

# The potential rise of relation-based outsourcing

Both clients and service providers aim to find more effective and sustainable partnerships by leveraging relation-based outsourcing agreements

The market is moving away from transaction-based outsourcing relationships towards relation-based outsourcing. This requires a change of perspective. Relation-based outsourcing focusses on a better understanding of mutual dependencies and complementary capabilities. Relation-based outsourcing methods such as Vested can be valuable instruments to achieve those objectives.

## Increasing relevance of relation-based outsourcing

Transaction-based outsourcing has dominated the outsourcing sector for decades. Common feedback we encounter is that transaction-based relationships fail to achieve client objectives and fail to cater for changing business needs. This insight triggers the market to consider alternative approaches and guidance to engaging and maintaining relationships between clients and service providers.

Relation-based outsourcing is an approach that differentiates the type of relationship and nature of service delivery. Moving away from transaction-based outsourcing, relation-based outsourcing emphasizes

the shared responsibility and is outcome-oriented. This requires trust in setting guiding principles in an arrangement, which we call a relation arrangement. Relation-based outsourcing is positioned in the middle of the outsourcing relationship spectrum.

*The adoption of relation-based outsourcing differs between the ITO and BPO market*

By differentiating between market domains, we also see a differentiation in the adoption of relation-based outsourcing:

- The supply chain domain has a growing number of successful examples of relation-based outsourcing.
- IT Outsourcing (ITO) relationships have a growing number of use cases where aspects of relation-based outsourcing are applied.
- Business Process Outsourcing (BPO) relationships are in the exploring phase of applying relation-based outsourcing.

## Client challenges for applying relation-based outsourcing

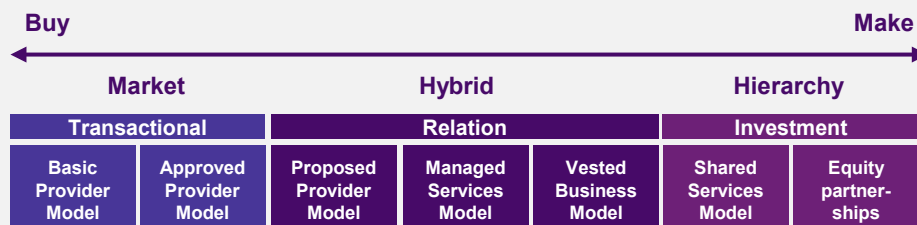
In order to implement relation-based outsourcing agreements in an effective way, both client and service providers need to put their effort and intentions from a mutual perspective. By having the intention to build a relation-based outsourcing relation, both parties face their challenges.

From a client perspective, we identify the following key challenges:

- The risk appetite of senior management does not always fit relation-based outsourcing. Risks are shared, which means the traditional risk profile on the client side might be higher from a legal and financial standpoint.
- Cultural fit between client and service provider must match. In reality, this seems quite hard as both parties need to adjust their intentions and way of working.
- After implementing relation-based components in the outsourcing agreement, it appears hard to live up to the relation-based contract elements due to traditional client/supplier thinking and the departure of key client stakeholders who safeguarded the original intentions.

## Outsourcing relationship spectrum

The continuum of sourcing relationships<sup>1</sup> identifies various types of arrangements that vary between transaction-based and investment-based arrangements. While transaction-based arrangements are market-driven in nature (outsource activities), investment-based arrangements focus on the provisioning of internal services. By combining the best of both worlds clients create an opportunity to bundle advantages of market-driven and investment-driven arrangements. These hybrid types of arrangements stress the importance of building relationships and complement formal agreements.



<sup>1</sup> University of Tennessee Unpacking Sourcing Business Model

## Service provider challenges for applying relation-based outsourcing

Service providers also face challenges in applying a relation-based outsourcing model:

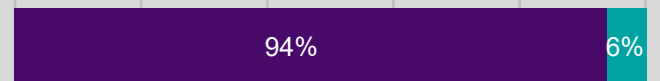
- The outsourcing business model does not align to relation-based outsourcing. Typical outsourcing pricing models do not fit the purpose to maximize business results. This requires parties to set clear expectations during the start of the relation-based outsourcing with regard to attitude and incentives.
- The typical service delivery model is transaction-based with standardized products and services. Relation-based agreements require parties to focus on mutual business outcome.
- In order to make proper use of relation-based incentives the trust levels between service provider and clients need to be on a certain level. This requires time and effort before finding the trust to sign relation-based agreements.



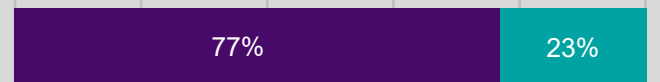
## Service providers acknowledge the need for more relation-based outsourcing

During the Service Provider Forum 2021 in the Netherlands, KPMG conducted various polls under 35 service providers and retained interesting data. The service providers acknowledged Vested as a methodology of relation-based outsourcing that will contribute to the competitive advantage of their firm (94%; see figure below). However, the service providers also indicated that their current business model does not fit relation-based outsourcing (77%; see figure below). In conclusion, there lays a gap between what service providers believe benefits their business and what their business models incentivize.

*Service providers believe relation-based outsourcing will contribute to the competitive advantage of their firm*



*Service providers indicated that their current business model does not fit relation-based outsourcing*



0% 20% 40% 60% 80% 100%

■ Agree ■ Disagree

## What are the benefits of applying relation-based outsourcing?

Relation-based outsourcing can be beneficial in every client-service provider arrangement. The main benefits of a relation-based outsourcing agreement are related to:



**Pain & gain sharing.** Sharing the risk on the long term, downsizes the risk. Potential benefits could be valuable for both parties.



**Flexibility in your business model.** Focusing on a business outcome, allows clients and service providers to be creative and flexible by setting up their business model.



**Adaption to market disruptions.** Change is constant in these disruptive times, therefore a shared focus to be ahead of the market could be significantly beneficial.



**Continuous improvement.** The mindset on both sides to keep improving the organization, to be ahead of the competition and to create mutual benefits.

**Do you want to know more about BPO or ITO? Our KPMG team has broad knowledge and experience in the field of outsourcing from strategy to execution. Please contact one of our KPMG experts!**



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