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Business Process Outsourcing

A better way to resolve business conflicts

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Having a realistic perspective that life is not perfect is a good thing—whether you're a service provider or a client. The ability to settle the smaller issues promptly and productively lays the groundwork for dealing with more serious, potentially deal-breaking problems that may arise down the road.

Most companies today have business relationships with multiple partners and collaborators. The number of strategic alliances across most industries, for example, has grown steadily over the past decade.

And a recent study has shown that 60 percent of companies worldwide now deploy outsourcing as a standard practice; an additional 19 percent say outsourcing is definitely in their future.

As executives adjust to the fact that relationship building is a significant part of their job description, they are running into the challenge that all relationships, human or corporate, encounter at some point: stuff happens—obligations can be misinterpreted; people don't always get along; expectations can conflict.

Then what?

In some cases, organizations involved in long-term business relationships such as outsourcing have learned how to resolve conflicts effectively—overcoming immediate challenges and ultimately strengthening the overall relationship. In other cases, however, problems have spiraled out of control, resulting in lawsuits and damages in the hundreds of millions of dollars.

Accenture research points to significant differences in how clients and providers in outsourcing relationships approach conflict resolution. On the one hand, there are what we call "aggressive" approaches, which focus on maximizing the short-term commercial interests of one side of the relationship. On the other hand, "balanced" and "collaborative" approaches—approaches to resolution that are no less conscious of the significant business implications and costs involved—are able to forge a path that keeps the relationship viable and helps it thrive in the long term.

Issues and conflicts

First, some perspective. It would be highly inaccurate to portray outsourcing or other types of long-term business relationships as somehow inherently vexed or inevitably problematic. Indeed, most of the providers and customers we spoke to in our research told us that they seldom if ever had significant conflicts.

That's because not every little misstep is a deal killer. One important distinction to make is between "issues" and "conflicts." Every business relationship is going to encounter minor issues: a service lapse, a project delay, a difficult interpersonal relationship, even something as mundane as a team member speaking disrespectfully or wearing too much perfume. Those are irritations, not conflicts.

When looking at a long-term relationship, both sides need to begin by acknowledging that such irritations are not a reason for escalation to a governance resolution committee. Understanding that life is not perfect is a good thing—whether you're a leader of a service provider or a client. Being able to resolve those smaller issues productively and in a timely manner lays the groundwork for dealing with the more serious problems that may arise down the road—problems that may be a source of true conflict.

Sources of conflict

Based on our research and conversations with executives, more serious conflicts generally arise for one or more of the following reasons.

Contract wounds

A lengthy contracting phase—say, more than a year—can end up being

contentious and even exhausting to those involved, leaving wounds on both sides that then affect the attitudes of those who have to pick up the pieces and actually deliver the new outsourced service. Protracted, unpleasant negotiations can, as one executive puts it, leave "the sort of smell that never goes away."

Unrealistic expectations

Previous research into outsourcing, focused on IT services, pointed to a situation dubbed the "winner's curse" in the bidding and selection process. That is, a provider may "win" a contract after a difficult bidding war or auction. But then that provider—now forced to deliver services at little margin or even at a loss—may be severely challenged to maintain sufficient levels of delivery quality to build a long-term relationship with the client. Providers also sometimes feel pushed by clients to render out-of-scope services for free, pressured by the argument that "this should be part of the provider's added value."

With one IT outsourcing relationship we studied, the client's extensive experience procuring products and services led it to adopt a purely contract-controlled, power-wielding approach. This ultimately failed and led to the breakdown of relations. The provider needed more guidance in understanding the client's operations, and the parties should have worked together to clarify the client's requirements and idiosyncrasies. Because this did not happen, significant conflict arose between the account managers. Service levels were low, and the provider lost money.

For clients, pricing issues—for example, sticker shock over a large invoice—were a more common source of conflict. Clients have reported being invoiced for services they considered in-scope or for calculations about improved performance (which would then trigger gainsharing payments) they considered inflated.

Insufficient information

The situation in the aforementioned IT outsourcing example was exacerbated because the client was replacing an existing provider. The incumbent knew precisely what the service provisions would entail, as did the client, but the new provider had to make its bid using only partial information from the client and competitor. As a result, the winning low bid was based on incomplete, incorrect and outdated information, which then had ramifications for the level of service the new provider could deliver.

Even in cases that do not involve unseating an incumbent, a provider can suffer from insufficient transparency into the client's overall IT situation. Providers sometimes must bid on the basis of incomplete information because the IT or business process environment is highly integrated in a way that spans multiple functions, departments and geographies, making it difficult to objectively evaluate the actual service costs and technical requirements of parts of that environment. Pricing based on unfounded assumptions about expected service volumes can result in low margins or losses for the provider, prompting a conflict.

Problems with inherited processes

Conflicts can also arise in business process outsourcing arrangements because the BPO provider is held to service-level agreements for an entire process—say, procure-to-pay in a finance outsourcing deal—but may not actually have control over everything. Parts of the process may be run by the client, others by a third party. Indeed, though it is hardly a best practice, the provider may be operating a process that was actually inherited from the client, whether

or not it was the optimal way to do things.

One executive from a finance BPO provider recalls the fateful moment when he received an escalation call from the client's COO. Problems in accounts payable had resulted in suppliers not getting paid, with penalties and lost discounts happening left and right. "We immediately doubled the workforce on point to address the situation," recalls the executive, "and got the situation under control. Yet our analysis showed that one in three invoices had problems on submission that caused them to be rejected for processing."

Benchmarking

Conflicts can also emerge when either side of the outsourcing relationship misuses external benchmarking results. Clients may contend that, based on the benchmark, prices are inflated. The provider may dispute the benchmark, claiming the comparison is unfair. For example, in one case, a client claimed that based on a current benchmark, its provider's price per function-point (a measure of a unit of software) was high. The provider argued that the benchmark might be appropriate for an environment based on newer technologies, but that it had to maintain the client's old information systems. The provider could not meet the best-in-breed price without seriously eroding its margin.

Another provider responded to a pricing conflict prompted by a benchmark by pointing out that a provider's margin is averaged over an entire basket of services. Although the basket is fairly priced overall, within the basket, some services will be overpriced and some will be underpriced. According to one legal advisor we interviewed: "Objective benchmarks don't help when one or both parties are hurting. The parties need a mediator to help negotiate what changes might be needed."

Resolving conflicts: Three approaches

When conflicts occur in an outsourcing relationship, how the parties approach resolution is crucial. We found three common approaches to resolving significant conflicts: aggressive, balanced and collaborative.

Aggressive

Aggressive conflict-resolution approaches are characterized by a party's spirited defense of its own commercial interests, without consideration of the effect on the other party's commercial interests. It's more like haggling over the price of a used car than talking about the potential value to be produced by an outsourcing arrangement. One party digs in its heels, and the other party normally reacts with a similarly aggressive stance. At best, this approach produces results that weaken the relationship; at worst, it leaves the partnership mortally wounded.

In one situation, for example, the client and provider escalated the fight over gainshare calculations to a formal dispute. The provider calculated a multimillion-dollar gainshare, claiming it should be paid for new products and pointing to new material codes as evidence. The client refused to pay, claiming that it was purchasing the same material and that the vendor was simply using different product codes on the newer models. Was it new wine or just old wine in new skins? Differences of opinion on the matter eventually resulted in a conflict that escalated to a formal dispute.

This aggressive approach resolved the conflict, but the partnership was weakened, according to the client: "It

went all the way to dispute process, and it left an incredibly bitter taste with our executive team." Eventually, the client switched providers and negotiated a better gainsharing mechanism with its new partner.

Executives we interviewed were quick to point out that conflict resolution can often result in a stronger outsourcing relationship—just as, in human relationships, the ability to face adversity together can bring people closer. However, this positive interpretation of conflict was never an outcome when the two parties took the aggressive approach to resolution.

As one provider executive puts it, "In most cases, there is shared responsibility between client and provider when things go wrong, but what may happen is a great deal of posturing and positioning to put one side or another in the best light. That's when, instead of sitting down face-to-face to resolve matters to both parties' benefit, you begin to get the official letters written by legal teams. Then almost inevitably, you're on a path where someone is going to win and someone is going to lose. And from one point of view, everyone then loses."

Balanced

If the aggressive approach is characterized by the need to win every battle, the balanced approach takes an attitude that, over the life of the outsourcing relationship, "you win some, you lose some." That is, advantages temporarily won by one side or the other tend to even out over time. Clients and providers are tough but fair negotiators. When conflicts arise, they are resolved quickly and often result in strengthening the partnership.

In one healthy BPO relationship we studied, we found ongoing cycles of give-and-take. For example, the provider did not charge a client for five extra staff people it added to meet an unanticipated surge in service volume. A few weeks later, the client did not demand service credits when the provider missed a performance metric. Both parties feel that the overall commercial relationship is fair and mutually beneficial. In a way, this approach is reminiscent of how friends may alternate in picking up the check when they go to lunch over the course of a year.

Though a balanced approach is certainly better than the scorched-earth approach of aggressive negotiating, its weakness is that it can result in a situation where the quality of the overall service—and of the relationship—does not necessarily get better.

Collaborative

Collaborative approaches to conflict resolution are characterized by close partnerships in which both sides seek to understand each other's concerns. Account executives from both client and provider look for a win-win solution and then, together, present a united front to sell the solution to their respective organizations. In this approach, conflicts can be resolved in a way that actually strengthens the partnership in the long run.

While the collaborative approach is the most desirable approach, it requires deep commitments from both parties. In fact, in some high-performing BPO relationships, the partners do not even call circumstances that could adversely affect one of the parties' commercial interests a conflict—they consider them problems to be solved.

The client in one finance outsourcing arrangement we studied claims there has never been a significant conflict. He says: "We've always sat down and found a common ground or financial outcome that is in our mutual interest. Obviously, there are times when I've said, 'Enough is enough, this is as far as I go.' I explained why

I think it is fair, why I won't go any further. I never had the provider coming back and saying 'no way' on that."

Do these partners argue? Of course—particularly when a situation has significant commercial implications. In one instance, after back-and-forth debates, one client and its provider agreed that they had to find a commonsense solution to a particular problem rather than relying on the letter of the contract. The parties split a settlement.

The lesson here is that a contract model does not necessarily produce a "fact" that is understood and agreed to by all sides but instead produces a starting point for a conversation. Ideally, the client lead and the provider account executive will attempt to work out an equitable approach before conflicts get escalated to a formal grievance hearing in front of a governance board.

Rules of engagement

Where collaborative approaches to conflict resolution are in place for outsourcing partners, we see a number of common rules of engagement.

We're in this together

Attitudes affect intentions, and intentions affect behavior. Collaborative approaches to conflict resolution therefore begin with an attitude that can be called a "partnership view"—one in which a client regards the provider as a strategic partner rather than as an opportunistic vendor. This mindset results in certain behaviors—such as resolving conflicts fairly and protecting both parties' commercial interests—that produce better long-term results for both the client and the provider.

Here's how one provider executive describes what he calls "the true partnership" his company has with one BPO client: "They understand what our cost drivers are, and they realize it's a zero-sum game. They know that if they want more value someplace else, we have to work together on what our goals and priorities need to be and how we best allocate spending to achieve those goals."

At one point in the relationship, when a conflict arose over how savings were to be calculated, having that partnership view in place was important in achieving resolution. According to the provider executive, "We basically said, 'Okay, we understand you better.' And they said, 'We understand that you need to claim value, so let's work together to define a little more clearly what value means.' "

All problems are "our" problems

The foundation for collaborative conflict resolution is built by the way partners resolve service issues. In effective outsourcing relationships, the partners view any problem as a shared problem. Rather than starting with commercial demands, the two sides perform a root-cause analysis, then identify the best solution that keeps both sides' commercial interests at the forefront.

One provider elaborates: "The client is very open when they are not getting an outcome that they want. That allows us to look at the problem not just in terms of what's in scope or what's not. Instead, we work together to stay focused on the outcome we're both looking for. What do we want, and how do we work together to achieve that?"

In our research, we saw evidence of many business relationships that had mastered collaborative conflict resolution.

At one global finance outsourcing program, the client and provider reported that although the transition to outsourcing generally went well, the internal help desk became overwhelmed by the volume of calls and the percentage of escalated calls. Rather than immediately blame the provider, the client offered to take back the help desk duties temporarily to give the provider time to address the situation.

One client executive explains the benefit of the collaborative approach this way: "Other clients might have said [to the provider], 'This is your problem, don't bother me.' My attitude instead was, 'We are in this together.' I find that the [provider's] folks come to the table and are open and honest about what they are doing." That attitude paid off. The provider diagnosed the problem, and the partners developed an interim fix as well as a long-term plan to improve service.

As much as possible, operate based on facts not emotions

When things go wrong, emotions often run high. Business might be suffering. People might feel—perhaps rightly—that their jobs, reputations and careers are on the line.

An important first step is to get all the facts out so that subsequent discussions move beyond emotions to reasonable interpretations of those facts and then to what needs to be done to resolve the situation.

"Good governance structures are essential," says one executive, "having set procedures and policies for making decisions when a wheel goes off the track." But you also need to have the two most senior executives from both sides be willing to sit down together in private to work things out. Adds the executive, "Sometimes, conflict resolution between two multibillion-dollar enterprises with lots at stake can really come down to two people sitting down over coffee and working it out. You need good governance, don't get me wrong; over time, you don't want every major decision being made by two people over an espresso. But there really are times when major conflicts can be avoided when you have large-spirited people who have the vision and courage to keep the big picture in mind at all times."

A relationship manager has a full-time or near-full-time role

As noted, the pricing and contractual phase of the relationship can create an adversarial environment. Providers are sometimes uncertain that they can even recover their costs, much less make margins. In these cases, the provider will need to concentrate disproportionately on recovering costs, under pressure from senior managers, a situation that results in trade-offs not ultimately beneficial to the client. Concern over cost containment can lead to inflexibility in interpreting the letter and spirit of the contract, which, in turn, can lead to an adversarial relationship.

The solution for one troubled IT outsourcing arrangement we studied was the appointment by the client of a full-time relationship manager. Part of that manager's job was aligning the provider's organizational structure with the client's. The client simply had taken the structure of the incumbent supplier and moved it over to the new supplier—a situation that did not succeed at all. Consequently, the client formalized its management reporting processes, outlining senior management meetings at which supplier performance would be monitored and reviewed. That would then determine when payments and bonuses got paid.

The partners are transparent

Collaborative approaches to resolving issues or conflicts require high levels of trust and honesty. From a practical

For further reading

"Masters of the mix," *Outlook* 2013, No. 1: http://www.accenture.com/us-en/outlook/Pages/outlook-journal-2013-masters-of-the-mix-outsourcing.aspx

"Partners in high performance," *Outlook* 2012, No. 2: http://www.accenture.com/us-en/outlook/Pages/outlook-journal-2012-partners-in-high-performance-outsourcing-bpo.aspx

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perspective, that means being transparent about a range of issues from general goals to specific pricing concerns.

Transparency was one of the top three things interviewees cited when asked about the secrets to great collaboration. In the words of a delivery manager at a provider for a global technology conglomerate, "We know exactly what the client is looking for because they are open with us about the key performance indicators they're being measured on. That way, we can then say, 'Let's figure out a way we can work together on hitting those metrics.' "

The partners care about and protect each other's commercial interests

In collaborative approaches to conflict resolution, each side cares about the other's commercial interests. This is not mere altruism; it is actually in the client's best interest to care about and protect the provider's commercial interests, and vice versa, because service performance is tied to financial performance.

The need to be concerned with each other's financial viability was confirmed by earlier research we conducted into IT outsourcing. In that research, for example, we investigated what happened to outsourcing performance when providers failed to meet their margins. In 15 cases of missed provider margins, 80 percent reported poor outsourcing performance. In 70 cases when the provider met its target margins, only 27 percent reported poor outsourcing performance.

Since the aim was to create a new commercial deal that benefited both parties, partners were willing to renegotiate when one party was financially disadvantaged. In one IT outsourcing arrangement we studied, the provider had made a number of naïve assumptions about the work involved and the resources that would be necessary. The provider had no choice but to alert the client and request an early contract renegotiation. The client responded favorably. Although the renegotiation phase was stressful for both parties, the ultimate outcome was, in fact, a positive experience for the long-term relationship.

On one account, the initial contract was priced using different rate cards for different types of work. After the transition, the client came to the provider and explained that its business case was not being met because it had underestimated the complexity of the pricing mechanism and the range of skills needed. The client asked to renegotiate the pricing mechanism. The provider agreed to a flat rate card in exchange for a longer contract and an increased scope of work. Both parties negotiated a better deal, and the relationship is now a high-performing one.

As we have noted, true conflicts—circumstances that put the commercial interests of one of the parties at high risk—are not common in outsourcing relationships. Indeed, many of the partnerships in our case study research have never experienced a significant conflict. Nonetheless, just one serious conflict can, if not successfully resolved, cost a party hundreds of millions of dollars.

As the outsourcing market evolves into more sophisticated pricing models and broader scopes of services, some miscalculations and unfounded assumptions are to be expected, even if only occasionally. Preparing for potential problems by learning about the collaborative approach to conflict resolution is a little like buying flood insurance—the risk of your home flooding may be only one in 1,000, but it is comforting to know you're covered. ■

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