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The Confidence Game

To reap outsourcing's greatest rewards, both client and vendor must trust each other

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AT THEIR BEST, outsourcing relationships can go beyond just reducing costs to create real value. But achieving both requires careful management. Effective outsourcing demands that client and vendor tightly coordinate activities and share information to ensure that unanticipated future needs can be met. For that to happen, the two parties must trust each other, even when the stakes are high and information is incomplete.

For a discussion of the risks of outsourcing, see ["The Build/Buy Battle,"](#) Dec. 1, 2000. Here, we focus on the rewards that can be obtained through trust and a sense of shared history.

Renegotiate or Die

The ideal outsourcing contract is long-term, unambiguous and binding on both parties. Yet it must also address strategic uncertainty, permitting ongoing adaptation over time. And herein lies the central dilemma of outsourcing IT: Those sets of characteristics tend to be mutually exclusive. So if the contract has the first three attributes, it is going to require renegotiation at some time. Unless this is fully understood at the outset and managed well, the result will often be failed renegotiations, leading in turn to a failure of the contract—sometimes at catastrophic cost to both client and vendor.

Renegotiating is rarely easy, thanks largely to four factors.

- The negotiations are usually "forced" in that they don't occur until they *must* occur—when one or both of the parties have come to find the

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existing situation unacceptable. They may feel not just vulnerable but exploited; one party may feel it is receiving too little service and paying too much, while the other may feel that it is working harder than agreed for too little compensation.

- Negotiations take place in an adversarial environment. One party's loss (overpaying or receiving poorly tested products) may be the other party's gain (overbilling or skimping on product testing).
- Renegotiations take place under conditions of uncertainty about actions and objectives. How hard is the vendor really working? What does the client really need?
- Interpretation is ambiguous: Each party will view specific, individual actions differently, according to its particular risks and fears. This will color interpretations of future events and interfere with future negotiations in subtle ways that may have catastrophic effects on the renegotiation.

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Differing Perceptions of History

The more perceptions of events diverge, the more each side will view the other's behavior as abusive. In such situations, most of us have no tolerance for uncertainty. We unconsciously act to eliminate it in a way that is consistent with our expectations and, too often, our fears. We find a pattern that seems to explain most of what happened, give the event a name (for example, "the Great Betrayal of the Y2K agreement"), stick our recollection of the event in its pigeonhole (vendor betrayal) and respond accordingly. No event ever fits perfectly within a pigeonhole, but once we have made our classification, we tend to ignore evidence that's inconsistent.

Clinging to an inaccurate pigeonhole causes us to misinterpret future events and thus to act inappropriately. Often we can no longer even perceive disconfirming evidence as new events unfold, and we cannot take appropriate actions

to restore trust or the stability of the relationship. As this happens on both sides, the two parties can no longer speak to each other about events as they occur. In essence, they are no longer experiencing the same events—they do not remember the same details as significant, and they can barely understand each other when they try to discuss recent history. Neither side can interpret—let alone tolerate—the actions of the other.

In this way, relationships can spiral out of control rapidly. But it is important to note that both parties usually believe that they are acting in good faith and in an acceptable manner. After all, it's the other guys who are being abusive—we're just trying to protect our interests!


How to Get a Good Grip on Bad History

In situations like these, renegotiations are hard to perform successfully. There are, however, techniques that can improve the chances of success. We have counseled many organizations facing situations like this in outsourcing contracts worth about \$25 billion in aggregate. To help them move beyond the miscommunication and mistrust, we walk them through the following steps. Note that a similar role can be performed by internal facilitators or executives who stand far enough "above the fray" to be able to remain objective.

- Elicit from the members of each party, privately, their view of the relationship's history and what they believe to be true. Affirm to each the reasonableness of their conclusions, given how they see it. ("Based on these facts, you're correct.")
- Privately walk each party through how history looks to the other side. Illustrate how each side is behaving reasonably, given what they believe they saw. ("Now you can understand why, based on their 'facts,' they feel so aggrieved.")

- Get each side to agree privately that whether or not the other party is properly informed or properly interpreting events, their actions can be explained without malicious intent, based on their interpretation. This significantly reduces animosity and improves future communications.
- Once the level of animosity is reduced, get parties together to share their perceptions of what value-creating opportunities exist, and how the value might be captured.
- Create among key individuals communication protocols that will enable each party to spot divergent perceptions in the future—before they do lasting damage.

The desired result is not agreement on which view of history is correct, because that is generally both unknowable and irrelevant to future success. Rather, the objectives are to get each side to understand how the other views the current situation and to recalibrate the contract toward mutual value creation.

A good working relationship requires constant evaluation and readjustment if it is going to produce economic rewards. Those rewards will be much larger if both sides focus on cooperating to create value over time rather than on fighting for a greater share of whatever limited value is created through conflict. By developing trust and managing long-term relationships, both parties can enjoy outsourcing's fullest rewards. 

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