



# What we know – and don't – about outsourcing

Exploring how to build outsourcing contracts on a firmer  
empirical and commercial foundation

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The Johari window, a well-established tool in organisational psychology, maps what is known to oneself against what is known to others — a framework designed to expose blind spots. It can also inspire us to examine outsourcing contracts. After more than three decades advising on upwards of 350 outsourcing contracts, the question worth asking is an uncomfortable one: how many of the clauses and constructs that lawyers and advisers routinely deploy actually work? And how many carry hidden costs that neither party has ever properly quantified?

	Known to self	Not known to self
Known to others	<b>Arena</b>	<b>Blind spot</b>
Not known to others	<b>Facade</b>	<b>Unknown</b>

This note attempts an honest accounting. It is not based on objective, verifiable data. Rather, it reflects the collective views of our team achieved through vigorous internal debate and sustained exposure to outsourcing in practice. Nor is it the final word. If clients or vendors recognise gaps or challenge our conclusions, so much the better — that kind of scrutiny is precisely what enables us to produce better contracts.

For the purposes of this note, a concept or clause “works” if it produces a demonstrable beneficial effect and achieves its underlying commercial intention — driving behaviour as intended, for instance — with financial implications and associated risk premiums that are reasonably well understood.

## What We Know Works

### Output-based contracts and service levels

The early history of outsourcing was characterised by contracts that described work processes rather than results. The shift to output-based contracts, with service levels expressing what the vendor must deliver rather than how, was a genuine advance. The principle is now well established: what cannot be measured and described will not be delivered, and vendors perform better when given operational flexibility to determine how they achieve the contracted output. There are narrow but important exceptions — business continuity and security requirements, where input specification remains advisable.

Service levels work, in the narrow sense that vendors will consistently strive to meet the targets they have agreed to. They are tangible, auditable, and a straightforward means of demonstrating contractual compliance. The persistent weakness, however, lies beneath the surface: the underpinning processes — updating documentation, continuously stress-testing supply chains, exercising business continuity plans — routinely go unperformed. Acknowledging this structural deficiency openly may be the more productive starting point for a constructive dialogue with vendors.

#### What we know works:

- Output-based contracts
- Service levels
- Deliver first, settle later provisions
- Agile delivery models

### **“Deliver first, settle later”**

These provisions are routinely characterised as onerous by vendor lawyers. Our experience is that “deliver first, settle later” clauses materially reduce, and in many cases eliminate, hostage-taking behaviour during disputes — and do so without any discernible risk premium.

### **Agile delivery**

Agile methodologies work — but only when both parties have genuinely embedded agile processes and operate within a clearly articulated agile framework. Agile without methodology is not agility; it is managed chaos, and the contractual consequences can be severe. Customers tend to underestimate the degree of active involvement and risk-sharing that agile delivery requires of them. The model is powerful in the right hands; it is a liability in the wrong ones.

## **What We Know Does Not Work**

### **Service credits**

Here the picture is less encouraging. Service credits have become a commercial norm, and vendors price them into their bids as a quantifiable financial risk. Yet our perception is that service credits rarely alter vendor behaviour in any meaningful way. The performance of team at the machine-room level performance reflects the vendor’s overall competence, its reporting disciplines, and its capacity to learn from incidents. Exceptional performance, when it occurs, is almost invariably a function of the quality of the customer-vendor relationship, not the threat of a financial deduction. The implication is that service credits as currently structured may generate a risk premium for which customers receive little in return.

### **Governance**

Governance is expensive. It consumes people, generates reports, and triggers elaborate internal processes within vendor organisations — costs that customers ultimately bear. Yet the uncomfortable truth is that the governance structures described in most outsourcing contracts do not function as intended. Governance bodies are, in practice, largely unable to drive strategic change, optimise the mutual commercial benefits of the arrangement, or resolve disputes efficiently. The sheer volume of contractual pages devoted to governance architecture is inversely proportional to its effectiveness.

Two responses to this are available. The first is radical simplification — strip governance back to the minimum required and reduce the associated cost. The second, and arguably the more ambitious, is to redesign governance around the principles of relational contracting, building in the collaborative processes and shared accountability that purely transactional frameworks cannot generate. Neither path is easy, but continuing to add pages to governance frameworks that do not work is not an option.

#### What we know does not work:

- Service credits
- Governance
- Misalignment of financial incentives
- Innovation

### **Misaligned financial incentives**

The fundamental tension in outsourcing is structural and has never been resolved. Customers want costs driven down and services expanded. Vendors want to protect contracted consumption levels, revenues, committed baselines, and margins. These objectives are not merely different in degree — they are in direct conflict. It is, we suspect, the principal reason why customer dissatisfaction in outsourcing remains persistently elevated and renewal rates are relatively low.

The current paradigm — transactional, adversarial, zero-sum — redistributes value rather than creating it. The only commercially rational response is a long-term, partnership-oriented model that focuses on expanding the overall pie rather than on margin squeezing.

## **Innovation**

Innovation is, by any honest assessment, largely dormant in most outsourcing contracts. The industry has experimented extensively — with aspirational innovation objectives, innovation-linked service levels, financial incentive models, and “evergreen provisions” of every conceivable design. The outcomes have been consistently underwhelming.

Where innovation has any realistic prospect of occurring is in arrangements where the parties have established a dedicated and detailed innovation governance structure, agreed that innovation constitutes a billable change, and committed sufficient paid resource to the exercise.

## **What We Know We Don't Know**

### **The cost of locking in vendors**

Outsourcing contracts negotiated by buyers with strong bargaining positions rarely extend to the vendor a right to terminate for convenience. The vendor is thus committed to a long-term arrangement that may, for reasons within or beyond its control, become financially unviable. The risk premium embedded in that lock-in is, in our estimation, substantial — but it is rarely quantified or even acknowledged.

*We don't see the effects of vendors not being able to terminate for convenience and elaborate transfer of risks schemes.*

The converse question is equally unresolved. What would the customer's exposure be if carefully tailored vendor termination rights allowed the vendor to exit before the end of the contractual term? And — critically — locked-in vendors exhibit the kind of “shading” behaviour that economists have long documented: a quiet, incremental withdrawal of discretionary effort that is almost impossible to measure but may represent a significant, unacknowledged cost to the customer.

### **The true cost of risk transfer**

Outsourcing contracts are, to a very large degree, instruments of risk transfer. The risks incorporated tend to reflect the prior bad experiences of the customer, its lawyers, and its advisers — a ratchet mechanism that produces ever more elaborate, customer-friendly risk allocation with each successive transaction.

The problem, however, is that maximally customer-protective agreements may produce their own problems:

- Parties may behave in a purely transactional manner, meeting the letter of their obligations and nothing more.
- The informal moral norms of good-faith collaboration — which often do more practical work than the contract itself — may be quietly suspended.
- Risk transfer provisions may become shields behind which parties shelter rather than act, even in circumstances where acting would be the economically efficient response.

The real costs of cost-of-living adjustment clauses and foreign exchange risk transfer are similarly opaque. Vendors and customers both employ hedging and other financial instruments as a matter of ordinary commercial practice, yet outsourcing contracts routinely allocate these risks without any serious inquiry into how they are actually managed — or what the associated premium amounts to.

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The commercial case for outsourcing, properly executed, remains compelling. It remains one of the most powerful tools available for driving out cost, acting as a catalyst for organisational change, and enabling businesses to concentrate on their core activities. The discipline of outsourcing contracting has advanced considerably. However, a significant portion of advisers' recommendations— and what customers accept — rests on habit and convention rather than evidence or reasoned judgement. Greater transparency, creative risk management, and a willingness to challenge received wisdom is needed.

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