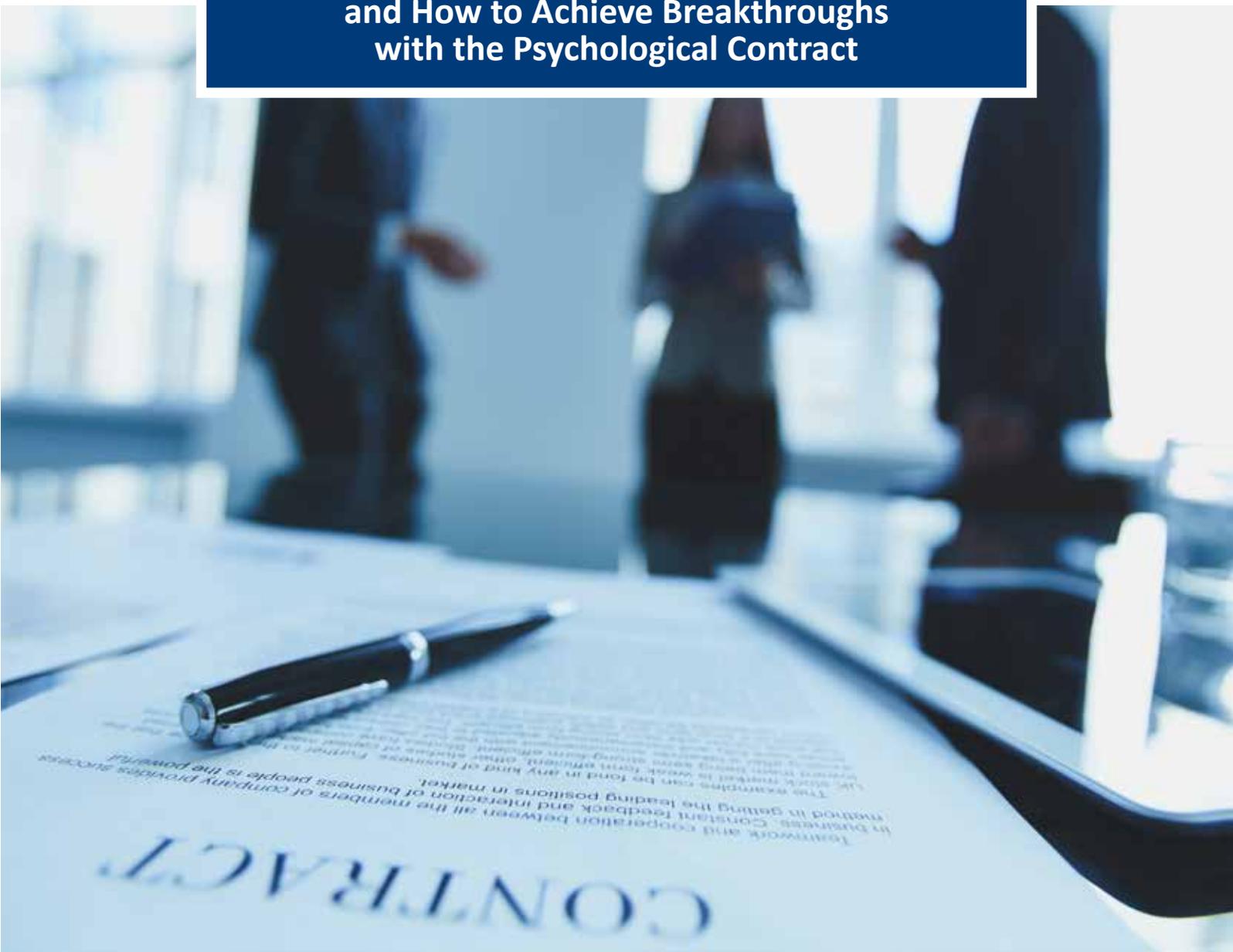


The 6 Myths of the Written Contract

and How to Achieve Breakthroughs
with the Psychological Contract



WHITE PAPER

open windows software

modular procurement

Dr Sara Cullen and Jay Jeong, University of Melbourne

Do you **manage contracts** or do they **manage you?**

DO ANY OF THESE PROBLEMS SOUND FAMILIAR TO YOU?

- **Missed deadlines** and decision points, with renewals by default
- Inconsistent information and **no single source of data**
- **Lost contracts**, missing paperwork and poor compliance
- Long contracting cycles, endless delays and **cost blow outs**
- High risk contracts with heavy liabilities and **no audit trail**
- Non-compliant contractors and a **lack of accountability**
- Heavy reliance on **time consuming manual administration**, open to human error
- **Negligible supply chain tier management** and due diligence
- **Reactive** variation **processes**
- **No visibility** into overall contract data

Take control of your contracts with **CONTRACT MANAGEMENT AUTOMATION**

In theory, the risks of managing contracts reactively are fully understood. But in practice too few organisations are managing contracts proactively and often not until a risk becomes a reality does the importance of contract management set in.

Open Windows contract management automation provides an integrated software tool to effectively manage down the risk of non-compliance, capture and improve the business benefits so you can manage supplier contracts proactively rather than just administer contracts.

Open Windows Modular Procurement Software Suite

Our modular software suite allows you to build a solution that meets your needs and budget, with the flexibility to easily integrate additional modules as you grow.



PROCESSES

The flexibility to design a contract management process that's right for you



CATEGORIES

Integrate upstream category management with downstream contract management



PROJECTS

A complete project management suite directly aligned with your contract management system



SOURCING

Formulate strategies that link business case, sourcing templates & SRM



TENDERS

eTendering fully integrated with contract management using single data entry



CONTRACTS

A real-time contract register, searchable database & multi tiered contract management facility



COMPLIANCE

Ensure 100% compliance in this risk management module including real-time audit trails



BUDGETS

Manage your project budgets, contract cash flows and variations in real time



SRM

Build strong relationships with suppliers using direct data entry by contractors



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Foreword

This is the sixth formal white paper developed and produced by Open Windows Software since the first paper in late 2015.

Each paper that we produce is focused on an aspect of the contract management discipline. They are intended as professional development pieces and contributions to the topic, not in any way sales pitches, which is evidenced by the quality and integrity of some of our authors, including Tim Cummins, Jonathan Dutton FCIPS, and Dr Sara Cullen.

I am pleased to report that they have been very well received and register much interest both online and offline. Of course, all of our white papers are available free of charge on our website.

In this latest Open Windows white paper, Dr Cullen and her colleague, Jay Jeong, consider the value of the psychological contract and bust the six main myths surrounding everyday commercial contracts between willing (and sometimes not so willing) buyers and sellers.

This paper reminds me of the famous Drucker maxim, 'culture eats strategy for breakfast.' The culture we form around the relationship between a commercial buyer and seller seems to have far more resonance than the actual written contract itself.

As one of the country's leading providers of contract management software, we too must start to think about how we could help users of our software better manage the psychological side of contracting.

Currently, our supplier relationship management module allows sellers to input data and reports to buyers. It can even record all communications through the system – a real-time audit trail. But this is not the same as 'tracking' a psychological contract.

Good contract management pays back a solid ROI. We know this, and our systems facilitate professional best practice contract management of the sort so often described in our Open Windows white papers.



Adam McInnes
Co-Founder & CEO
Open Windows Software
www.openwindows.com.au

Executive Summary

Getting two parties to draft, negotiate, and finalise a written contract usually comes with a hefty price tag. These costs are generally seen as a necessary investment to protect the parties. But how often does this investment yield a positive return (ROI)?

Many believe that the value of the written contract is its ability to keep us away from the courtroom. However, the probability of litigation is only .007%¹. This implies that the contract as an investment to stay out of court may not necessarily be providing the best ROI.

The contract's primary purpose today is not so much a litigation instrument, as a commercial one. It is not intended to be an instrument of war, but rather to aid and support the parties during its term.

However, many of the things we have come to believe about the contract must be challenged if it is to be a valuable business investment. Set out below are six common myths that restrict your contracts' ROI.

Myth 1. The contract controls the parties.

It is up to the people delivering and managing success who, post-award, determine how and if the contract is used. Many use it as a last resort to resolve disagreements, not to inform or guide.

Myth 2. The contract drives performance.

Half of all organisations experience the 'green key performance indicators (KPIs), red feelings' syndrome, whereby successful achievement of KPIs does not yield satisfaction in the eyes of the stakeholders.

Myth 3. People read and understand the contract.

Many people delivering results post-award are either not privy to the contract or not overly interested in it. Even if it is read, all contracts are subject to individual interpretation. It is not a question of understanding the contract; it is whether it was written to be able to withstand multiple views and perspectives.

Myth 4. The contract is managed.

We have yet to encounter an organisation that has put a contract management budget against every clause in the contract. Instead, people make choices based on the time and skills they have and what they perceive to be important.

Myth 5. The contract represents a fair agreement.

Many contracts were never intended to be written based on the principles of balance and fairness, but on power and the use of it.

Myth 6. You must get the contract right.

Contracts are always incomplete, because one cannot foresee all possible events and opportunities. The effort in attempting completeness has diminishing returns.

To ensure an improvement in the ROI from contractual relationships, it is imperative that organisations break through these myths. Writing better contracts is certainly required. Also required is to understand a different type of contract – the psychological contract (PsyCon).

A PsyCon is the perception of the promises and obligations that individuals hold in their mind. The fulfilment or breach of these PsyCons has a significant impact on the attitudes and behaviours demonstrated. It is these attitudes and behaviours that make a contract work.

So how do you identify, establish, and maintain a positive PsyCon amongst your people, as well as all people in both parties? In this white paper, we explain specifically how this can be done, so that you can break through the myths surrounding the written contract.

“Creating a positive shared PsyCon can be the breakthrough you are looking for to achieve high performance.”

¹ IACCM (2016), *Maximising ROI from Contract Management*.

Introduction

Contracts have underpinned commercial relationships between parties since time immemorial. Originally simple agreements of 'you do X and I'll give you Y', these have become very Byzantine documents for what remains a 'you do X and I'll pay Y' arrangement, even though the X is increasingly complex, and likewise the Y.

Over many decades of practice, the practical limitations of contracts have become starker. For instance, circumstances can change dramatically over the term; therefore, contract owners are less and less likely to know what they truly require. Nor do they fully understand what the actual risks may be moving forward. In addition, providers rapidly change offerings and capabilities, and markets are created, expanded, and narrowed regularly.

There is one thing, however, that has not and will not change: the importance of the people who ultimately deliver success – and how little they rely on the contract to do so.

In this white paper, my colleague, Jay Jeong, who is currently researching this topic at the University of Melbourne, and I share with you the criticality of the psychological contract – the deal that you perceive has been agreed to.

But first, it is necessary to explore just why the written contract may not be all it's cracked up to be.

The Six Myths of The Written Contract

Organisations write contracts to plan how an exchange of money for goods and/or services will occur. The contract is also intended to cover the various risks (and opportunities) that may occur during this exchange.

However, in today's complex business landscape, the contract represents not only the transactional terms, but also the complex strategic and social aspects of the working relationship.

This is because truly successful outcomes now go beyond just adhering to the written terms of the agreement. They also depend on the fulfilment of the beliefs and expectations of the stakeholders on both sides.

This poses a difficult challenge. Everyone's expectations for the agreement are different, and everyone's notion of what entails a satisfying result also differs. This is because, at the end of the day, how contractual terms are interpreted is based on the eye of the beholder.

Unfortunately, many people still place significant emphasis, and rely heavily upon, the written terms to ensure that their goals and objectives are met. But can the written contract really do that?

To answer that question, we need to understand the limitations of the written agreement or, if you will, explode the myths surrounding it.

“Successful outcomes from a contract now go beyond just adhering to the written terms. They also depend on the fulfilment of the unwritten expectations of the stakeholders on both sides.”

Myth 1: The contract controls the parties.

Formal contracts are generally used to mitigate risk and/or reduce opportunistic behaviour. Parties aim to do this by trying to control behaviours identified as undesirable with adversarial contractual mechanisms.

However, many view the enforcement of the contract terms as a form of distrust, which causes even more points of conflict and increases the likelihood of opportunistic behaviour and risk. This is because so many commercial endeavours are relational in nature (that is, highly dependent on a non-adversarial relationship). Managing the day-to-day issues and resolving points of conflict most often depend on the level of commitment and trust established within the relationship and not on what is stipulated and written in a formal contract.

The contractual terms do not change the inherent nature of the working relationship. In fact, it works the other way around. When relationships are adversarial, the contract is often selectively employed in an adversarial manner, despite the existence of partnering provisions. When the relationship is collaborative, people ignore many of the punitive clauses as contrary to what they believe is the spirit of the agreement.

At the end of the day, a written contract is merely a piece of paper. It is up to the people delivering and managing success post-award to determine how, and if, it is used.

Myth 2: The contract drives performance.

Many organisations believe that service level agreements (SLAs) and KPIs can lock in performance that will meet stakeholder needs. But much rides on the applicability and accuracy of these performance measures. These measures often have a monetary effect, can be the basis for the decision on whether to continue the commercial relationship, and are ultimately used to determine the level of success.

However, one of the most difficult challenges faced by organisations is accurately measuring performance levels. For example, a report by Deloitte² found that almost half (48%) of those surveyed were not satisfied with the service quality levels provided by their contract partners, despite the performance standards in the contract being reached. This is known as the 'green KPIs, red feelings' syndrome. Success is being reported, but stakeholders do not perceive it as such.

This ‘green KPIs, red feelings’ syndrome occurs because, in many instances, contracts measure only what can be easily measured, rather than what really matters (which may be more complex to articulate or more subjective to measure). Sometimes, they measure how well a task has been performed, but not the intrinsic value generated for different stakeholders by conducting those tasks, such as innovation, leadership, and collaboration. At yet other times, the metrics are put in place merely to comply with an organisational directive towards performance-based contracting and having KPIs (...any KPIs).

While this ‘ticks the box’, it does not reflect the true business context or the value that the parties are trying to create.

Myth 3: People read and understand the contract.

We must state the obvious and be honest with ourselves – a contract is rarely read after it is signed. People want to put it in the drawer.

More often than not, the full contract is only read by particular individuals like those within the legal and procurement teams. And contracts are drafted in a convoluted way, with clauses often referring to other clauses. Reading only parts of a contract rarely offers the full picture. Ultimately, the majority of people may end up reading only a summary or even just a brief notice that a contract has been struck.

However, even if everyone in an organisation reads the contract in its entirety, two different people might not interpret it in the same way. This is exacerbated when the individuals are from different parties and compounds with every person involved. Add in the fact that just 12% of contract managers find contracts easy to understand³ and you can quickly surmise how little ‘black and white’ there really is in a written contract.

Subjectivity is inherent in all contracts. Accordingly, it is not a question of understanding the contract; it is whether it was written to be able to withstand multiple views and perspectives. This is rarely the case.

Myth 4: The contract is managed.

As specialists in the contract management field, we have yet to encounter an organisation that has put a contract management budget against every clause in the contract. To do so would highlight the practical unaffordability of actually taking the contract seriously enough to invest in monitoring, complying with, and enforcing all aspects of it.

What really occurs, in reality, is that the contract clauses merely reflect the formalities of each of the parties and what is needed to get it signed off internally. From that point on, it is up to others to do with it what they will. The choices that individuals make post-award are heavily based on their own skills, availability of resources, what they deem to be the most important at that time, and the best return for their limited availability.

What is important to one person is not necessarily so to another, as the case studies that emerged from our research demonstrated.

CASE STUDY:

A large client organisation had included in the contractual terms a requirement to conduct bi-annual governance meetings and quarterly performance reviews.

An interesting observation was that the perceived importance of these meetings differed amongst the client stakeholders.

The procurement manager saw these meetings as critical in being able to evaluate the vendor’s performance and ironing out issues, whereas the manager in charge of development and delivery saw these meetings as mere formalities and quite unproductive.

As a result, any initiatives and/or feedback from these meetings were rarely passed on to the development and support teams, who were oblivious to the contractual terms and far too operationally busy to care anyway.

Myth 5: The contract represents a fair agreement.

Most individuals like to believe that their decisions are fair and balanced and benefit everyone involved.

But this is only true when the belief is reciprocated by others involved. When there is a sense that it is not, there is a strong emotional urge to punish perceived bad behaviour, even when the cost outweighs the benefits. This is why the enforcement of the contract is primarily an emotional response that generally occurs when there has been a breakdown of the relationship.

However, many contracts are not drafted based on the principles of balance and fairness, but rather based on wielding power. For example, it is naïve to think that there is absolute fairness and balance in a contract set forth by a large multinational company and presented to a small local enterprise.

In response to this potential abuse of power, the Australian Competition and Consumer Commission oversees a law passed in 2016 to regulate unfair contract terms imposed on small business (fewer than 20 employees) for contracts under \$1 million⁴.

Myth 6: You must get the contract right.

In an ideal business environment, a contract should be able to represent the obligations and rights of both parties who are committing to the agreement fairly and in its entirety.

However, the complex nature of our contracts today and the dynamic business and government landscapes mean that the terms and conditions will always remain incomplete. It is impossible to cover every single possible future event that may occur or ensure that every single action or governance measure is covered through the contract. Indeed, the research is so high profile and so strong in this field that the 2016 Nobel Prize in Economics was co-awarded to Oliver Hart, who is renowned for his research and work on incomplete contracts.

The effort in attempting contract completeness is highly questionable in terms of the return on investment. More important than covering every nook and cranny in the contract is creating and sustaining a strong business relationship which is capable of productively catering for uncertainty at the onset, and then ensuring that events are constructively dealt with as work progresses.

“The effort to draft a contract that covers every possible future event or opportunity has diminishing returns. Creating and sustaining a strong business relationship capable of catering for uncertainty and constructively dealing with events is likely to yeild a far greater return.”

⁴ See *Unfair Contract Terms Act 2016* <https://www.accc.gov.au/business/business-rights-protections/unfair-contract-terms>.

Explaining the Psychological Contract

The myths surrounding the written contract illustrate that contracts today often struggle to become a viable asset that delivers results and a return on investment.

Success is not only determined based on what is written in the contract, but also on whether the perceived obligations and promises held in the minds of individuals are fulfilled. This is because, at the end of the day, it is the individuals who make contracts work, not the piece of paper by itself.

The opinions that individuals hold about the agreement, such as what each party is bringing to the table, how people will conduct themselves, and what each party's obligations are to the other, is known as the psychological contract or PsyCon.

A person's PsyCon can be guided by their interpretation of what has been written in the contract but is usually influenced more by beliefs, assumptions, and interpretations of discussions and documents. All these impressions and perceptions form unique and specific expectations.

The concept of PsyCon was first applied in the area of employment contracts in 1960 when organisational psychologists made an interesting observation about why people quit their jobs. It was often not because there was a breach of the employment contract, but because of a breach and violation of the employee's PsyCon, it was observed.

The employment PsyCon is what each employee believes has been promised by an employer in exchange for his or her workplace efforts or behaviour (e.g. 'In exchange for opportunities to learn new skills and progress my career, I will work hard and be loyal.'). No written contract said this; it was just what the employee believed to be mutually understood.

Researchers found that when an employee thought the PsyCon had been breached by the organisation, anger, frustration, and even retributive acts (e.g. working slow, ignoring tasks, badmouthing management, etc.) by 'wronged' employees often followed. The PsyCon had a more significant effect on the employee/employer relationship than did the written employment contract.

The interesting thing about the PsyCon is that it often exists independent of the formal contract. And while written contracts can be ported from one provider to another, the PsyCon cannot, as exemplified in the following case.

“Whether a party meets your PsyCon is ultimately what will drive your contractual satisfaction.”

CASE STUDY:

At the conclusion of a re-tender, a federal government department selected a new provider that was priced well below the incumbent provider's bid.

The incumbent had been quite flexible in its approach, allowing scope creep and permitting the client to exceed capacity restrictions without extra charge, etc.

However, the new provider was well known in the market as a vigorous 'out-of-scope' hunter, typically bidding low then making profits from minimalist interpretations of scope and charging for additional work.

The client behaved with the new provider as it had with the old one (e.g. exceeding capacity, changing scope, etc.). It quickly learnt that the new game was different; it was all about managing scope variations and cost escalations.

Too late to change, the client was now aware that the PsyCon it was able to establish and operate under with its previous provider could not be carried forward with the new one, even though the written contract had been.

Just because the PsyCon is something that cannot be physically seen does not mean that it is supplementary. The psychologically binding nature of the PsyCon means that it can be fulfilled and breached just like written contracts.

However, unlike the fulfilment or breach of a written contract, which can trigger a formal or even legal response, the PsyCon triggers an emotional response that influences attitudes and behaviour towards the agreement and the parties to it.

For example, over time a breach of the PsyCon may lead to a sense of anger, betrayal, and resentment by the individual, eventually causing them to either give up on the relationship or raise arms against those who have breached the PsyCon.

In addition, contract partners often rely on the spirit of the agreement when they come across terms and conditions that are not explicitly incorporated into a formal contract.

Whether your contract is 5, 50, or 750 pages long, the issue remains the same. It will often be your perceptions of whether the spirit of the agreement was fulfilled that will determine whether you are satisfied, not whether the contract was followed to the letter. This is because it is the PsyCon that people operate under, uphold, and hold others accountable to. Therefore, it is the breach of the PsyCon that can have severe consequences for a relationship.

In fact, following the contract to the letter has been shown to contribute to failure.⁵ Over-reliance on the contract has contributed significantly to failure in many deals, leading to inflexibility, over-legalistic or officious interpretations, and lack of responsiveness to current issues, to name a few. You might use the written contract to litigate, but it will be the PsyCon that is first acted upon in practice.

A PsyCon can be quite a challenge to live up to, since it is unwritten and each individual holds his or her own unique view. However, the research we have conducted has helped us shed light on the different types of PsyCons that exist.

The PsyCon Types

By now, you may have realised that knowing one's own PsyCon type mix is quite valuable. Equally important is knowing the PsyCon type mixes of others.

This is why we have dedicated years to researching the PsyCon in practice and created an online profiling instrument completed by thousands across the globe to help determine PsyCon types.⁶

People have a range of styles, with most having a single lead style that is displayed more often than the other styles. When working with different people, this can be a source of bias and conflict or a source of strength and effectiveness.

Determining PsyCon types has helped individuals sharpen their approaches, create high-performing teams, transform organisations and their perceptions over contracts, and help warring parties put down their arms and learn to create productive relationships.⁷

This has been achieved by understanding how different people can learn to work better together through mutual understanding of others' PsyCon types. Indeed, one person may have different PsyCon types for different contracts. Or even a leading-style or dominant style over a second tendency. A short summary of the PsyCon types illustrates the point best:



Relationship Developer

The *Relationship Developer* PsyCon type revolves around trust, respect, and interpersonal relationships. Their core belief is that interpersonal relationships, not contracts, deliver success. Their focus is getting the relationship right via strong rapport and yielding returns by discussing matters in an open and candid way.

It is important to have a Relationship Developer in your team who can gain the trust and respect of individuals in the other party. Their building of relationship capital will help to overcome inevitable bumps along the life of the contract. However, during the course of friendly discourse, Relationship Developers may also agree to things outside of the written contract that can create downstream issues when left undocumented or not agreed in detail.

This PsyCon type is the most common one based on our research, particularly amongst the people delivering contract success (post-award). Therefore, this is the type you might want to expect and plan for more than any other.



Problem solver

Problem Solvers make things happen and fix problems. They view issues as hiccups, not obstructions, and like to break down barriers that get in the way of results. They rarely care who is to blame for something going wrong; they just want to get it fixed.

These are the superheroes of a contract, flying around rescuing operations, stakeholders, and financials. You name it; they save it! However, Problem Solvers have little time or sympathy for bureaucracy, which can result in clashes with those who try to slow them down.

Perhaps unsurprisingly, the provider side is significantly populated with this PsyCon type, and clients attribute success to the ability of providers to deliver despite any challenges. However, the absence of this PsyCon type on the buyer side has contributed to unproductive adversarial situations, rather than a shared ability to resolve hitches before they become obstacles.



Organiser

An *Organiser* maintains better records, audit trails, controls, plans, and processes than the other PsyCon types. Their PsyCon revolves around good processes, systems, and documentation.

When neither party can find a signed version of the contract, the necessity of this archetype is glaring. Their emphasis on systemic collection of evidential matter is crucial to the resolution of misunderstandings and possible disputes. They are also heavy users and developers of templates created to enable efficiency.

However, Organisers can become overly controlling or bureaucratic. The templates and prescribed processes they often require others to comply with can be considered necessary evils, rather than of value.

Legal and procurement people have the most striking inclination towards this PsyCon type. This explains their wide use of templates, policies, and procedures. The low presence of Organisers in the rest of the business may explain why everyone else struggles with these tools.

⁶ See, for example, Jongkil J., et. al. (2018), "Psychological Contract in IT Outsourcing: A Systematic Literature Review". 51st Hawaii International Conference on System Sciences, Waikoloa, January; Cullen, S. et. al. (2017), "From default to high performing: A case study of relationship success in outsourcing". 3rd Annual International Association of Outsourcing Professionals Research Workshop, San Antonio, February; and Cullen, S. et. al. (2017), "A Framework for Relationships in Outsourcing: Contract Management Archetypes". 50th Hawaii International Conference on System Sciences, Waikoloa, January.

⁷ To find out your PsyCon type mix, go to Contract Management Style Profile Report <https://whiteplumepublishing.dpdcart.com/>



Entrepreneur

An *Entrepreneur* seeks innovation, better ways of doing things, and long-term potential outside of the relationship. They loath to accept an explanation of ‘that’s how we’ve always done it’ as a reason to continue doing something a certain way. Thinking outside the box is what they do best and value in others.

Individuals with Entrepreneurial inclinations can get frustrated at the lack of new ideas or continuous improvement (despite the contract being silent on this). Those low on this PsyCon type, however, find Entrepreneurs exhausting. They can feel inundated with new ideas for things that are not broken and frustrated by the way Entrepreneurs believe their ideas can be easily implemented.

Without question, we find that this PsyCon type is largely present in the PsyCons of people at executive levels. Unfortunately, it is present to a much more limited degree everywhere else.

Although providers are often blamed for the lack of innovation, it is truly endemic across both parties – especially amongst more junior levels of staff.



Scanner

A *Scanner* is well networked and connected, a natural explorer, and seeks and shares data and information as part of the evidence-based management that they prefer.

They are characterised by a keen ability to find information (e.g. via the internet) and/or have many acquaintances. Their focus on seeking data and external information is driven by their desire to be as informed as possible.

The greatest value of this PsyCon type is bringing the outside world into an otherwise inwardly focused group. However, Scanners can overwhelm people with too much data and slow things down while they seek out information.

Unfortunately, this PsyCon type, which seeks evidence and the hard-won experiences of others, is not common. This may explain why we see the same mistakes made in the contract lifecycle, decade after decade, and not the rapid adoption of its successes and best practices.



Monitor Protector

Monitor Protectors believe that their organisation must be protected. They focus on the risks that the other party brings. When drafting the contract, they may prepare a biased agreement in favour of the party they represent. If in charge of the contract, they prefer to focus on the other party’s performance and non-compliance.

This PsyCon type sees risks where others do not. When used proactively to identify potential hazards and the likelihood of their occurrence, the effect can be mitigated or the treatment agreed rather than disputed. However, Monitor Protectors are more likely to exhibit asserting/defending interchanges. A Monitor Protector’s behaviour may resemble that of a bully. However, more commonly, the behaviour will be a firm and unyielding position with little concern for the other party.

This PsyCon type is the one we have observed the least. In fact, it is the rarest. Most people demonstrate at least a little of all the PsyCon types. However, the Monitor Protector is the only PsyCon type that is completely absent from some profiles; about 5% do not possess any of these characteristics at all.

Perhaps this is why adversarial contracts are not useful in practice; they are designed for the absolute minority.

Exploring the PsyCon Types – Cases

“Understanding psychological contracts is crucial for high performance across party and organisational boundaries. Get this right and you are on your way to a proven success pathway.”

This section offers two case studies. The first is about a person who realised that his PsyCon type was not going to work and chose to view the problem from another perspective. The second concerns a contract that was officially put in dispute and seemed hopeless. While we have many cases, we would like to share with you these two that show how understanding the PsyCon types can help individuals in their work as well as turn around an entire agreement.

Case 1: A Bank’s Strategic Sourcing Manager

The company. This publicly listed bank grew out of a cooperative building society. It was a heavy user of third-party services, ranging from head office functions such as legal, IT, and recruitment, to bank operations such as cash collections and mortgage settlements.

The issue. The strategic sourcing manager was tasked with negotiating a lower price with the bank’s provider of travel and online booking services. He first collected as much information as he could through his personal contacts about what others were paying for similar services. Once satisfied that he had sufficient evidence that the bank was ‘paying more than anyone else’, he presented the data to the provider and demanded a downward price adjustment. The provider refused. He then continued to collect more data of a similar nature until he believed the evidence was overwhelming and repeated the demand. This was again rejected.

The PsyCon type. After completing the online profiling tool, he realised he had a stronger-than-normal inclination towards Scanner (in the top quartile) and that he was employing Scanning techniques (use of benchmarking data as persuasive evidence) to little effect.

The action. Rather than continue in this mode, he decided to put aside his natural inclination. He learnt that Relationship Developer was the leading PsyCon type in general and decided to try techniques common to that type rather than his preferred methods. Relationship Developer was his weakest and least-preferred type, and he would not normally view an issue through the Relationship Developer lens, nor attempt to resolve it using techniques common to that PsyCon type.

The outcome. He asked the provider if everything was working from their end, and if they had any issues working with the bank’s people. After initial hesitation, the floodgates opened. The provider was frustrated that so many of the bank’s staff refused to use the online system for bookings and itinerary changes, booked outside of the provider despite an exclusive agreement, and berated staff at the customer care centre beyond tolerable levels. Under no condition was a discount to be considered when the bank was breaching the intent of the agreement and being difficult to work with.

It was the first time he became aware of the premium that providers can place on customers who are difficult to work with – a concept foreign to him at the time. The manager took it as his personal mission to fix this situation. He left with a verbal promise to revisit pricing once he formed a solution that had begun to show positive effects.

Back at the office after his experience, he saw the value of the Relationship Developer PsyCon type but also knew that he did not intuitively operate within it. Relationship Developer was his lowest-scoring PsyCon preference and well below that of others (in the lowest 3%). He now seeks relationship-based advice and insight from others in his team prior to embarking on discussions with providers.

The lesson. One of the important benefits of the PsyCon type framework at the individual level is developing self-awareness and, from there, recognising the possible need to adapt. In this case, the result was achieved by adapting to the most common PsyCon type.

He realised that continuing to ‘act native’ was unlikely to achieve the cost reduction. Two attempts at using data as a persuasive tool had ‘gotten him nowhere and was an act of insanity – doing the same thing over and over again and expecting different results’. When he changed his mode to Relationship Developer, he opened a constructive dialog with the provider that was crucial to the context.

Case 2: Hospitality Group

The company. Hospitality Group was founded in the UK in 1941 and expanded over the decades to become a major provider of catering and support services, employing more than 500,000 people in 50 countries. In this case, they won a tender worth US \$32 million per year for hospitality services.

The issue. Things began to go awry shortly after the contract was signed. Operations began spotty and got worse, eventually resulting in formal default.

Even though operations were struggling, the provider was focused on delivering the innovation called for in the customer's request for tender (RFT). In the first year, they submitted numerous proposals. All were rejected. The frustration some of the customer's senior executives were feeling was expressed by one as, 'They are focused on selling more stuff to us, not delivering what they had already sold.'

The PsyCon type. The customer's strategic sourcing group, which issued the RFT, had three times as many Entrepreneurs than the business units that they were representing. The provider unconsciously stocked the management team to match the RFT with Entrepreneurs (three times that typically present in providers).

But after contract award, strategic sourcing handed the deal over to be managed by the business, which was dominated by Relationship Developers. The only innovation the business was interested in was cost savings, not any of the creative ideas proposed in the provider's bid or raised subsequently.

The action. Once the PsyCon type differences were identified, it became obvious to Hospitality Group that the goalposts had changed and that it must too. It realised that it had staffed its team to deliver to the RFT, rather than the business. It quickly changed tack. All innovation stopped, leadership pairing to key customers took place, and the emphasis was put on relationship development and operations delivery.

The outcome. The relationship reset began to yield results within months, culminating in an extended contract and what was described by Hospitality Group's CEO as the 'greatest turnaround in our history'.

The leadership pairing was a key initiative that opened a dialog that had never previously occurred and created the basis of personal trust. The new leadership pairs, and the chemistry between them, enabled the parties to rethink everything about the deal. A new contract was signed after six months' work on a radical transformation of the contract and governance structure. It is now the ideal model promoted by both parties in other agreements.

The lesson. Contracts have a lifecycle, and there will be many people involved over its life. These people will have different mixes of PsyCon types that necessitate a change in strategy throughout the life of a relationship. Hospitality Group management understood that customer firms have many stakeholders that must be catered to. This was the first time, however, that management realised that tender documents might reflect the desires of one particular group rather than the majority of stakeholders.

Management has taken this lesson to a similar situation, where a much larger contract was developed and awarded by a group that was different from the one they would be working with. It is treating that contract as a framework rather than a bible and has begun discussions with each stakeholder group to form a bespoke supplementary agreement specific to the differing expectations of each.

Harnessing The Power Of The PsyCon

Understanding and aligning the PsyCon types enables the power of the PsyCon to come to the fore, helps you break through the myths surrounding the written contract, and enables supplier relationship management.

However, to create a high-performance team that delivers results, we first need to understand the concept of a hybrid organisation and how teams move from storming to performing.

The Hybrid Organisation

The hybrid organisation is the interparty union that results when the parties sign off on a contract (Figure 1). It represents the inter-linking of cross-party people, systems, and processes which produce the results. It is an informal joint venture of sorts.

To have this hybrid organisation working at optimal levels, it is crucial that a shared culture exists and is sustained. This means having positive and constructive PsyCons that are shared and consistent between the parties and amongst all individuals.

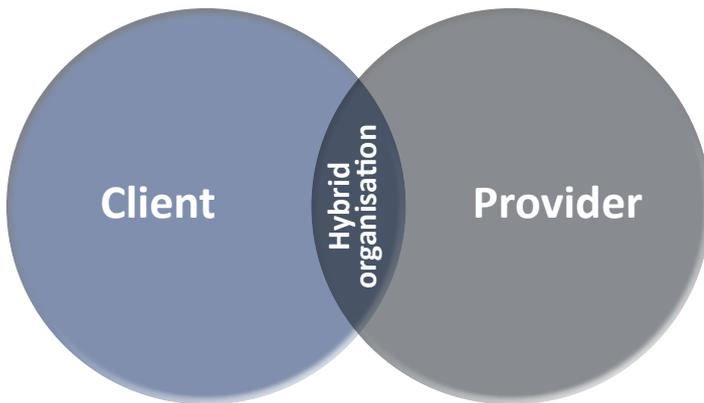


Figure 1: The Hybrid Organisation
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We emphasise that the positive and constructive element here is essential, as well as the need to sustain it. This is because shared values and cultural aspects of a hybrid organisation may seem aligned at the start but can emerge as dysfunctional over time, as demonstrated in the next case study.

CASE STUDY:

A client from the telecommunications industry made a large investment in forming a productive and trusting relationship during the bidding and negotiation stage of a national infrastructure maintenance contract.

Together, the parties found ways to absorb the client's 300 staff into the provider, set KPIs far beyond what the client had been achieving, and strike a happy balance between risk and reward for performance and new investment.

But it ended there. When they were handed the deal to run, the client's contract managers mostly held an adversarial Monitor Protector PsyCon. As a result, they believed that all suppliers were out to get as much money as possible, and this one was no different. According to one manager, 'You must manage them tough, so they don't take advantage of you and think you're an easy target.'

The client's team acted out its PsyCon by disputing all bonus and out-of-scope work claims and disallowing any requests for excusable delays, etc.

The provider quickly changed tack and set up its defences. This included not performing work until a variation form was signed off (a very long process in the telco), refusing to scale up KPIs that were being achieved with little effort, and reporting only the minimum information that was explicitly defined in the contract, not the plethora of information available in the system (unless the client paid extra).

What this case shows is that different people throughout the contract lifecycle will bring different PsyCons into play. Therefore, the culture of the hybrid organisation must be able to survive this churn, as over time, many people on both sides come and go. Being able to set up a productive culture is only the start; the ability to maintain it becomes the crucial factor.

Norming The PsyCon

PsyCons start out as individually held beliefs and understandings, but as people begin to exchange opinions and expectations, ‘clans’ begin to emerge. A clan is born when values become shared and understandings become consistent within a group

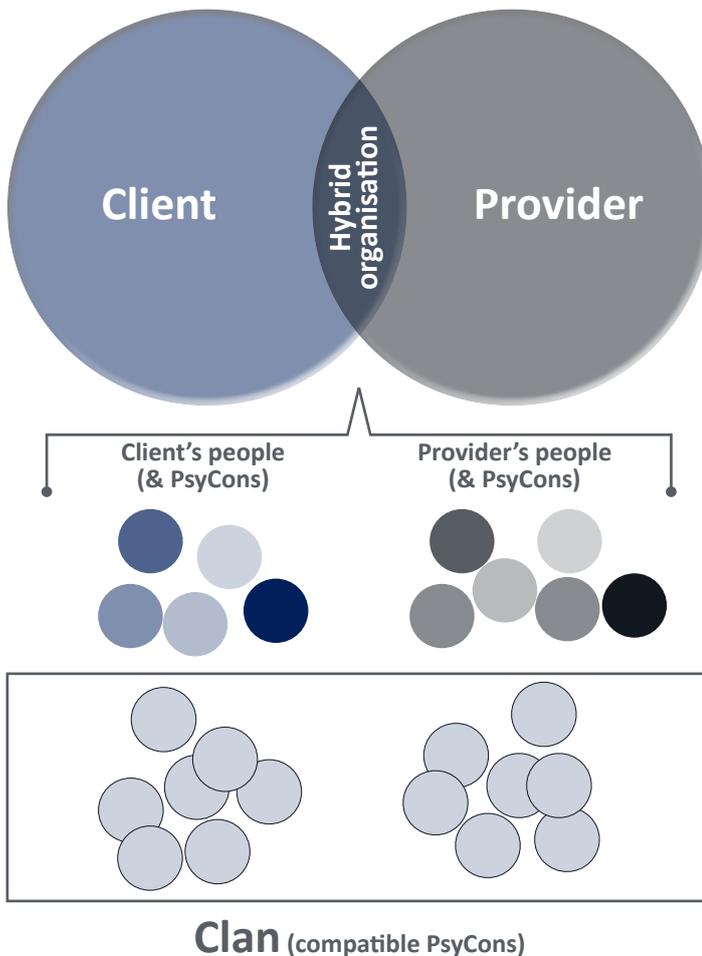


Figure 2: PsyCon Clans
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Non-clan people will still hold their PsyCon outside of the group, but the clan will start developing the dominant interparty culture of the hybrid organisation.

Over time, a clan can be a force for constructive or destructive dominant behaviours. As an example of the latter, a clan of managers in a national organisation called themselves the ‘toe cutters’.⁸ They took great pleasure in getting penalties out of suppliers. One stated, ‘If we make penalties equal to our salaries, then we’re self-funding. But if we make penalties greater than our salaries, then we’re a profit centre.’

Everyone who joined the clan was indoctrinated into this philosophy. Despite it being rather perverse – wanting failure and poor performance as contract outcomes – this clan was able to thrive for a decade. It was eventually unwound due to the damage that was inflicted on supplier relationships and the client’s reputation in the supplier market.

The ‘toe-cutter clan’ is an illustration of a unilateral clan (i.e., it only existed in one party). More commonly, clans are formed amongst individuals across both parties. These clans more often show positive behaviours such as mutual flexibility, rather than strict adherence to the contract, and joint problem solving, rather than using the fault-orientated clauses in the contract. The next case shows this in practice.

CASE STUDY:

A bank offshored the re-engineering of two of its 40+ year-old core banking applications to an India based provider under a 5 year, 150 person, fixed price contract. The vendor had outstanding credentials, so the bank assumed the vendor would need no help. But, as it turned out, it needed all the help it could get.

The vendor did not have banking experience and therefore did not understand the bank’s processes. At the same time, the vendor was of the understanding that the code would be in English. But it was in German. Oops.

Nothing regarding these two issues was in writing – it was just assumed. The formal contract made no mention of either issue and had no solution.

This is where the PsyCon of the hybrid organisation filled the gap. The parties could have ended it all, given that the entire project would need to be re-engineered. In fact, a group of managers at the bank were on the legal warpath. However, the collective PsyCon was one that harnessed the Problem Solver type and led to everyone working collectively to ensure that the project was successfully delivered whatever the cost. And in the end, it not only delivered high-quality applications, but also created a clan that delivered results despite significant obstacles.⁹

If clan members are influential enough and consistent in carrying out a collective PsyCon that is backed by proven results, then it can become the norm – ‘the way we do things here’ for both parties. Once these behaviours become how we do things, a clan’s collective PsyCon can quickly become more important than the written agreement. This collective PsyCon can also form a stronger and more productive culture than the corporate cultures of either of the ‘parent’ parties.

⁸ ‘A Toe cutter’ is slang for a standover man. As the name implies, this involves painful removal of the digits of one’s foot.

⁹ For more, see Prifling, et. al. (2009), “Changing Psychological Contracts and the Effect on Control Models in Offshore Outsourcing Projects – A Case from the Financial Services Industry.” 42nd Hawaii International Conference on System Sciences.

Creating A High-Performance Clan

Forming a successful and sustainable hybrid organisation takes time and leadership. Beginning with the time factor, members of the hybrid organisation often go through recognisable stages as they change from being a collection of strangers to a united group with common values and goals.

Tuckman's classic stages of team evolution – the 'Forming, Storming, Norming, and Performing' model (Figure 3) – best describe the phases a team goes through, from its first meeting to eventual sustainable performance.¹⁰

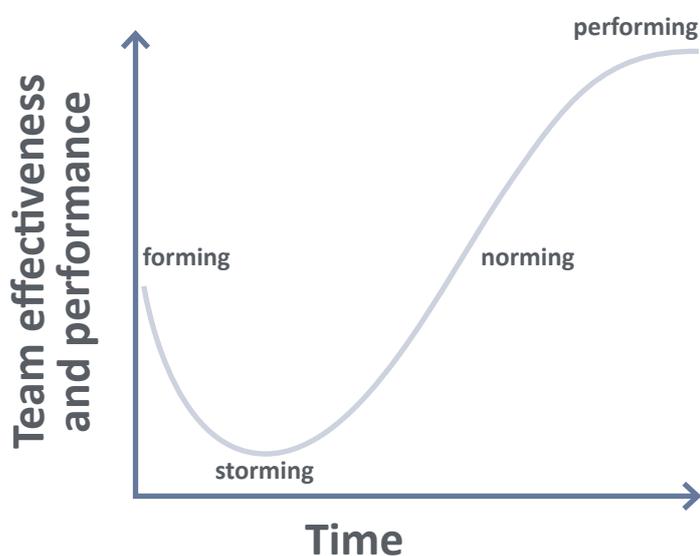


Figure 3: Tuckman's Team Stages

Forming – This is a short stage where the interparty team meets, gets to know a little bit about each other, and learns about the opportunities and challenges. The team then agrees on goals and begins to tackle the tasks. This is when the hierarchical leaders, as well as the opinion leaders who influence others, need to begin to act in accordance with the PsyCon that they want others to adopt.

Storming – Differences in individual PsyCons emerge. This is generally where conflict arises. For some, this occurs during negotiations; for others, after the contract has been signed and a different group takes over. Many parties never leave this stage once it has been entered. Some also loop back when there has been a change in leadership or the addition of another key member whose PsyCon differs from that which the hybrid organisation has normed upon. This is when the leaders need to reinforce the positive PsyCon in action, praising those acting in alignment, calling out bad behaviours, and fortifying the desired PsyCon through their own behaviour.

Norming – Consensus and agreement are achieved. There is clarity on both the party and individual roles. PsyCons are normed, trust has been earned on both sides, and a clan is formed. The leaders can now start taking a step back as sustainability has begun to set in.

Performing – The clan has a clear strategy and a shared vision. Collective values result in efficiency, effectiveness, knowledge sharing, and issues being positively resolved. Leadership of the shared PsyCon is no longer concentrated at the hierarchical leadership level, since everyone is now an opinion leader. When there is the inevitable churn within either party, new people will go through the team stages faster than the original clan. Non-constructive beliefs and behaviours contrary to those that have been proven to deliver high performance are jettisoned, and fresh constructive contributions made welcome.

10 Tuckman, Bruce W. (1965), "Developmental sequence in small groups." *Psychological Bulletin*, Vol 63(6), June 1965, 384–399.

The PsyCon's Effect On The Legal Agreement

In the previous sections, we explained what the hybrid organisation is and how it establishes its own culture of compatible PsyCons amongst individuals from both the client and provider organisations. This culture then drives the acceptable behaviours and shared values of the new collective unit. Over time, this becomes the norm and forms the basis of the implied contract – an agreement created by actions, not words.

Apart from the terms expressly agreed, implied terms may also exist to impose obligations on the parties. Implied terms can be inferred from a large number of individual acts that show an established understanding of a course of business (known as *terms by custom* in Australia). This occurs in several main ways.

Firstly, this happens through something known as the course of performance. The *course of performance* refers to a pattern of behaviour that occurs after a contract has been signed and acts as a variation by conduct (rather than a written or verbal variation). A clan acting on their collective PsyCon can bring the course of performance into play through their behaviour patterns. For instance, if the clan ignores penalty clauses, because they are against the spirit of the agreement, this behaviour becomes an accepted course of performance over time.

Secondly, this happens through the *course of dealing*, which refers to a recognisable pattern of behaviour between the parties prior to the signing of the current contract. For example, if the parties had previously ignored onerous reporting requirements contained within the contract templates, it would be reasonable to assume this will continue. A party can rely on this past behaviour continuing unless the other party states otherwise (and acts accordingly). The course of dealing establishes a common basis of understanding for interpreting a current contract and the expected conduct.

These two then work in tandem with a legal principle known as estoppel, which precludes a person from asserting something contrary to what is implied by a previous action.

Estoppel can be enforced if the courts determine that it is objectively reasonable to do so when certain actions or words contradict what is written in the contract. Hence, it is often pleaded as an alternative to a contract.

As you can tell, the PsyCon can have a profound impact on the legal agreement. The patterns of behaviour established through the PsyCon can supplement and even override parts of the written one, as it covers aspects of the working relationship that are not covered in the written contract.

In Figure 4, we show how this works.

We all know numerous situations where, according to the collective PsyCon, the consensus of opinion is that the contract is to be 'kept in a drawer'. We can now be fairly certain that the original written contract has not been touched, but it is now augmented, informed, and replaced in part by an established normative PsyCon (the implied contract).

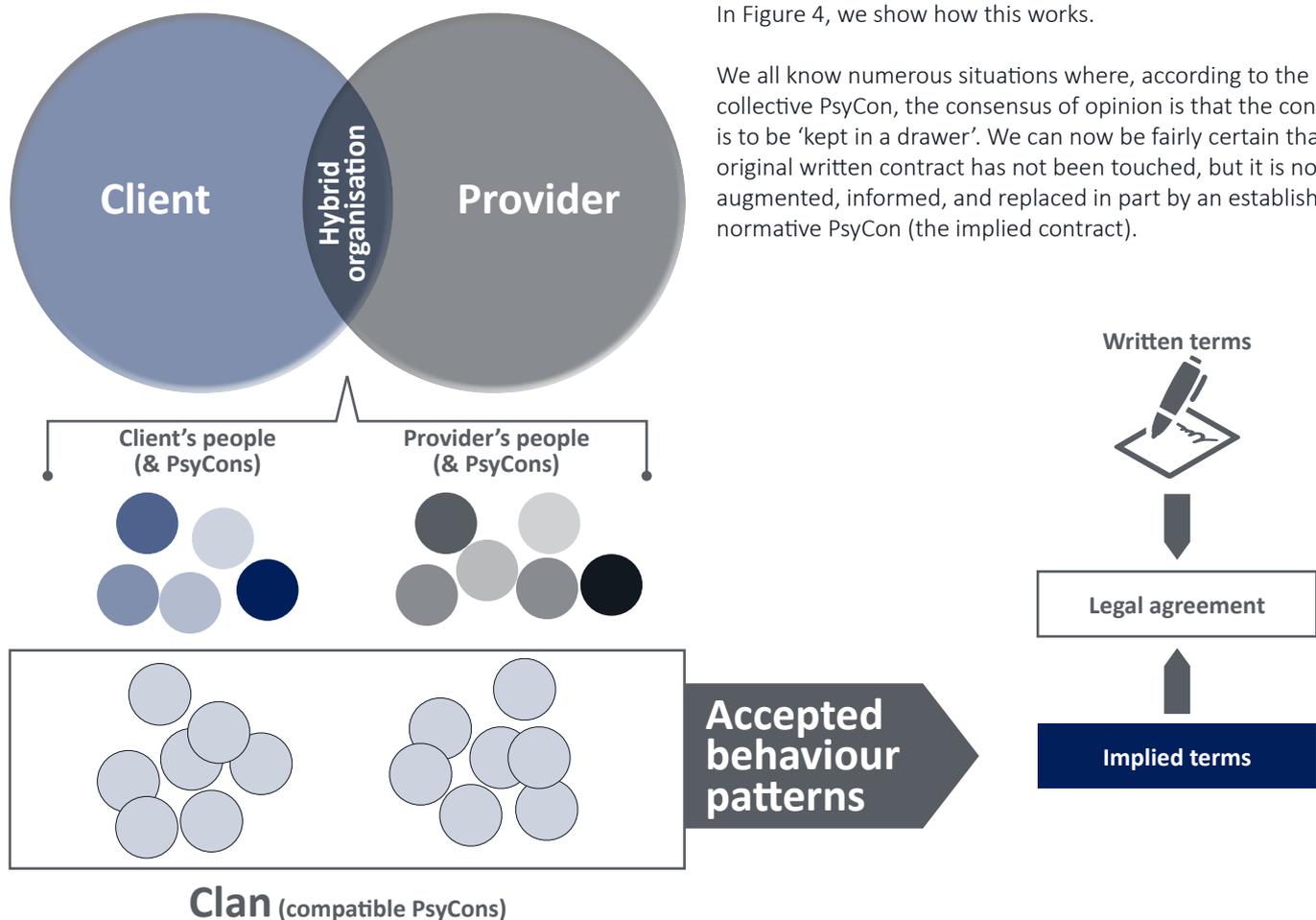


Figure 4: The Legal Effect
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Conclusion

In this paper, we discussed the key myths that often surround the written contract and how they question the resultant ROI. We also explained how understanding and harnessing the PsyCon enables you to break through these myths and unleash the performance of clans (interparty teams made up of people with compatible PsyCons).

It must be noted that the purpose of this white paper is not to say that the written contract is not important. It clearly plays a vital role as a fail-safe device, should something go wrong. It can also be a valuable guide to the parties, if designed to be so.

However, as mentioned throughout this paper, it is impossible to predict and cover everything in its entirety through a written contract.

When addressing the inevitable bumps in a commercial relationship, without positive aligned PsyCons, disappointment is unavoidable and the written contract will be of little use.

Moreover, we have all surely experienced, to different degrees, the harmful effects of negative PsyCons and have felt let down when ours have been breached.

The value of harnessing the positive aspects of the PsyCon is collectively rising above the adversarial nature of the written contract and the adversarial nature of some of the individuals with whom we work. Aligning and reinforcing positive shared values across both parties results in more productive relationships.

When the parties can rely, trust, and commit to each other, the desired results (efficiency, innovation, cost savings, etc.) become not only easier, but also a pleasure to achieve and bring tangible future opportunity.

However, in order to get there, you must ensure that PsyCons are mutually shared and understood between the parties and then harnessed and reinforced at every turn.

In fact, we recommend articulating stakeholders' and contract managers' PsyCons before attempting to draft a written agreement. Then use the collective PsyCon to frame the formal contract.

This will result in a contract that reflects actual expectations, is written in a way that people can understand, is much shorter and fit for purpose, and has the additional benefits of being faster to produce and designed to be managed rather than litigated.

Sure, get the lawyers and commercial or procurement managers together to hash out the terms and conditions; have the subject matter experts agree on the specifications/SLAs; and get the financial people to knot out the numbers. But also, do think about getting the leadership team together to agree on the collective PsyCon and then make it happen with the right people with the right attitude.

Revolutionary? Perhaps. Logical and efficient? Yes. A great ROI? Definitely.

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She is recognised by the Global Sourcing Association (UK) as one of the world's foremost thought leaders in their A-list of trailblazers. Her in-depth knowledge is globally acknowledged, resulting in research reviews for the Harvard Business Review, the California Management Review, Journal of Information Technology, and IEEE Transactions on Engineering Management.

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Jay's research has been extensively published through numerous peer-reviewed academic publications, and he has been a frequent guest lecturer/speaker at numerous academic institutions and industry-based conferences around the world.

Prior to his current role, Jay worked for over 12 years in the commercial space as the managing director of Elegant Minds – an IT consulting firm specialising in offshored ICT development. He also started up the WebAsia initiative during his time at Melbourne IT, which involved the establishment of a strategic partnership agreement with Alibaba – one of China's largest ICT companies.

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