

**THE OUTSOURCING
CONTRACTS DILEMMA:
SURVEY OF CONTRACTS FORMATION
WITHIN THE OUTSOURCING LIFECYCLE
AND SUGGESTED BEST PRACTICES**

**IACCM Ask the Expert Audio Call
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THE OUTSOURCING CONTRACTS DILEMMA

Introduction

- Initial work was done advising company specializing in a risk assessment and value trading methodology
- Lead to 100 plus hour research project
- Discoveries
 - dissatisfaction with outsourcing contracts generally among outsourcing professionals
 - surprising number of different approaches to contracting for outsourcing
 - no direct treatment of subject of outsourcing contracts formation
 - caused reconsideration of contracts management principle of finalizing all contract terms before beginning work

THE OUTSOURCING CONTRACTS DILEMMA

Outline

I. Lifecycle

- Identify outsourcing phases and stages and goals to be served

II. Taxonomy

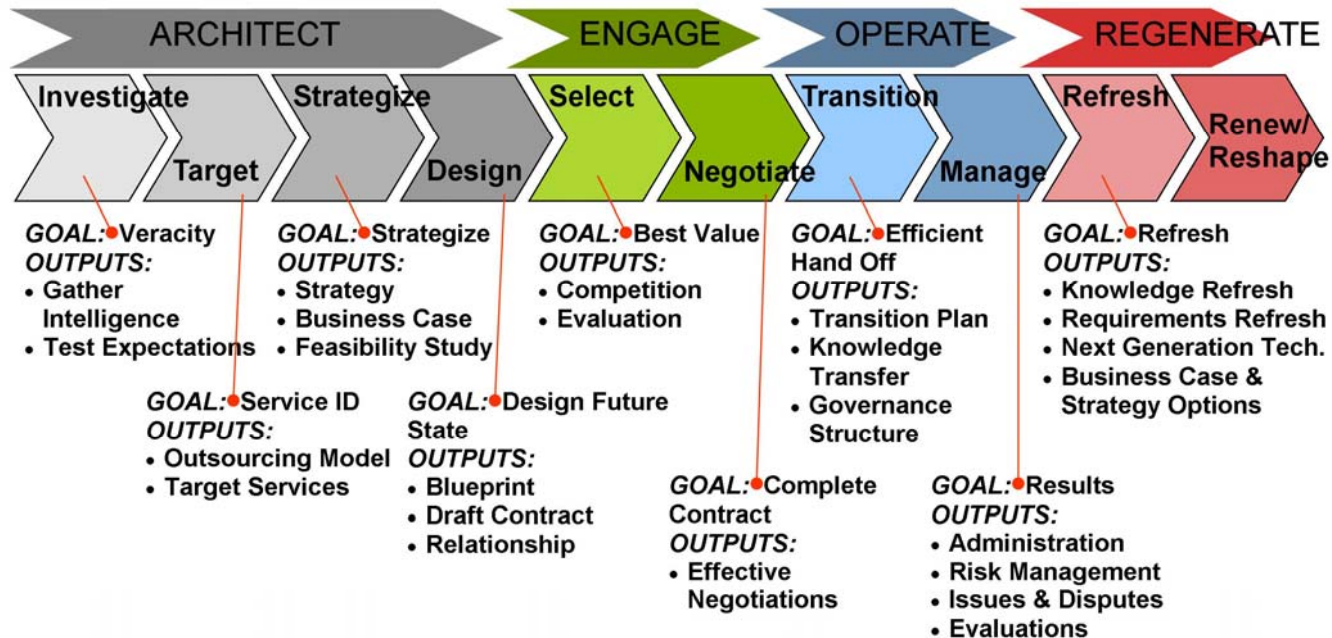
- "The classification of organisms in an ordered system that indicates natural relationships."
- Each approach represents a different way of initiating contract formation/negotiation in the outsourcing lifecycle
- Approaches *not mutually exclusive* but can be stand alone

III. Best Practices

- Analysis of approaches
- Guidelines for employing approaches

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Outsourcing Lifecycle



Adapted from S. Cullen, P. Seddon, and L. Willcocks, "Managing Outsourcing: The Lifecycle Imperative," MIS Executive Quarterly Vol. 4, No. 1, March, 2005

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Taxonomy of Approaches to Outsourcing Contracting

1. Strategic Sourcing
2. Term Sheets
3. Must Have's
4. Framework Agreements
5. IAOP Book of Knowledge
6. Structured Negotiations
7. Governance
8. Sole Source
9. Accelerated Competitive Dialogue
10. Renegotiations

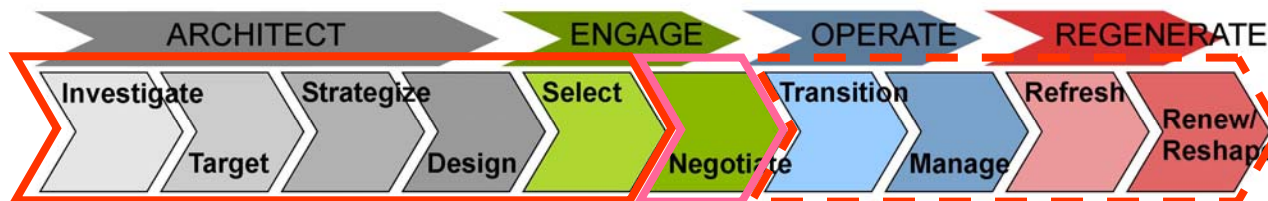
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Taxonomy

- 1) Strategic Sourcing
 - Customer drafts contract to include all strategic goals, service-related terms, legal terms, etc.
 - RFP and negotiation processes disallows substantial changes to terms by providers

PROs: As name implies, emphasizes incorporation of strategic plans into contract

CONS: Prevents negotiation including mutuality of agreement and value trading



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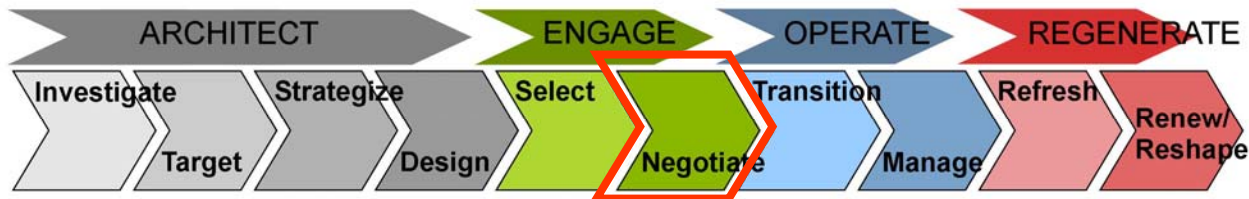
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Taxonomy

- 2) Term Sheets
 - Tool for kicking off negotiations; sheets usually include commercial (service) terms but can include legal terms as well
 - Entire contract must be executed before work begins

PROs: Directly supports efficient transactioning and contract finalization

CONs: May not support value trading, probably does not support strategic goals



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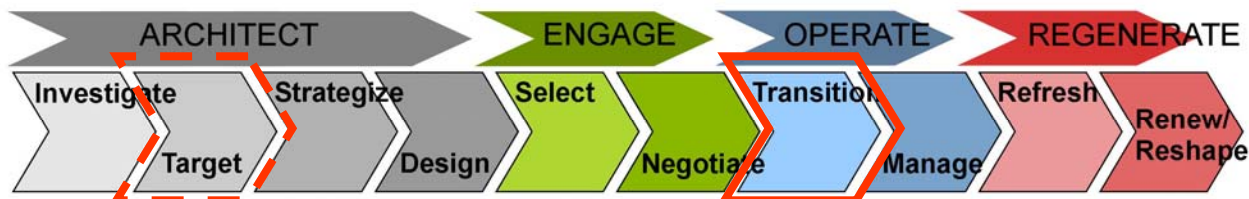
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Taxonomy

- 3) Must Have's
 - Like term sheets but limited to most contentious terms
 - Work can begin before contract executed

PROs: Eliminates delays in beginning work, can allow for better definitization of service related terms

CONs: Work at risk, creates captivity, does not explicitly support any other lifecycle goals



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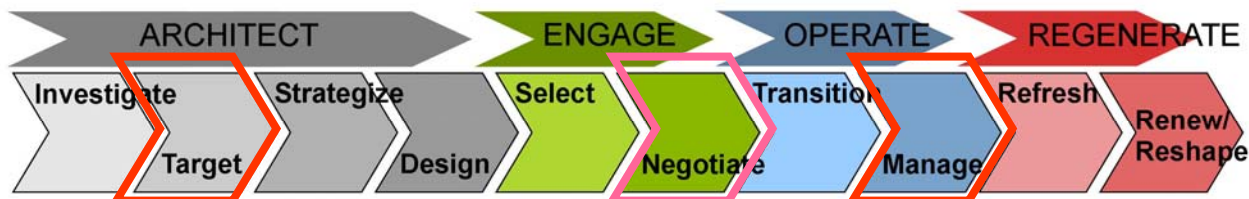
Taxonomy

- 4) Framework Agreements

- Framework terms include A) final terms and B) defined processes for definitizing other terms, mostly commercial
- Remaining terms finalized based on assessment

PROs: Balances delay with contract finalization, directly supports well defined service related terms, can allow for more flexibility in operations management

CONS: Can prevent value trading, potentially leaves some terms “on the table”



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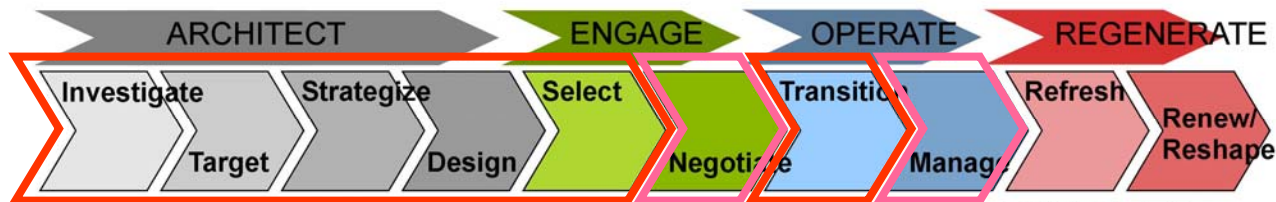
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Taxonomy

- 5) IAOP Book of Knowledge
 - Customer drafts contract which is included in RFP
 - Providers may propose changes which become evaluation criteria
 - Resulting “master framework” contract includes all terms except service descriptions and pricing; change management terms included

PROs: Makes negotiation part of selection, supports strategic goals and operations management, balances delay with contract finalization

CONs: Creates individual service contracts, does not support whole value trading, can create inconsistencies in terms and operational dysfunction



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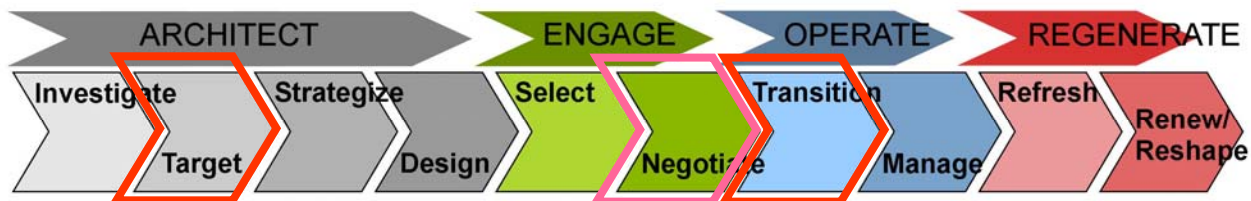
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Taxonomy

- 6) Structured Negotiations
 - Transition-imperative terms segmented out and negotiated first – People, Structure, Process, Security and Continuity
 - Transition-imperative terms can be binding or non-binding, but all terms must be finalized by transition's end

PROs: Directly supports successful transition while balancing contract finalization, can allow for better definitization of service related terms

CONs: Lifecycle-specific division of negotiation terms, undermines value trading, work at risk



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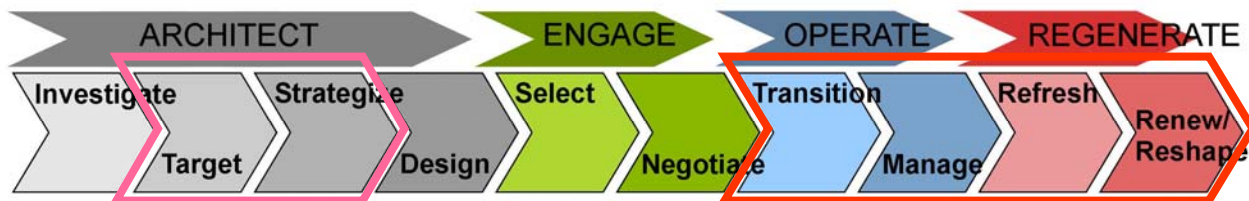
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Taxonomy

- 7) Governance
 - Philosophy is to manage outsourcing through “good faith” relationship, not through “adversarial” enforcement of contract terms
 - Governance organization and procedures described in contract
 - Terms are freely subject to change as decided by the parties

PROs: Recognizes tension between classic contract law and outsourcing, directly supports agile operations management and relationship building

CONs: Rejects the concept of a controlling contract, creates dysfunction between existing contract and governance actions



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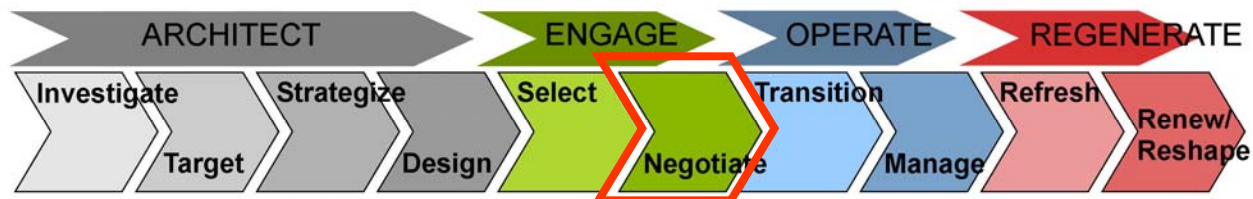
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Taxonomy

- 8) Sole Source
 - RFP process eliminated as costly and without benefit
 - Negotiation with one provider
 - Contract finalized before work begins

PROs: Reduces transaction costs, directly supports full negotiation and finalization of contract

CONs: Prohibits sourcing selection, does not explicitly support any other lifecycle goals



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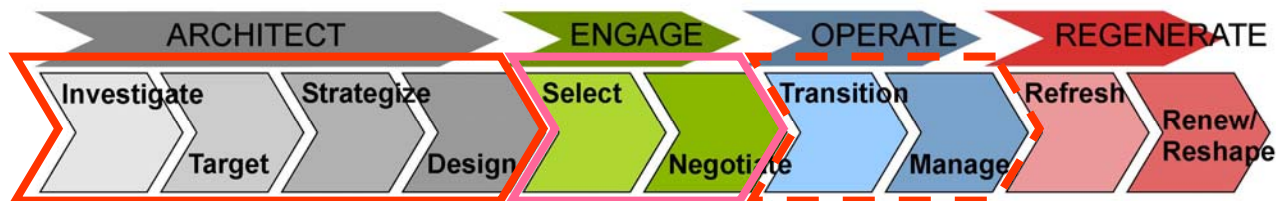
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Taxonomy

- 9) Accelerated Competitive Dialogue
 - Field of potential providers invited to participate in strategic planning
 - Based on experiences, customer selects winning provider and negotiates contract

PROs: Directly supports strategic planning and vendor selection of the best vendor, implicitly supports transition and operations management

CONs: Undermines “arms length” sourcing and negotiation



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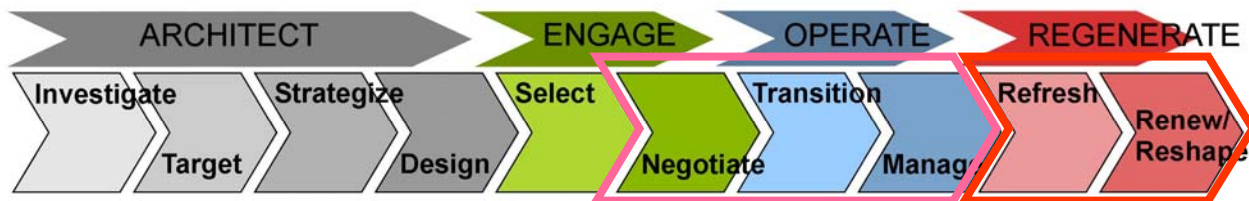
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Taxonomy

- 10) Renegotiations
 - High incidence of renegotiation in outsourcing industry
 - Intent to negotiate complete contract and commence work then conduct in toto renegotiation

PROs: Maintains finalized contract

CONs: Undermines controlling contract effectiveness by calling into question contract's authoritativeness



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Evaluation of Taxonomy

- All approaches considered sound legal and business practices
- Utilization driven by purposes each serves and needs of the parties to a given transaction
- Next level consideration takes into account A) goals served, B) effectiveness and C) effects on negotiation and relationship

Needs of the Outsourcing Parties	Outsourcing Approach That Meets the Needs	Competencies and Skills Most Important to Approach
<i>"We want to outsource as quickly and cheaply as possible, including doing the deal?"</i>	Sole Source	Legal Dept., Targeted Ops Mgmt. & Personnel
<i>"We want to get a bullet proof contract in place to protect us in case things go wrong?"</i>	Renegotiation	Legal Dept., Outsourcing Project Team
<i>"The outsourcing must align with our strategic goals, so strategy must be built into the contract?"</i>	Strategic Sourcing, Accelerated Negotiation Dialogue	Outsourcing Project Team, Procurement Dept. (with input from Executive Mgmt.)
<i>"We'll never really know the true picture of the targeted operations, or how it will look in the future, so any contract has to be completely flexible?"</i>	Governance	Targeted Ops Mgmt., Contracts Mgmt. Dept.
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<i>"The outsourcing project is too big to digest all at once, we need to outsource in smaller bites."</i>	Framework Agreement, IAOP	Outsourcing Project Team, Contracts Mgmt. Dept.
<i>"We need to start the outsourcing project right now if we are going to benefit from it, with or without a contract?"</i>	Terms Sheets, Must Have's, Structured Negotiations	Executive Mgmt., Legal Dept. (for contract, Outsourcing Project Team and Targeted Ops Mgmt. for Transition)

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Best Practices Stepped Approach

1. Create Outsourcing Contracting Team
2. Identify the factors that shape outsourcing contract formation:
 - A. Reasons for outsourcing (strategic or tactical)
 - B. Size and complexity of outsourcing
 - C. Unpredictability of assumptions and requirements
 - D. Assessment, sourcing and management competency of parties
 - E. Bargaining power
 - F. Transaction costs incurred
 - G. Need for contract enforcement
 - H. Need for knowledge development and retention
3. Quantify factors and make trade offs.
4. Make case for contracts formation approach to Outsourcing Steering Committee
5. Acquire third party resources as needed.
6. Manage contract formation process.

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SURVEY KICKOFF

Kick Off of IACCM/JRC Survey
of Contract Formation Practices