

Contractual Do's and Don'ts for The Buyer of Outsourcing Services

This series of short articles, which address a wide spectrum of ITC (Information Technology and Communications) related outsourcing activities, is grounded in an initial definition and an outline of scope and more usual rationale underpinning its adoption and use. (Refer 'contributions to date' <http://1stadvisory.com/Tips-Challenges.html>) Any decision to outsource needs to be tempered with the recognition of problems and challenges that are all too often associated with such an initiative.

Generally speaking, when launching into outsourcing it is advisable not to pay too much attention to the sales hype and lofty descriptions put out by those vendors involving the use of adjectives like 'adaptive', 'transformational', 'co-sourcing' 'in-sourcing' – something of an oxymoron- and laterally, 'the Cloud'.

Indeed recently, some of the big ITC outsourcers e.g. Accenture and IBM, who one would assume should know better, are jumping on the 'Cloud' bandwagon, proclaiming through spurious research 'surveys' and 'white' papers how it is going to be the all encompassing 'virtual', 'cheap, and 'new' technology that will 'revolutionise' the outsourcing industry.

There is nothing especially 'new' about the so called 'Cloud' which considerations such as privacy, data security, performance, legal and other drawbacks render it, in its basic 'public' – and relatively cheap- manifestation, of limited application e.g. email. Functionally similar manifestations of the concept, albeit without the accompanying promotional hype e.g. 'virtuality', have been around for many years and in various guises such as 'timesharing', 'ASP', and 'utility computing'.

Its origins and that of commercial ITC outsourcing generally as we know it today can be justly attributed to Ross Perot who started EDS (now part of HP) back in 1962, using a 'virtual' resource, as constituted by the availability of spare processing capacity on some of the 1000's of mainframes in his native Texas.

A lot has happened in the industry since Ross Perot started the ITC outsourcing ball rolling almost half a century ago – not all of it positive.

The level of User satisfaction with outsourcing generally, as confirmed by ongoing surveys, continues to be worryingly high within the region of 80% of users reporting time and cost overruns and around 70% citing varying levels of overall dissatisfaction with it.

The cause of this dissatisfaction in quite a number of cases can be traced to a mix of: unrealistic User expectations, inadequate definition of needs, limited due diligence, and attention to detail resulting in varying levels of contractual dissonance. This situation is sometimes further aggravated by Provider sales strategies, including offers of low entry costs followed by aggressive charging for 'extras'.

Getting the contract right therefore is very important and at a minimum it is advisable to do the following:

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DO's

- **Housekeeping**
 - Foster good Provider relations – remember the Provider needs to make a profit
 - Check out other, similar, present/past client experiences and any litigation history
 - Interview Provider Account Manager/s and support staff

- **Term**
 - Technology changes rapidly as do business circumstances so avoid contractual 'lock-in' for several years
 - Negotiate periodic review/ audits/ benchmarks and related 'exit ' options
 - Clearly determine termination handling and timing e.g. / notice conditions

- **Operational**
 - Determine and secure retrieval 'in-house' logistics including business continuity processes, liabilities and cost sharing arrangements.
 - Incorporate flexibility regarding changing business conditions and technology advances
 - Build in Provider related performance incentives
 - Structure appropriate penalties for non-performance and impact on exit options
 - Define and ensure comprehensive Provider communication/escalation protocols and reporting coverage
 - Transfer risk of overruns to Provider and ensure that any necessary incremental charges are scaled favourably
 - Structure contract to facilitate new initiatives such as M&A activities

- **Pricing and Charges**
 - Benchmark, Benchmark - use industry comparators and indices
 - Try and align charging with business metrics/outcomes
 - If cash rich explore discounted (NPV/CAPM) advance payment options
 - Look for predictability of costs especially over the mid to longer term

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Don'ts ...

- **Heads of Agreement**
 - If possible dilute/avoid them by omitting the word 'Agreement' and/or substituting an unsigned memorandum, outline or similar.
 - If Provider starts work based on signed and dated 'Heads' before main contract is executed the User is 'de facto' contractually committed
 - Do not allow 'Heads' to pre-empt main contract negotiations in any way
 - Address, incorporate and/or suppress 'Heads' in main contract

- **Service Level Agreements (SLAs)**
 - Avoid using the word 'agreement' in the heading; preferable words are 'schedule', 'definitions', etc
 - If dated and signed SLAs look like a contract although they may not have a contractual framework
 - Note that service requirements can change regularly but contractual frameworks never unless renegotiated
 - Include provisions for SLAs handling in main contract

Although structuring and negotiating outsourcing contracts can involve many more 'do's' and 'don'ts' than those mentioned above, when diligently done, a contract can herald important benefits for the User including:

- Transition of surplus or non-business strategic resources/ people to the Provider which reduces costs and facilitates improved management focus on core business
- Contractual guaranties covering services hitherto subject to the vagaries of internally managed operations
- Access to a Provider's extended infrastructural and specialist resources
- Built-in ITC technology refresh often associated with specialist Provider
- Cash flow stabilizing benefits of predicable/ reduced Provider charges

As in most business transactions contracting for outsourcing is a function of balanced judgements about risks and rewards, acceptable to the parties involved. Sound business aligned contractual underpinning is a critical factor in facilitating them and the other stakeholders involved to realise their goals.

The intention of the foregoing is to highlight some of the more critical issues, which arise when contracting for outsourcing services.

The next article in this series will examine another salient aspect of outsourcing; its advancing globalization via the practice of 'off-shoring', and comment on some of the legal, quality, business and brand risks, and challenges faced by those involved with it.