

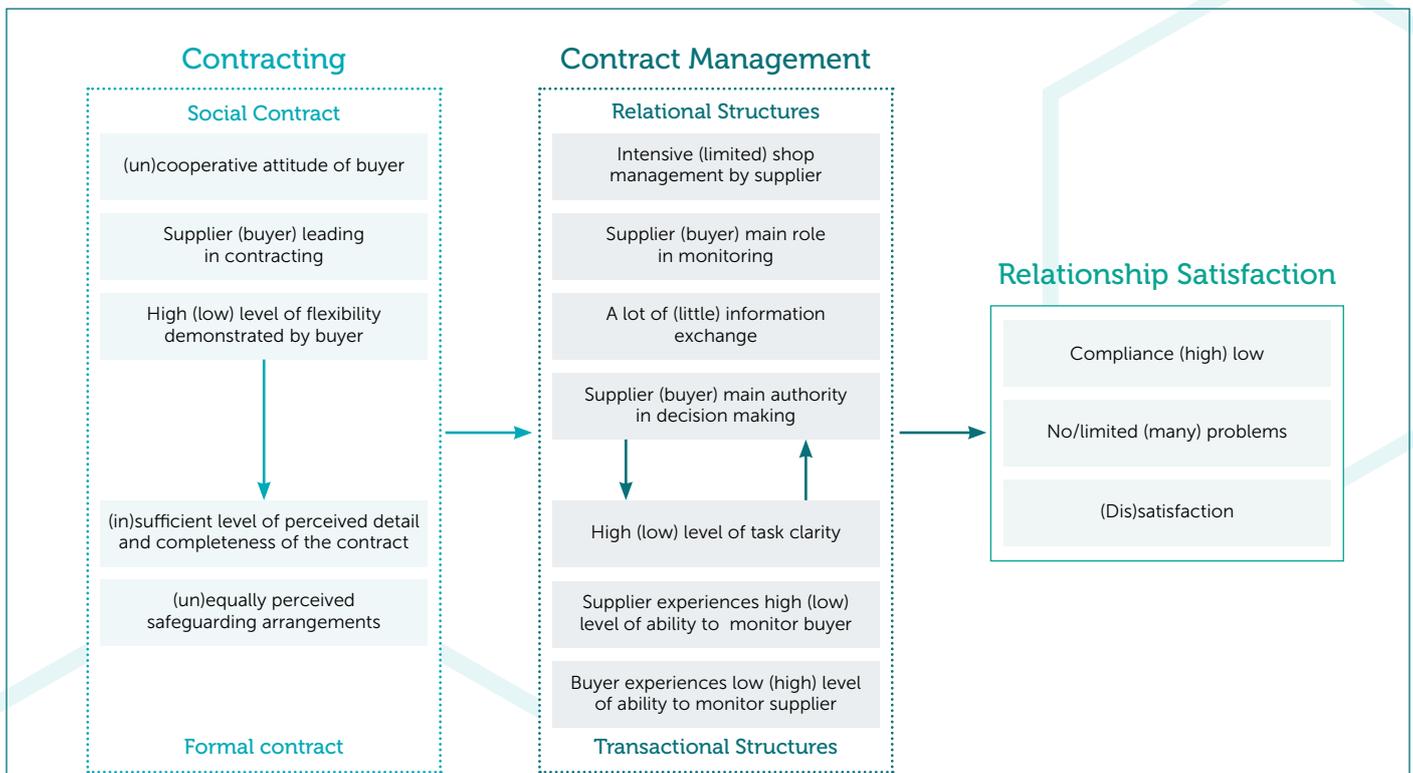


Criticality of social contracts in outsourcing: Purchasing in service triads

Considering the relationships between the three parties to an outsourcing arrangement of the buyer the supplier and the end customer (or stakeholders) can be reflected as a service triad according to the research conducted by Broekhuis & Scholten ¹. While the research paper focuses on the context of an external customer, the principles and nevertheless broadly align to that of internal stakeholders empirically. The recognition that both the buyer and the supplier (outsourcing service provider) build up expectations during the process of negotiating and putting in place a formal contract are recognised in this research. Hence the researchers refer to this as a “*service triad*” where the customer (internal stakeholders) are not fully party to the formal arrangements and mechanisms that are put in place.

The position of this research is that often the practices of contracting (up front activity pre contract award) are treated as separate to the (post contract activity) of contract management. Further, there is a recognition that research in this area is very limited. An important recognition of the fact that focusing purely on the rigor and transactional completeness of a contract versus a focus on protecting and enhancing the relationship results in less enforcement downstream when the contract has been placed. In short having governance that concerns itself with socialising and monitoring effectively moderates the relationship between key contractual dimensions of complexity, fairness (performance) and reoccurrence. In essence we create a “*social contract*” long before we put in place a formal contract and as such establishes behavioural standards and specific outputs the serve as foundation for the future relationship. Hence, this social contract becomes the precursor to a positive influencing mechanism in the contract management phase post contract. The research performed shows a direct link of the positive effect of having performance and behavioural orientated standards how a combination of performance-oriented and behavioural-oriented contract terms covering a mix of topics related to both the customer-experience and to buyer-supplier oriented aspects, contribute to aligning buyer’s, suppliers’ and customers/ stakeholders interests.

Given that most business transactions are usually based on a formal contract under which a principal (buyer) engages an agent (supplier) to undertake some action on the principal’s behalf this in academic circles is referenced as “Agency theory”. In short Agency theory is concerned with circumventing problems e.g. opportunism, differing goals or risk preferences that might arise during the initiation, ongoing and termination phases of a relationship with the supplier/service provider (agent). Hence the need to consider what is the most effective way to approach governance in the pre contract phase. This consideration of governance aids significantly the issues surrounding goal divergence and alignment of joint incentives (during the social interaction in contract negotiation). Consequently, this governance enables a legally binding formal contract to be established that is fair and equitable. In term this enables the parties to address incentive alignment, decision rights, performance expectations, consequences of contractual breach and a fair process for resolving disputes and issues of non-compliance. However, from empirical evidence and research we must recognise that formal contracts have limitations because they can never cover all scenarios and eventualities (Sanchez ²) and the rigid application of formal contracts can negatively impact the flexibility and cooperation leading to reduced trust. Conversely, a strong social contract formed at the outset will act as an effective attribute where such eventualities are not covered in a formal contract. Trust provides mutual confidence that neither party will act opportunistically in a relationship, and relational norms help to provide a framework of reference for all parties. The following diagram illustrates the connection between Contracting, Contract Management and Relationship Satisfaction that acts as a good visual summary.



Causal model of relationship between contracting and contract management in service triads ¹
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In summary the formal contract is inherently also relational in that it establishes a relationship of recognition and respect between the signing parties (Markovits ³). I personally appreciated the quote from a research paper that expressed a view on what contracts are: *“Contracts may be envisaged as the sedimentation of the negotiation and commitment stages that partners go through. In this interpretation, contracts can be seen as both the basis and outcome of cooperation”* (Klein Woolthuis ⁴). In essence the cooperative attitude and flexibility during the social contract phase influence the required level of contract detail and completeness, and then contract management. In short, the social contract precedes and influences both the formal contract and, subsequently, contract management. Consequently, satisfaction with the perceived fairness of both the contract and downstream contract management are determined by the mutual perceptions of the social contract itself.

The research implications for practitioners are clear:

- Apply effort into establishing a mutually perceived social contract.
- Have a clear idea about the kind and the intensity of the relationship you want to establish.
- Be transparent about your capabilities, aims and aspirations and do not make assumptions about the other party.
- Take responsibility for using expertise wherever this lies
- Explicitly include both performance- and behavioural-based contractual terms that relate to the end customer/stakeholders.
- Recognise that the social contract, is often carried out by other employees than those who will later be responsible for actual contract management!

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¹ Broekhuis, M. and Scholten, K., 2018. Purchasing in service triads: the influence of contracting on contract management. International Journal of Operations & Production Management.

² Sánchez, J.M., Vélez, M.L. and Álvarez-dardet, C. (2013), “Evolving functions of interorganizational governance mechanisms”, Managerial and Decision Economics, Vol. 318 Nos 3-5, pp. 301-318.

³ Markovits, D. (2004), “Contract and collaboration”, The Yale Law Journal, Vol. 113 No. 7, pp. 1417-1518.

⁴ Klein Woolthuis, R., Hillebrand, B. and Nooteboom, B. (2005), “Trust, contract and relationship development”, Organization Studies, Vol. 26 No. 6, pp. 813-84