OUTSOURCING CONTRACTS

Considerations When Preparing to Renegotiate an Outsourcing Contract

ISG

INTRODUCTION

Most outsourcing arrangements will be renegotiated during their term. These renewals and restructuring constitute a significant and growing portion of the outsourcing market, especially in the more mature arenas such as the United States and United Kingdom. In some cases, such renegotiation activity is driven by a change in service scope requirements or in volumes to be consumed. In others, the approaching end of the original term will encourage the client to seek refreshed and improved contractual conditions. More often than not, the client will also be seeking better prices. Though restructuring doesn't necessary indicate dissatisfaction with the sourcing relationship it is a common driver, with most companies reporting that they receive less value than expected, often because their expectations were unrealistic to start with.

These interventions can take many forms. A remediation is usually a highly targeted or tactical action focused on resolving specific issues in the relationship or with the service delivery, and may or may not result in changes to the contractual terms. A restructuring is normally a wider engagement aimed at changing the shape of the deal, such as the scope, quality level or price of the services. These events typically occur mid-term and result in contract change. Most extreme in terms of impact and complexity are renewals. These events usually occur as the end of term approaches, as the client takes the opportunity to seek a fundamental transformation in the way that services are sourced and delivered, or seeks to adapt the operating model to major changes in the business strategy. Some renewal processes will be competitive, with service providers other than the incumbent are invited to participate, but all result in a wholly refreshed contract.

Some renewal processes will be competitive, with service providers other than the incumbent are invited to participate, but all result in a wholly refreshed contract.

A successful renegotiation will require careful preparation. The relationship and the performance of the service provider will need to be assessed, and the contract will need to be read carefully so that all rights and obligations are understood in detail. The financial will need analysis, and various outcome scenarios should be modeled and valued in advance of discussions with the provider. In ISG's view, the following practical considerations are also paramount when preparing to renegotiate an outsourcing contract.

ESTABLISH CLARITY OF PURPOSE

Clients often enter into renegotiation without a clear shopping-list of intended outcomes. It is all too easy to drift into discussions – perhaps provoked by specific service outages – with a general desire to improve service quality and reduce costs. While a failure to set out realistic aims is often cited as a standard reason for any change program's lack of success, the effect of entering into renegotiations without a pre-determined definition of victory is particularly damaging. Not only will the lack of clear goals make progress difficult to gauge, but it will usually be detected by service providers who will be less willing to respond to the client's demands and will probably take the opportunity to procrastinate in discussions too. It is not unheard of for renegotiations to conclude with the client signing up to additional service scope that they didn't know they wanted, while the original source of the trouble goes unresolved.

It is not unheard of for renegotiations to conclude with the client signing up to additional service scope that they didn't know they wanted, while the original source of the trouble goes unresolved.

It's an easy trap to fall into. End users in the client organization are often highly vocal in their criticisms of the service provider, but find it hard to convert these strongly-felt but often vague or even contradictory dissatisfactions into specific and actionable remedies. Initiating a conversation with the service provider often seems an easier option than executing the internal maneuvers required to drive out a clear and shared change requirement, and additionally creates the impression of decisive action. Indeed, some clients enter into renegotiations without a clear objective precisely because it avoids taking a decision on what is required. Yet the argument that simply "hearing what the provider has to offer" is a sensible way to avoid introducing constraints into the discussion too soon, though seductive, is often mistaken and will waste time and possibly derail the negotiation process entirely. It's best to start with a short list of "must haves" rather than a longer list of "nice to haves."

BUILD INTERNAL ALIGNMENT

Clear negotiation aims must also be widely shared among decision-makers within the client organization. It's no good if the negotiating team believe they are tasked with improving service delivery and perhaps shaving a few percent off the investment costs if the board care only about delivering the run-rate cost reduction already announced to the market. Renegotiations are often undermined by what appears to be unpredictable meddling from senior management, but which could have been anticipated had the project team spent adequate time digging into the genuine motivations of the main stakeholders. Making this effort is particularly important in organizations that aim to manage by consensus, as dissent is often unvoiced rather than eliminated. It is better to unearth such competing objectives earlier in the process rather than later.

DEMONSTRATE A CREDIBLE THREAT

Raising the possibility that an uncooperative provider will be prevented from bidding for future scope can be an effective commercial lever, but underwriting almost any request to renegotiate a contract is the threat of termination. Often, service providers will not respond to requests to negotiate, or will seek to drag out the resulting discussions, because they do not believe any such threat is credible. Perhaps the provider believes that their offer is more or less at market levels, or that there is no stomach at senior management levels in the client organization to end the relationship. Frequently, the service provider will believe – often with justification – that the client lacks the internal capabilities to manage the transition of the services to an alternative provider.

Transitioning between providers or even terminating a contract is no small thing, and despite supportive words, project sponssors will - and should - think carefully before choosing this route.

First, it should be determined whether the client organization genuinely has the appetite for change. Transitioning between providers or even terminating a contract is no small thing, and despite supportive words, project sponsors will – and should – think carefully before choosing this route. No matter how compelling the business case, doubts will persist. Does the client have access to the right skills to manage the transition? Are the upfront costs too high? Is such a change advisable given other ongoing initiatives? In short, is it all too risky? Assuming that the client is aware of and accepts or is able to mitigate the risks, the credibility gap must be closed with the service provider. The client must be seen, for example, to be strengthening its internal service management and transition capabilities. Negotiations should also be strictly time-boxed. It is worth considering telling the incumbent provider that if no satisfactory outcome is reached by the deadline, they will be excluded from any RFP or approach to market for alternative services. The prospect of a competitive tender can work wonders.

CONSIDER THE SERVICE PROVIDER'S POINT OF VIEW

With the effort required to drive out clear and shared renegotiation objectives, it can be easy to forget to consider the view from the other side of the table. Yet it is vital to spend time analyzing and modeling what the service provider would hope to achieve from a renegotiation. Although the ideal of a "win-win" outcome is seldom realized – despite how often the phrase appears on marketing material – some outcomes clearly mean more to the client than the provider. Conversely there are often easy giveaways for the client that can be significant for the provider.

Think too about the individuals on the provider's negotiating team. How have they behaved in the past? Do they have a stake in the current service delivery model or are they generally resistant to change? If so, is it worth asking to have them replaced by fresher people with more flexible approaches? How are the service provider's team measured and incentivized? Their behavior will be different if they are more concerned to protect margin rather than revenue.

RECOGNIZE REALITY

Outsourcing relationships are complex, and those on boards and steering committees have little time. Be aware that despite best efforts to communicate the subtleties, unrepresentative – and perhaps not even particularly important – features of the service provision can develop undeserved prominence and crowd out other considerations. Of course, it's better if this can be prevented from happening, and if the project team can establish time to regularly update senior management in detail on the status of the deal. Yet what starts as attempt to simplify for purposes merely of communication can end in simplification for purposes of decision too. One or two things – usually the savings or specific and isolated targets such as improved benchmarking rights – will often stick in the mind, and can come to wholly define a successful renegotiation outcome. For a busy project team grappling with a multitude of complications it can be frustrating to see the deal reduced to a single variable. But ignoring this common situation if it does occur will only compound the problem. Instead, project teams should acknowledge the new negotiation objectives and take a fresh look at their plans accordingly.

ABOUT ISG

ISG (Information Services Group) (NASDAQ: III) is a leading global technology research and advisory firm. A trusted business partner to more than 700 clients, including 75 of the top 100 enterprises in the world, ISG is committed to helping corporations, public sector organizations, and service and technology providers achieve operational excellence and faster growth. The firm specializes in digital transformation services, including automation, cloud and data analytics; sourcing advisory; managed governance and risk services; network carrier services; technology strategy and operations design; change management; market intelligence and technology research and analysis. Founded in 2006, and based in Stamford, Conn., ISG employs more than 1,300 professionals operating in more than 20 countries—a global team known for its innovative thinking, market influence, deep industry and technology expertise, and world-class research and analytical capabilities based on the industry's most comprehensive marketplace data. For more information, visit www.isg-one.com.

Let's connect NOW...

ISG™

imagine your future®

