

'Legislating for Success'©

Why the service procurement process across the public and private sectors is failing both clients and providers.

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This paper argues that service procurement has evolved in such a way that it has become detrimental to the parties it is intended to serve. This is true across all sectors and geographies. Even Europe, which has traditionally been less litigious than the US, seems to be driven by the same procurement agenda of mistrust and blame and the default position is conservation and self-protection rather than collaboration and innovation. When both parties focus almost exclusively on failure and blame, by default the really important matters become secondary.

This paper examines ways to break out from this deep-seated practice of legislating for failure alone and advocates a new and higher-value approach based on '[Legislating for Success](#)'©.

Background

Major Service Contracts typically take months to negotiate and conclude, and are extremely resource and budget consuming. Anyone who is professionally involved in these exercises can testify to the intensity, emotion and stress involved, particularly in the last few weeks. There is little or no time to build relationships and understanding between client and provider. In fact, the opposite happens and contract signature is, at best, a trigger for relief rather than celebration. Closer examination of any contract process will reveal the same list of points of contention and key topics for negotiation irrespective of industry, geography or service area (IACCM, 2007). Sadly this list will be heavily, almost exclusively, biased towards terms and conditions which add little or no value to either party except in the event of catastrophic failure.

This ludicrous and hugely sub-optimal situation is perpetuated by the belief that good corporate governance is best observed this way and by the disinterested advisors and professionals who are employed to 'help' at this stage. All too often they see their role purely as risk allocators and managers and, as they will no longer be involved after contract signature, legislating for success in a programme isn't their responsibility or concern. Sometimes the nonsensical negotiations continue because they simply don't know any better as they lack sufficient experience of the business to know where the market norms are¹. It is also, in part, caused by client fear and mistrust – not just of third parties but of their own internal capabilities and management competence (IACCM, 2007).

This negative approach leaves little or no time for attending to the really important factors which include: relationship management, governance, retained organisation structure, change management, transformation, transition planning and execution, innovation, KPI's, performance and service management. All too often these crucial success factors are therefore derogated or ignored. Sometimes standard (pro-forma) schedules are completed in order to tick the governance box or cover performance management. In some instances, transition management is not even contemplated until the contract has been signed and retained organisation design is sometimes overlooked altogether.

¹ For a list of law firms we know to be experienced in Sourcing and Outsourcing please contact info@8020i.co.uk.

At the same time as it is squeezing the success factors (and the value) out of the arrangement this anachronistic approach is also serving to drive the wrong behaviours from the providers.

Draconian terms and conditions for service contracts tend to have the opposite effect to that intended and drive the wrong kinds of behaviour. Faced with such terms the prospective providers will respond in a number of ways:

- Those who can (i.e. those in highest market demand) may refuse to accept the terms or decline to bid altogether.
- Others will load their cost models (and therefore the price) with risk ^{(IACCM, 2008)²}.
- Some will accept the risk, either because they feel they have to or because they don't know any better.

In all cases little 'value' has been created by adopting this stance and much potential value is leaked through the mis-allocation of resource to non-value added activity.

Despite the fact that no real purpose is being served by this hard-nosed approach to contracting, it is frequently the starting premise, particularly in public-sector procurement. If the relationship is master-slave and the service provider is kept at arms-length (under a one-sided contract) then its performance will usually reflect this. If the risk to the provider is high and the rewards are minimal then there is nothing to be gained by performing anything other than 'to contract'. This in turn leads to dissatisfaction from users, a poor working relationship and possibly early termination.

An example of misguided focus on low value-add terms is Limitation of Liability (LOL). Practically all service contracts will (by necessity) have a LOL clause. In the back-office services industry a market norm has evolved, the range of which has been used in the vast majority of service contracts. However, despite the existence of the de facto

² This IACCM Survey was conducted in November / December 2007 and drew input from almost 800 organizations, representing many thousands of negotiators in over 80 countries. See the detailed results online.

standard, this is the single most negotiated term with heated debates lasting well into the night. Clients are encouraged to seek higher than the average LOL and the providers, in turn, strongly resist this. Ultimately the outcome is predictably within the normal market range and nothing has been gained by either party. There have been exceptions where providers have accepted limits of 2 or even 5 times the norm. However, this does nothing to motivate the provider to perform or over-perform in terms of service. What it is more likely to do is factor in a higher risk-premium to the price and increase the resource it has assigned to risk management.

Similarly, heavy service penalties are rarely motivating. None of the providers want to provide a poor service and most care more about their market reputation than the financial penalties themselves. Over a sustained period the constant application of penalties will simply create a 'problem account' where no-one wants to work and where the Provider seeks to just minimise its losses or withdraw altogether. The Caveat Emptor here is 'buyers get the providers they deserve'.

A recent study by the IACCM (2008) found that [Public Procurement policies and negotiation behaviour in the European Union diminishes value and raises costs by an average 28%](#). Topping their list of complaints is that public procurement policies frustrate communications and prevent the type of collaboration that is necessary to support complex, high risk relationships.

IACCM has monitored the most frequently negotiated terms and conditions over a number of years across a broad range of industries and service sectors world-wide. It is worrying that the top 10-15 terms are not only almost identical in every jurisdiction and are almost entirely focussed on negative assumptions (liabilities, penalties, failure to perform, termination) but also that despite all the talk around collaborative innovation (World Economic Forum, 2008) this list shows no sign of rebalancing towards more positive factors.

Clearly there is a need to protect client and provider and these terms and conditions are necessary both in the event of failure and to set certain ground-rules for behaviour (for example non-solicitation of employees and use of IP). However the time has surely come where there is sufficient -familiarity and confidence to standardise the 'boiler-

plate' terms and conditions across the industries. By doing so, far more time and energy can be devoted to 'Legislating for Success'©.

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Instead of focussing on what might go wrong, an alternative approach that is more likely to result in successful outcomes, is:

- **Focus on relationship building.** Craft a relationship with the provider that is based on trust and understanding. It is neither naive nor commercially weak to trust your chosen service provider(s); in fact it is essential. Trust and understanding, in turn, are based on relationships which can be built immediately following selection and further developed during the negotiation process. The perceived ability to work closely with a provider should form a key part of the selection criteria.
- **Concentrate on driving positive behaviour and outcomes.** Start with the premise that the provider wants to perform well and look at incentives in preference to penalties. Most arrangements focus entirely on the in-scope services and the consequences of failure to perform to the prescribed levels of service. The well-known players in this market have a wealth of knowledge, resource and innovation that they can bring to bear but are rarely motivated or challenged to do so.
- **Develop a clear picture of the goals and aspirations of both parties.** A clear set of objectives (for the arrangement) will form the basic framework for governance. This is particularly important where key personnel are likely to change on either side.
- **Focus time and resource on what really matters.** "Legislate for Success"© through the use of KPI's, performance metrics and Maturity Models. Some of the provider organisations such as OPI are already moving in this direction and have deliberately designed their standard service contract to be client neutral/positive which speeds up the commitment process and facilitates relationship building. Satisfy corporate compliance with industry standard approaches.
- **Work with the experts.** Seek help only from expert law-firms and sourcing advisors in this field. Don't assume that your preferred law-firm has sufficient

relevant experience to provide the support you need³. There are very few lawyers who have the requisite experience, knowledge and attitude to do this well. This is highly specialised work. Choose experienced sourcing advisors who will work with you throughout the life-cycle and who regard their role as delivering value not just managing a process.

Conclusion

In the age of the networked economy where collaboration and innovation are becoming the new buzz-words, prospective clients should reappraise their approach to contracting for back-office services. This starts with a rethink on allocating resource with a heavy bias towards focussing on the things that are success-orientated. These include: relationship management and governance, a mutual understanding of objectives and constraints, incentives and reward structures, change management and transformation planning and execution and performance indicators and measurement. This approach is far more likely to result in a successful outcome. Lawyers and advisors should only be selected if they can bring directly relevant first-hand experience and should be instructed to concentrate on areas that bring real value.

³ Mergers and Aquisitions experience is largely irrelevant.

About EightyTwenty Insight

EightyTwenty Insight, the sourcing advisory company, was formed in 2007 to provide strategic and pragmatic advice in a changing sourcing market. It builds clients' business value through scoping, designing, contracting and helping deliver tailored sourcing solutions. It provides both public and private sector advice across all process areas including human resources, information technology, finance & accounting and procurement.

With EightyTwenty Insight, organisations (multinationals, nationals, public and private) are able to navigate their way through market diversity, a crowded set of providers and the complex delivery models available to them.

EightyTwenty Insight prides itself on its expert staff, the experience-rich methodology it uses, its ability to think about tomorrow's needs as well as today's, and the empowering way in which it transfers knowledge and skills to its clients.

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