

It Takes Two to Tango: How Relational Investments Improve IT-Outsourcing Relationships

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Abstract:

The IT outsourcing, industry landscape is dotted with broken contracts - results of unsuccessful client-vendor (C-V) partnerships. Approximately 78% C-V partnerships fail in the long term, inflicting high transition costs on clients. The recent economic downturn has strined C-V partnerships further. Despite the criticality of this issue, there is a relative lack of efforts to understand the issues leading to failed partnerships.

Keywords: IT | outsourcing | management | client-vendor partnerships

Article:

The IT outsourcing, industry landscape is dotted with broken contracts - results of unsuccessful client-vendor (C-V) partnerships. Approximately 78% C-V partnerships fail in the long term,⁷ inflicting high transition costs on clients. The recent economic downturn has strined C-V partnerships further. Despite the criticality of this issue, there is a relative lack of efforts to understand the issues leading to failed partnerships.²

We discuss these issues in light of the clients' onus towards improving the longevity of C-V partnerships.

We adopt a two-pronged approach. First, we try to identify the client characteristics that influence their potential to forge a long-term C-V partnership. To that extent, we discuss a partnership maturity curve (PMC), which categorizes clients into three dynamic stages, and predicts their potential for developing mature partnerships based on their outsourcing objectives and their fit with vendors' capabilities (see Figure 1).^{1,3}

Second, we try to understand vendors' perspective on the issue. We interviewed 21 executives in nine established IT-outsourcing vendors in India. It has been recommended that vendors' perspective is critical to understanding C-V partnerships.³ Vendors highlighted an interesting mix of their own as well as client-generated issues, which we discuss in light of the client dynamics identified by PMC, to propose guidelines for clients interested in developing successful C-V partnerships. The study confirms existing belief that improving the longevity of

C-V partnerships requires relational investments from clients. We identify various areas for clients to make such investments.

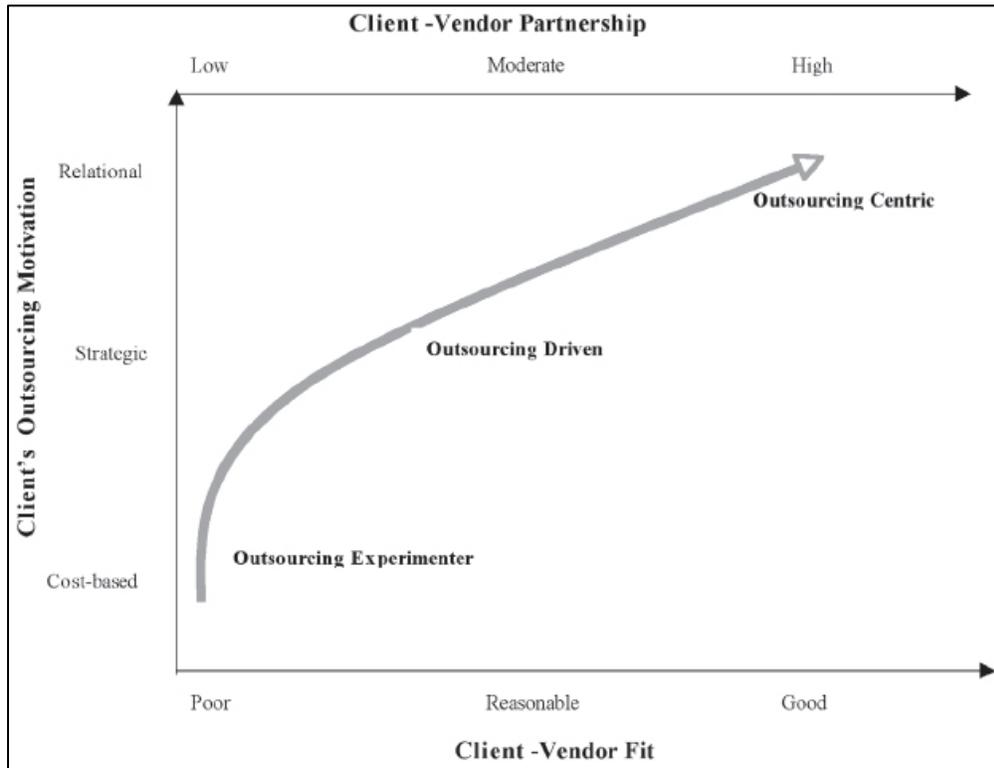


Figure 1. Partnership Maturity Curve

Partnership Maturity Curve

Two critical determinants of successful C-V partnerships are client's outsourcing objective and its fit with vendor's capabilities.^{1,3} The motivation for clients in stage 1 of the PMC is short-term cost savings. Clients, at this stage, are termed *outsourcing experimenters* as they lack a long-term vision for IT-outsourcing, and are trying it on a tentative basis. Vendor-selection is guided by primitive issues of cost and convenience, thus increasing the possibility of poor C-V fit, which combined with the lack of client's long-term commitment towards outsourcing, results in poor potential for developing a mature C-V partnership.

Clients in stage 2 are termed *outsourcing-driven*, as their IT-outsourcing goals are strategic. Such clients typically outsource their non-core IT functions to focus on their core IT capabilities. They choose their vendors carefully based on the vendor's ability to attain their long-term outsourcing goals. Thus, compared to *outsourcing experimenters*, outsourcing-driven clients typically have a better fit with their vendors and a higher commitment to maintaining long-term partnerships with them.

Clients that derive competitive advantage from stage 2 are likely to mature to stage 3.¹ They gradually develop a mix of relational and strategic focus towards outsourcing.¹⁰ Eager to improve their strategic gains from the previous stage, the clients (referred to as *outsourcing*

centric) intend to make significant investments in their partnership with vendors – even to the extent of sharing knowledge and other resources with vendors to jointly solve each other's problems. Thus, outsourcing-centric clients intend to forge mature C-V partnerships. Relational synergies emerging from such partnerships can develop new capabilities for both clients and vendors, especially helping the clients achieve their long-term strategic IT goals.

It Takes Two to Tango

For clients in stage 3 of PMC, or those trying to move to stage 3, it is imperative to make relational investments in their partnership with vendors.⁹ We identify specific areas in which clients' relational investments will strengthen C-V partnerships. Vendors' perspective was sought to identify those areas, and interview-based inputs were obtained from nine established vendors in India. All firms were capability maturity model (CMM) Level 5 certified, were members of the National Association of Software and Services Companies (NASSCOM), and provided an extensive portfolio of IT services to Fortune 1000 clients. Majority of their clients met the criteria of a typical outsourcing-driven client with strategic IT-outsourcing goals (see the sidebar "How the Study was conducted").

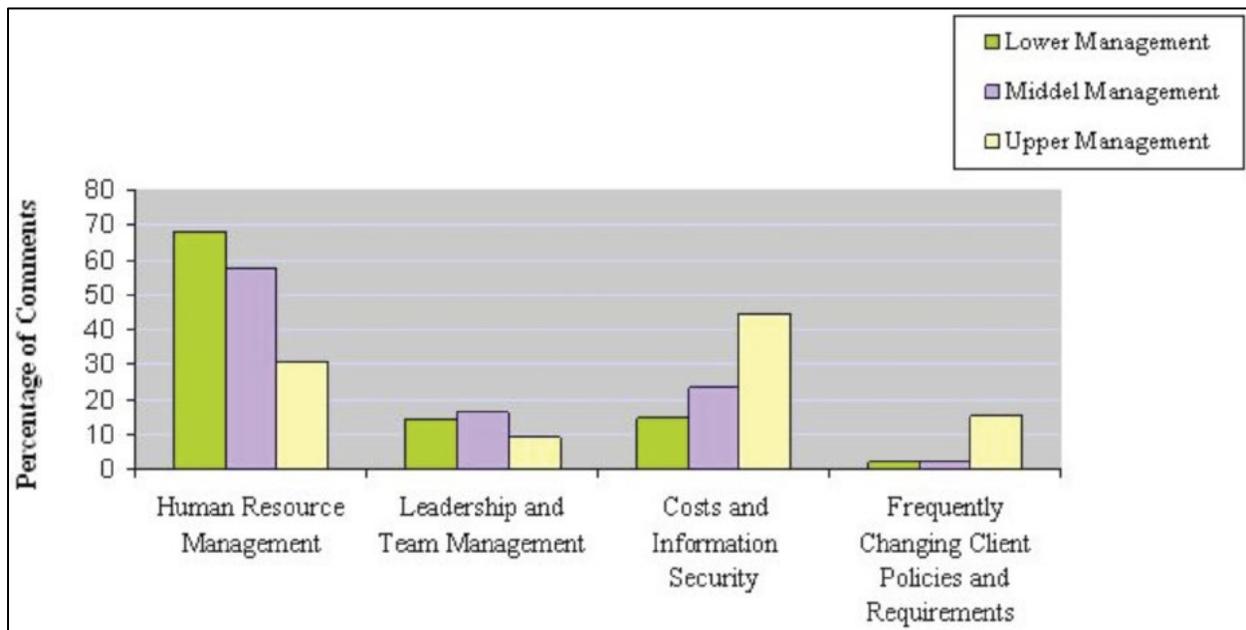


Figure 2. Key vendor challenges

Relational Investment Guidelines. The results of this study show that even established vendors face challenges pertaining to four areas: human resource management; leadership and team management; frequently changing client policies and requirements; and costs and information security. Figure 2 presents the percentage of inputs pertaining to each issue. Two of these issues (HRM, leadership and team management) were internal to the vendor. The quality of outsourcing service received by the clients being dependent on vendors' utilization of their human resources,⁴ these two issues have implications for clients if not resolved. Interestingly, the other two issues (costs and information security, changing policies and requirements) actually arise from client's actions and requirements, thereby suggesting that the onerous nature of client's own

demands may hurt the longevity of C-V partnerships. For example, client's stringent demands for information security may compel vendor to modify its operations, which in addition to constantly changing client's requirements may hurt its economies of scale and increase client-vendor transactional costs.⁴

Thus, we suggest that in the interest of their partnership with vendors, clients in stage 3, or those trying to move to stage 3, make relational investments in the four areas identified above. Table 1 summarizes the possible nature of such investments, and how they will help clients, vendors, and their partnership. In the absence of prior support for these specific investments and their potential benefits, we follow the precedent set by previous speculative articles⁶ and consider our suggestions as provisional in nature. Others have recognized the importance of client's relational investments, and have suggested that greatest outsourcing benefits accrue to the clients that actively participate in developing an interactive relationship with the vendors.^{4,10}

Table 1. Suggestions for client's investments and their benefits

Critical Areas	Client's Investment	Client and Vendor Takeaways
Human Resource Management	<ul style="list-style-type: none"> • Help vendors develop world-class HR policies, practices, and procedures • Provide training and development support • Provide HR consultancy in return for other benefits 	<ul style="list-style-type: none"> • Improved retention, job-satisfaction, and commitment among vendors' employees • Improved service quality to the client • Mutual benefits from resource sharing
Leadership and Team Management	<ul style="list-style-type: none"> • Help vendors identify and groom potential leaders • Provide support for leadership, team-management, and skills training 	<ul style="list-style-type: none"> • Better project outcomes for the client • Improved vendor productivity
Costs and Information Security	<ul style="list-style-type: none"> • Help vendors implement security protocols and privacy standards • Sharing implementation costs for protocols and standards • Help vendors change their cost-focus 	<ul style="list-style-type: none"> • Better vendor sensitivity towards information security and privacy issues • Reduced operational costs for vendors • Vendors develop capabilities to fulfill clients' future IT needs
Frequently Changing Project Requirements	Set up a pre-project partnership with vendors to: <ul style="list-style-type: none"> • Assess their potential • Build trust and develop mutual understanding of project requirements 	<ul style="list-style-type: none"> • Substantial cost-savings for client if they decide against a formal contract • Otherwise: <ul style="list-style-type: none"> ◦ Improved ability to anticipate and avert future problems with the vendor ◦ Improved C-V trust and mutual understanding of key issues ◦ Improved C-V communication and coordination

Table 2. Distribution of Comments

Key Areas	Upper-Level Executives	Middle-Level Executives	Lower-Level Executives
Human Resource Management	31	90	78
Leadership and Team Management	10	27	17
Cost and Information Security	45	38	17
Frequently Changing Client Requirements	15	2	3
Total	101	157	115

Human Resource Management. Respondents across all levels identified human resource management (HRM) as a key challenge. Lower-level managers complained about the job-related

stress, lack of training and development, and ambiguous promotion policies. Middle-level managers blamed inappropriate selection practices and stagnant growth as key reasons for stress in employees. As one project manager commented: "There is less scope for career growth as the promotion policies are unclear." Upper-level managers cited high employee turnover as their challenge. One manager lamented: "High turnover is a real problem within the industry. Our own annual turnover is around 12%."

Vendor's HR-related issues are a key source of risk for client's IT projects.¹¹ To mitigate this risk, clients aspiring to be outsourcing-centric can help their vendors develop robust HRM policies and practices, such as better recruitment policies. IT-outsourcing industry has typical job requirements including – IT self-efficacy, aptitude to work in teams, ability to manage complexity and uncertainty, and a capacity to deliver results under strict time schedules. Lack of focus on these selection parameters reduces employee-job fit within the vendor firms - an effect that showed up in our study. While, some lower-level and middle-level managers found it exciting to work on cutting-edge technologies, others found it challenging to stay abreast with new knowledge in the field.

Clients motivated to make relational investments can help vendors improve their employee-job fit by integrating appropriate selection tools in vendors' recruitment process. Clients can also help vendors with their high turnover problem by helping them develop effective employee retention policies, such as clear promotion guidelines and as future growth opportunities. Clients can also invest in vendors' training and development programs. Escalating operational costs are shrinking vendors' training budget, and training is typically provided only when it becomes a necessity, such as when a new project requires knowledge of a new technology. Clients can share vendors' costs and other resources required for providing new skill-development training to vendors' employees.

Leadership and Team Management. Issues pertaining to leadership and team management were most prominent among middle managers. In the absence of appropriate training to lead and manage teams, they adopted improper approaches to motivate their team members, as one project manager pointed out: "My biggest problem is to induce team members to do their best. For some people, the only thing that works is to tell them that it's going to harm their appraisal." Upper-level managers echoed similar sentiments, as one respondent mentioned: "Motivating the work force is the biggest challenge. People quickly get used to the facilities and money part of the job, to keep them moving beyond that is important."

Clients wishing to invest in the C-V partnership can provide leadership and team management training to vendors' middle-level employees. Another option is to sponsor seminars, conferences, and management courses for vendors' employees directly related to their projects. Such need-based training and development activities will significantly improve motivation and performance of vendors' employees, thereby serving clients' interests. To tackle the leadership problem among vendors' upper-level managers, clients can even help vendors identify and develop transformational leaders from among the middle and upper cadres of their management.

Costs and Information Security. C-V partnerships exist because of the cost differential between two parties, and rising vendor costs can impact the very foundation of this partnership.

Upper-level managers in our study lamented escalating operational costs. Middle managers complained about budget cuts constraining resource allocations to project teams. Echoing a similar sentiment, lower-level employees complained about the lack of critical resources for successfully executing their tasks.

Clients' strict information security standards contributed to cost escalation, among other things. Vendors complained of excessive resource redundancy required to maintain clients' security standards, as one vice-president explained: "We have to house project teams in separate buildings, which are firewalled from the rest of our campus. Even inside those buildings we have to install multiple levels of network security."

Clients aspiring to be outsourcing-centric can ease vendors' cost burden by sharing the cost of implementing security standards. This can be especially helpful to small vendors with limited resources. In the long run, such an arrangement might prove cost-effective to clients, compared to changing vendors over security infringement issues. Clients can also train vendor's employees on implementing and maintaining their information security standards, thereby improving the implementation of these standards.

Clients can also help vendors change their business focus. Many vendors are predominantly cost oriented and their organizational structures, procedures, and processes are imbued with that focus. Truly outsourcing-centric clients can help vendors develop a strategic focus. Clients can consult vendors about growing strategically, and about aligning their organizational processes with their growth strategy. This would help vendors develop new capabilities to achieve clients' future IT-outsourcing goals.

Frequently Changing Client Policies and Requirements. Change is seldom managed effectively between clients and vendors.¹² In our study, constantly changing client policies were considered especially challenging by upper-level vendor managers. A senior manager emphasized: "Our operations are influenced by the client's policies, especially if that client accounts for a major chunk of our revenues."

At middle- and lower-levels, employees were perturbed by the frequent increments in project requirements. A project manager commented: "Requirements creep is a major problem. The client wants us to work on this new platform, and I don't have experts on that platform."

To resolve this issue, clients in stages 2 and 3 of PMC, can form *pre-project partnerships* with vendors to mutually understand project requirements before entering into a formal contract.¹² Given the cost focus of *outsourcing experimenters*, they may not want to invest the time and resources required for a pre-project partnership.

During pre-project partnering, both parties can agree upon a formal project charter that formalities project requirements, as well as procedures and provisions for future changes in those requirements.^{5,11} *Outsourcing centric* clients can also utilize this partnership to appraise vendor's potential as a long-term strategic partner. Thus, pre-project partnering can establish the groundwork for a long-lasting C-V partnership,⁶ as senior project manager remarked: "If we can

develop client-vendor relations so that client's outsourcing decisions are taken jointly at strategic levels for both parties, we may see a new kind of business model developing."

Conclusion

Practitioners can utilize the PMC to better understand client dynamics governing C-V partnerships. Given the strategic nature of their IT-outsourcing goals, it is important for outsourcing-driven and outsourcing-centric clients to make relational investments in their partnerships with vendors. This involves collaborating with vendors across various areas and at multiple levels. Relational synergies emerging from such collaborations will help clients achieve their strategic IT goals.

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