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THE CLIENT-PROVIDER RELATIONSHIP

A Secret to Innovation and Growth

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ISG WHITE PAPER

INTRODUCTION

Enterprises today need real value and innovation from their service providers. To create a contractual relationship that undeniably adds value, sourcing buyers must take a hard look at the performance of both parties. It's easy to point fingers across the divide and find fault with the way the provider delivers contracted services or fails to meet service levels and project milestones. But the more productive move for enterprise sourcing buyers is to look at their own behavior and accept responsibility as an active partner in a living, breathing relationship. This begins by carefully asking even the most basic of questions: how well does the organization understand the nature of the services it's contracting and how a contract relationship works? We have found this fundamental element of outsourcing – understanding the nature of the services being outsourced – is often missing or insufficient.

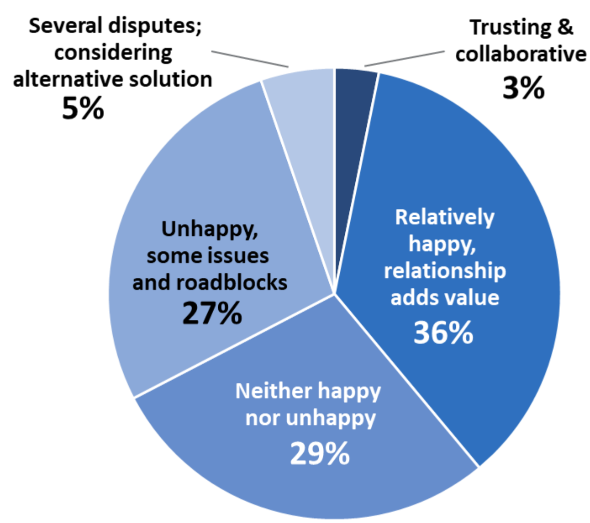
Healthy relationships depend on consistent introspection between and within both the client and provider organizations. The failure to evaluate a sourcing relationship from the perspectives of both parties limits the potential of that relationship, whether it is a traditional sourced services relationship or a more complicated digital sourcing relationship.

ISG research shows that improving an enterprise client's engagement in its sourced services relationships is the only sure way to produce the innovation it is looking for. Focusing on the relationship also functions as a risk-management activity; it improves outcomes, matches expectations with service delivery, and reduces the long-term costs of changing providers, which is an expensive and time-consuming activity that disrupts continuity and introduces transition risk to the enterprise. **ISG calls this improved relationship condition Coactive Governance.**

Unhappiness Abounds in Outsourcing

Let's look at the state of sourcing relationships today. The ISG Outsourcing Happiness Study conducted in August 2019 looks at the global ISG governance consulting team's perception of nearly 600 relationships over the last three years. Findings show that neither clients nor providers focus enough on their relationships with each other.

Figure 1 shows that, while less than 40 percent of relationships in the study are relatively happy, nearly 60 percent are mediocre or unhappy. In our experience, when the relationship is not definitively happy, it is at risk in several areas, including service quality, cost, business stakeholder perception and non-renewal or restructuring.



Source: ISG Research August 2019 N = 95 respondents, January 2018 N = 59 respondents

Figure 1: How would you characterize the majority of the provider/client relationships you see in your practice experience?

We then asked ISG consultants which party was responsible for the relationship's happiness or lack thereof. What we find is that the responsibility for the state of the relationship is generally split evenly between clients and providers. Figure 2 shows that, when the relationship is healthy, it is because both parties are working together effectively most of the time. When a relationship is considered to be just mediocre, responsibility is split evenly between the parties, and when a relationship is considered an unhappy one, it is slightly more likely to be perceived as the responsibility of the service provider – but only slightly more in the combined scores than the client.

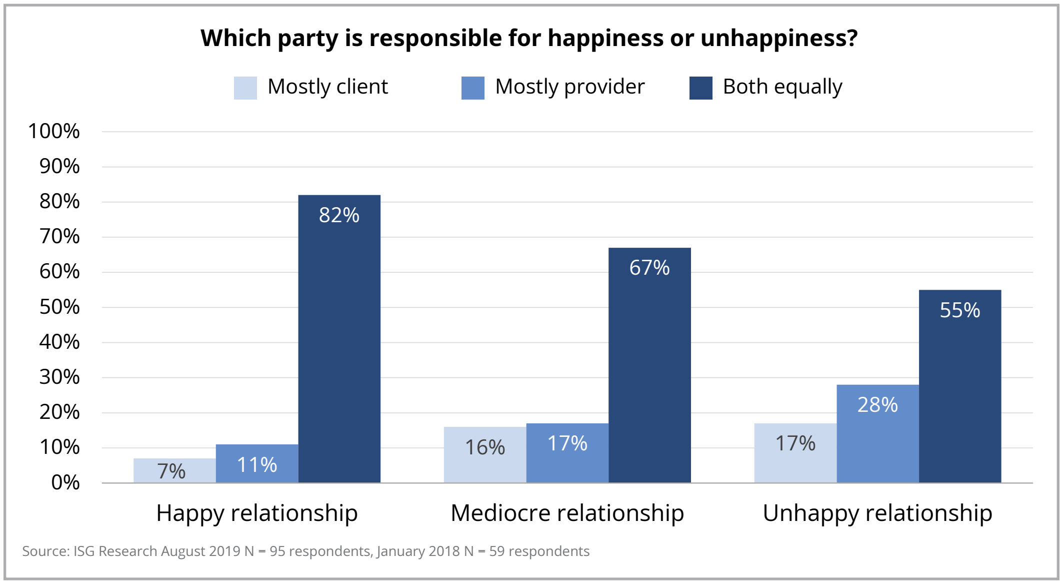


Figure 2: Survey Question

Interestingly, as happiness decreases in a relationship, the perceived responsibility of each of the individual parties increases (see both lighter blue bars on this chart), with unhappiness being more often attributed to one side or the other. This tendency to pin responsibility on the other side is something both clients and providers need to consider as they work to grow their relationship engagement and understanding.

When we asked which factors cause healthy relationships, our consultants identified the following as the top five major contributors, in order of importance:

1. Appropriate levels of trust between the parties
2. Client staff understanding of the way a sourcing relationship should work
3. Effective governance
4. Provider staff understanding of the way a relationship should work
5. Sense of common goals and achievements between the parties

Among contributing factors to healthy relationships, the "appropriate engagement of business stakeholders" rose from 15th place in 2018 to 10th place in 2019. For the first time, we have evidence to suggest a change in the perception about IT's outsized role in influencing happy relationships. We know that business involvement matters and is key to the perception of healthy relationships.

When we asked what caused relationships to become less happy, the list was interestingly similar with the following top five causes in order:

1. Ineffective governance
2. Lack of trust between the parties
3. Lack of a sense of common goals and achievements between the parties
4. Insufficient understanding by client staff about the way a relationship should work
5. Insufficient understanding by client staff of the contract

Trust, strong governance and common goals are the predominant themes in happy relationships. When relationships go bad, our consultants observe that insufficient understanding by client staff about the contract and how a sourcing relationship should work are key contributing factors.

Enterprises are not Ready for Sourcing

The ISG Sourcing Readiness Study is part of the ISG FutureSource™ transaction methodology and measures a client's readiness for a sourcing relationship by asking them to rate their own capability and identify how important the capabilities are. When we ask companies that are entering a sourcing transaction how ready they are for managing their service provider, many acknowledge that they are decidedly not ready. Figure 3 below can be understood by reading the top-range descriptions to understand the readiness score and the lower-range descriptions for the importance score. The overall aggregated rating clients give themselves is surprisingly low with the black circle representing how ready an enterprise perceives itself to be and the green circle representing how important the enterprise perceives readiness to be.

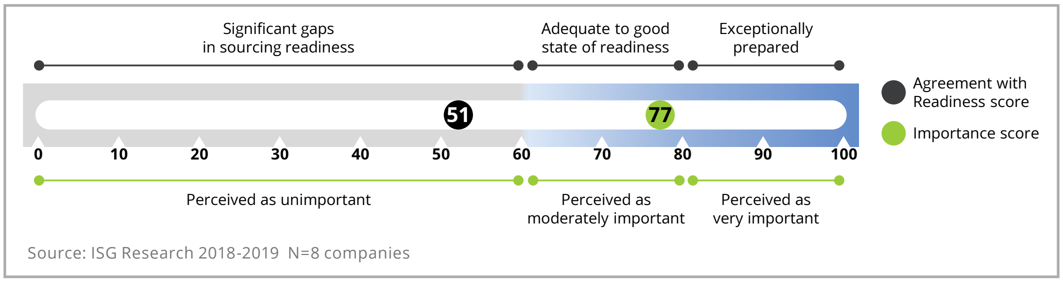


Figure 3: Aggregated Sourcing Readiness Scores

The data includes first-generation sourcing clients and second or third generation sourcing clients, with sourcing for all types of services – not specifically one tower area. The fact that enterprises collectively rate themselves below adequate in readiness, while understanding it is important to be able to do all the tasks and processes related to sourcing capability points to a significant disconnect. Figure 4 shows that, while client stakeholders from executives to working teams believe they have strategic alignment, all the other categories of readiness fall significantly short though they are considered important – organizational change, sourcing management readiness, risk readiness, knowledge management readiness and operational readiness are in the danger zone, according to the aggregate responses of stakeholders ranging from the CIO to VMO.

Coactive Governance, in which the client and provider act as a team and work together toward common goals and innovative solutions, requires team members that are aware and ready to manage and work with their providers. In this context, these findings are worrisome. Enterprises in the process of executing a transaction admit to themselves that they are unprepared (regardless of whether they are first- or third-generation sourcing enterprises) and that they know how important it is. Yet, we observe these capabilities consistently being put in second place. As enterprises negotiate contracts worth tens of millions of dollars, the focus tends to be on the sourcing process and the current moment – not on the long-term effects of the new services relationship. This leads to serious relationship and execution problems down the line.

Figure 4: Aggregated Sourcing Readiness Scores by Category

A deeper dive into this data reveals that clients deem themselves ill-prepared because they have not identified adequate resources, trained their teams or defined their working processes with their providers. Respondents from the CIO to the VMO agree: these things are important, but they are not ready to achieve them.

Sourcing Buyers Must Understand Sourcing Contracts

In 2018, we began to see a trend that showed clients with expectations far beyond those that were in the contract. In some cases, business stakeholders wanted to implement programs to test and validate the capabilities of provider team members with whom they interacted – in situations where we knew the service levels for the capabilities of those provider team members to be green. While it may seem obvious that they needed to stop and evaluate their contract, adjust service levels or look at their own management culture and that of the provider, the instant response from the client team was to blame the provider (who was delivering to the contract) and "take over" to show that the provider didn't know what it was doing.

Unfortunately, this is a typical phenomenon when relationships go bad. As we see in the ISG Happiness Study, sometimes decreasing happiness is the fault of the provider, but just as often these problems are the fault of the client who does not understand the nature of the way the services they are sourcing will be delivered. This is particularly evident when business stakeholders interact directly with providers but do not understand what the provider is contracted to deliver. These management constructs, in which a third party does mission-critical work, are not what employees in an enterprise are accustomed to accepting. Failing to address this results in mayhem in the services relationship – and ensures that trust and innovation are the last things on either party's mind.

As part of this study, we asked questions of both the client and the provider. In the typical case shown in Figure 5, we see all the service levels being met. The client stakeholder responses come from a group of more than 150 individuals in both the IT team and business (represented in the figure with solid purple markers.) The provider stakeholder responses come from the relationship management and delivery teams (represented by the striped markers). All responses are anonymous. Responses where the markers fall in the upper left white area denote "important but not done well" and responses falling into the gray area reflect respondents whose values are in conflict with the productive management of services – they don't think they perform the function well, and they don't see why it is important.

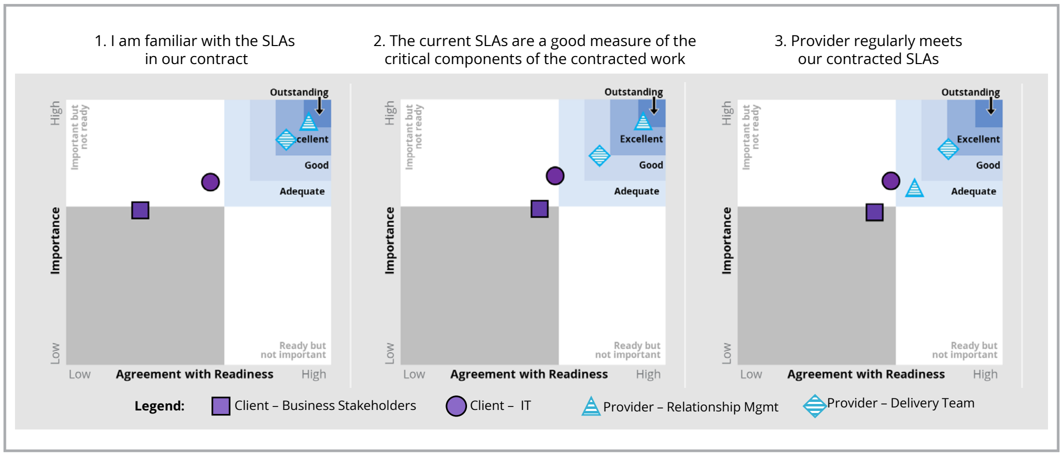


Figure 5: A selection of responses by client and provider stakeholders

What we find are substantial disconnects in nearly every area. The example in Figure 5 is notable as it speaks directly to the perception and awareness of the fundamental delivery structure for a contract. In response to the first statement, "I am familiar with the SLAs in our contract," neither of the client stakeholder groups say they know the service levels, and they also don't think they are particularly important. Not surprisingly, the provider is sharply aware of both the service levels and their importance. In response to the second statement "the current SLAs are a good measure of the critical components of the contracted work," the client business stakeholders say they do not agree and are uncertain about the value of them. The client IT team feel the SLAs are not a good measure but important. Of course, the provider team thinks they are a good measure and very important.

In response to the third statement, "the provider regularly meets our SLAs," the client disagrees, and, while there is some division on the provider side, they still believe the SLAs are adequate to good.

What does this show? The client has no idea how the contract should run, but is still unhappy, and clearly has no idea what to do to change things. The provider soldiers on, likely assuming that no one will ever be happy. Needless to say, this is not a conducive situation for innovation or for getting closer to Coactive Governance.

Two Thirds of Contracts are Competitively Rebid When they End

In late 2019, ISG evaluated more than 150 global engagements and compared this data to the last study in 2016. We found little change.

Surprisingly, the ISG Happiness Study identifies that 60 percent of the engagements of which we are aware are at risk. We also know that a contract renewal goes to competitive bid 66 percent of the time. This is not good news for the client or the provider. Most clients and providers assume that when a contract is signed, the relationship will continue for some time – this assumption means risk, cost and churn are expected to decrease.

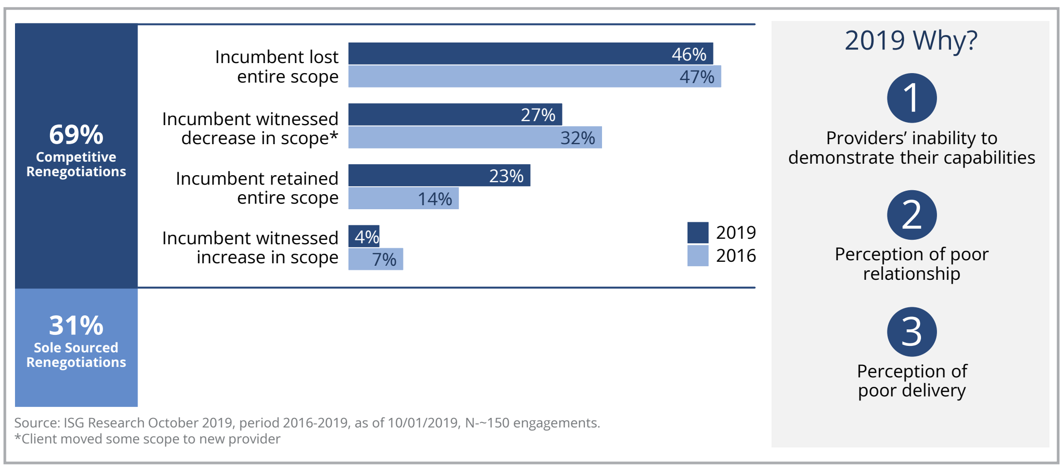


Figure 6: Incumbency research showing frequency of competitive bids at the end of a contract

Most often, the relationship fails to survive the first contract. When an enterprise competitively rebids a contract, the provider loses some or all of the scope three quarters of the time. As is illustrated in Figure 6, clients claim three primary reasons: the provider didn't demonstrate new capability, the quality of the relationship is poor, and the quality of the delivery is poor.

The financial implications of these perceptions and renegotiation realities is unexpectedly complicated – especially for the provider. Our data, as seen in Figure 7, show that the larger the deal, the more likely it is to recompete. The great complexity of services in a multi-tower contract seems to undermine the client and provider's ability to navigate the governance requirements that would allow both to find happiness with the services. Complexity of services also hinders the parties' ability to trust each other in a way that allows for greater results, such as continuous improvement and innovation.

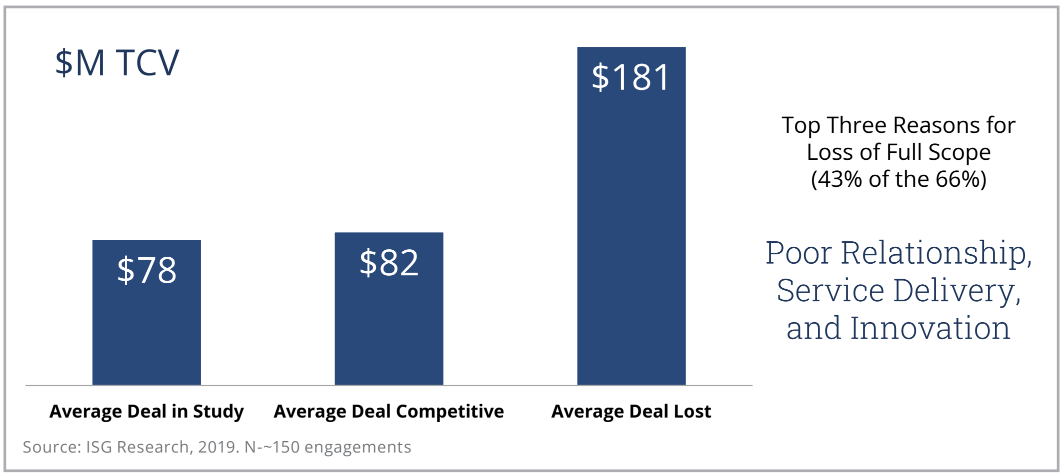


Figure 7: Competitive losses are more than twice the value of average competed deal

In the sourced services world, service providers seldom fire their enterprise clients. But clients fire their providers regularly – and as we have seen in this paper – it is often because clients are not able to look at their own role as a factor in their dissatisfaction. When clients do not understand the sourcing contract or how to change it, they often blame the provider for not meeting their desired (but not contracted) objectives and then move on. More often than not, enterprises that experience this tend to repeat the same process in the next relationship.

The Costs of this Disconnect are High

The ongoing disruption of rebidding and renegotiating outsourcing contracts exacts a huge toll on the industry. ISG knows that responding to a single tender is a significant undertaking for a provider, typically costing between $500 thousand to $1.25 million – and competitive tenders can involve from two to five providers. If a client retains ISG or another advisor, its costs for the tender and advisory services could be as high as $500 thousand. Outside legal services add cost to a client and is more likely if the relationship is unhappy. No client executive wants to duplicate the same unhappiness in the next relationship and will assume that a better, stronger contract will prevent it from happening. Conservatively, the cumulative cost of this scenario of competitive rebidding ranges from $1.5 million dollars to more than $6 million dollars for the participants – money that could be saved if a recompete were not required.

Add to that the cost of transitioning to a new provider, which is often significantly underestimated both in dollars and in time. The technical transition takes time, adds risk and often brings a raft of problems and frustrations to the business. Then there is the "lather, rinse, repeat" effect that plagues so many enterprise clients that fail to adjust their own behavior when entering a new sourcing relationship. The likelihood is that the same thing will happen again. And the same applies to providers – it seems that both parties keep repeating the same mistakes over and over.

Providers are not without fault. As noted in the ISG Happiness Study, providers contribute to relationship success and failure just as much as clients do. When a relationship fails, providers need to ask themselves what more they could have done through the governance process to anticipate client unhappiness with aspects of the contracted services and address it, to document their offers of correct service delivery and innovative ideas, and to prepare for the contract end with appropriate governance and sales engagement much earlier in the process. This can sometimes be a result of the "island effect" in which provider teams are marooned at a client site and become detached from the provider headquarters' brain trust. The provider executive needs to be closely attached to the progress of the relationship and build an open channel for team members on the ground to provide truthful reports about the state of the relationship and services. As we can see, green service levels don't always tell the full story.

Likewise, the client leadership team is responsible to lead the team to a place of trust and engagement. This is not simple – the basics of vendor and contract management must be in place to address the noise of service dissatisfaction and build correct expectations in organizational change management programs and educational programs to the provider management team, VMO and business stakeholders. The goal is to get the client and provider into one boat and to row together toward a state of trust and innovation.

Happiness is a prerequisite to the development of trust, creativity and innovation, but so often, nobody is happy. When clients do not understand how to operate a successful sourcing relationship, and the provider fails to perform the needed relationship functions to break through that, both parties end up spending more money at the end of the contract term to recompete. When an enterprise client has not solved the internal challenges it faces in managing the provider, it will inevitably repeat the experience. This is an untenable situation for sourcing in the digital ecosystem, where collaboration and communication are essential to getting what digital sourcing can deliver: competitive advantage, cost savings and greater opportunity for growth and differentiation.

Both clients and providers need to think differently. When a client needs help, the provider needs to be prepared to help them – the renewal depends on it. When a provider is engaged to solve problems or reduce service frustrations, the client should work proactively to build trust and engagement.

Successful sourcing relationships are happy ones. Innovation and collaboration do not thrive in an environment of unhappiness. These are not new problems – they have existed since the beginning of outsourcing in the 1990s. The remedy lies with both parties, whose best interests are to work toward a state of Coactive Governance, in which both clients and providers can thrive in a competitive market, achieve greater innovation and generate growth.

Further Reading: **Coactive Governance Paper**

ABOUT THE AUTHOR

The Client-Provider Relationship: A Secret to Innovation and Growth

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Cynthia Batty is the ISG's Chief Knowledge Officer. In this role she is the ISG service methodology architect and global integrator of the company's products and services, and is the leader for developing, growing and leveraging ISG's accumulated intellectual property resources. Prior to this role, Cynthia was a lead in ISG's Governance and Transformation practices, and maintains a continuing role in the Organizational Change Management practice. She brings 25 years of practical experience to advise clients on their sourcing governance and service management design, as well as organizational change management and maturity development. She is a recognized expert in sourcing governance, vendor and contract management. She has helped more than 50 governance organizations with business management and service management processes in both single-provider and multi-provider environments.

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