

Strategic outsourcing decision-making: heads versus heart?

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Executives are entrusted to make difficult, complex outsourcing judgements critical for their organisation's success. A wrong decision can cost the company dearly at best and can put the business in jeopardy at worst.

However, many businesses (and the public sector) simply jump onto the outsourcing railroad, and once they're on, it's more or less impossible for them to come off (as the recent defence contracts in the UK showed, where the outsourcing vendors have the client, "the UK tax-payer", by the short & curlies....).

Organisations would be wise to have a thorough decision-making process which starts by questioning why they need to change the status quo in the first place:

- Why are you thinking of outsourcing anyway?
- What is the most appropriate sourcing approach – is outsourcing the only answer?
- What type of sourcing engagement model is appropriate at that moment in time?
- What type of relationship is being sought or should be sought with a vendor, given the environment, internal capabilities, enabling infrastructure, resources etc?
- What is the most appropriate project management approach?
- What is the most appropriate governance model?
- To what extent is security important and what does that mean in terms of sourcing arrangements?
- What are the must-have and nice-to-have contract clauses, clauses that help the organisation realise business goals, rather than tick all the boxes that a lawyer will have listed for the sake of completeness?
- Which vendor meets the organisation's requirements, will fit into the business culture, and have the relational attributes that make a partnership model possible?

Many jump to the last of these stages, straight to thinking about which vendors do we know about and who can we get them to respond to an RFI/ RFQ?

A proper starting point should be the identification of the various stakeholders affected by, or who have an interest in the outsourcing programme. The next stage calls for a appropriate decision framework, which allows the organisation to rationally take input from these stakeholders to build a picture of what the "organisation" needs, and would require, from an outsourcing programme - unless you get all these stakeholder requirements, and more importantly prioritise these, they will never be contractualised, and there won't be any control for success or failure (or avoid the short-and-curly scenario arising).

Frankly, vendor selection should be the least of your worries. If the organisation has built a thorough decision framework and applied it to the stakeholders, and prioritised the organisational requirements, this could quite easily become the template for evaluating the most appropriate suppliers that can meet these needs – in this sense; the process aligns internal stakeholders, aligns the customer and supplier, and helps align cultures.

Outsourcing executives on the whole assume managers make rational decisions and chose the best option available to them; however when it comes to outsourcing, most decisions are guided by the heart than the head.

Making the right decision is less important than focusing on how the decision is made!

Deeply held assumptions about customers, competition, business models can become so ingrained that the organisation can go on blindly accepting conventional wisdom. Pressures for conformity by individuals also arise because of the relatively homogeneous groups of like-minded people that may make up the



senior management within the firm.

The absence of healthy debate and dissent frequently leads to unwise decisions.

Of course, conflict alone does not lead to better decisions. Executives also need to build consensus in their organisations.

Consensus should not mean unanimity and complete approval by a majority of the stakeholders.

Consensus must have two key components:

- A high level of commitment to the chosen course of action - helping prevent the implementation process from being derailed by departments or individuals who object to the selected course of action. Commitment can also encourage managers to persevere in the face of obstacles.
- A strong, shared understanding of the rationale for the decision, allowing individuals to coordinate their actions effectively, and enhance the likelihood that everyone will act in a manner that is consistent with the spirit of the decision.

When executives do engage in debate (which doesn't happen that often) during the outsourcing decision process, people can become dissatisfied with the outcome, disgruntled with their peers or seniors and putting it politely, not fully dedicated to the implementation programme.

Conflict may diminish consensus, and thereby hinder the execution of a chosen course of action.

The real challenge is therefore to foster conflict and dissent that enhances the quality of decisions while also building the consensus required for successful implementation of an outsourcing programme.

In constructing an outsourcing decision process, executives should be mindful of the seven deadly sins of strategic decision making:

1. Availability heuristics

People usually assess the probability of an event by the ease with which occurrences of the event come to mind. However, availability is affected by factors other than frequency and probability. We have a tendency to give preference to recent information, vivid images that evoke emotions and specific acts and behaviours that we personally observe and relate to. All these cause biases in decision-making – i.e. why the public sector is hell-bent on going down the outsourcing route, because they assume (sometimes wrongly) that outsourcing “always” delivers significant savings....

2. Representativeness

Unrecognised tendency of decision makers to judge the likelihood of an event's occurrence based on its similarity to previous events leads to representative bias, i.e. outsourcing can save at least 20% from our current costs. If managers challenged these assumptions and long-held beliefs, they may come to a more realistic conclusion – i.e. around a third of deals result in an overall loss...

3. Anchoring and adjustment

Anchoring is a widely prevalent trap in decision-making. It is so common that sometimes it is hard to think that the decision may be biased. The mind gets anchored on initial assumptions so much that any decision made subsequently revolves around what was presented initially – i.e. we need to save a bucket load, therefore outsourcing has to be the answer....To ensure that the decision-making process is not guided by such anchors, executives must view the issue from multiple perspectives, involving people with different thinking-styles and creating an environment for dissent and debate.

4. Loss aversion

Loss aversion is a human tendency to prefer avoiding losses than acquiring gains. Loss aversion leads to status quo bias in decision making where people prefer maintaining the status quo to avoid losses – i.e.



we've been doing this for years, so it must be a core competence and surely it shouldn't be outsourced....

5. *Mental accounting*

Mental accounting is a set of cognitive operations used by individuals to organise, evaluate and keep track of financial affairs. Existing outsourcing programmes may have less stringent controls compared to current outsourcing deals, whereas, there may well be more to gain from scrutinising existing programmes - i.e. managers should set a clear set of criteria for evaluating performance on an ongoing basis, with continuous improvement being fundamental to long term outsourcing programmes....

6. *Hindsight bias*

Hindsight bias is a tendency to see things as more predictable and obvious when they have occurred, whereas in fact the event could not have been reasonably predicted before the onset of the event. It is easier to reconstruct why something worked or did not work after the event has happened. Managers can assume the future as more predictable in developing strategies than may be the case. As a result, they may face challenges executing those strategies or may not achieve projected results when the external environment changes. In this era of high uncertainty in the external environment, there is even more need to be aware of hindsight bias – i.e. scenario modelling and organisational flexibility are paramount...

7. *Over-confidence*

Being confident is considered as a great asset; unfortunately however, we systematically overestimate our decision-making abilities with what objective circumstances would warrant. If the skill required is great and the task is complex, we tend to get even more confident of our abilities and judgments. Related to over-confidence is a bias of over-optimism. We tend to be over-optimistic in predicting what we desire will happen. When we have more information, we feel more confident (illusion of knowledge). Similarly, if we spend more time on analysing the situation and longer the run of prior successful outcomes, we feel having more control over the outcome (illusion of control). The tendency to see the future through the lenses of over-confidence and over-optimism can create unrealistic forecasts which are not met – *i.e. estimation of synergies in an outsourcing partnership, that never materialise post deal...*

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