/tighten commercial principles where the parties see and agree the value | • Agree during procurement what information will be shared (set according to the nature of the relationship)<br>• More open discussions about value and context of relationship to both parties (true partnering or following the crowd)<br>• More time on how incentives can be built around cost drivers<br>• Joint forward planning<br>• Clear about how disputes will be managed without jeopardising the relationship<br>• A practical means to celebrate success (for staff in particular) | Establish a code of practice, i.e.:<br>• A list of principles, but specifically defined according to the relationship and agreed by both parties<br>• Clarity on "contractual" transparency and what will rest within the "relationship" as part of good governance<br>• Behaviours to support difficult discussions (e.g. a client may require more agility, service provider needs more revenue)<br>• Being clear about no-go areas<br>• Agreeing where transparency will prevail throughout the contract |

From this study there was overall consensus that to ensure transparency is maintained, and survives staff and other key changes over the contract lifecycle, careful thought should go into capturing the principles as far as possible in the contract. However, it was also acknowledged that not everything that creates transparency, trust and more value opportunities can be contractualised. Good working relationships, open and honest discussions can be equally or more important. If this can be preserved by working to a code of practice (or agreed principles) that provides the ground rules for engagement and promote the behaviours to safeguard transparency long term, significant additional value could be achieved.

## Conclusions

Some contributors to this study believe they have achieved an additional five-to-seven per cent in value, simply by heading off poor decisions, arguments and being more honest about their goals. As yet, however, there is no comprehensive analysis to prove that greater transparency in contracting relationships will guarantee an increased level of value.

The time feels right for buyers and service providers alike to share more to gain more; no opportunity to create further value should be lost, otherwise we may see more organisations questioning the scope and purpose of their outsourcing strategies. Consequently, for the future and to genuinely create real partnerships, win/win and all the other positive things about good outsourcing, greater transparency will increasingly feature in some form to help keep trust at the centre.

To develop the idea of a code of practice (or principles) to support long term and productive transparency in outsourced relationships, the next step is to agree a statement of principles with, and endorsed by, the NOA, that contracting organisations can use as a template to create their version of transparency for their relationships.

I would like to thank my fellow professionals who kindly helped with this research, for their candid and detailed contributions, and generosity in imparting their profound knowledge and experiences.