

Outsourcing - Getting Started Properly

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INTRODUCTION

With the rapid increase and popularity of outsourcing over the past 10-15 years the same mistakes made in the beginning are still all too prevalent. When corporations look at and consider outsourcing they still tend to look at it from a global view. Not just global from the standpoint of international outsourcing but from the viewpoint of benefits to their company. The popular opinion is "we can reduce cost". All too often performance is overlooked and the decision is made on a perceived reduction in cost to provide the services.

DEFINING SUCCESS

There are a number of steps required to determine whether outsourcing provides the desired result:

- Establishing an accurate baseline
- Detailed well-defined Service Level Agreements
- Establishing clear, concise and measurable performance standards and metrics
- Establishing adequate warranties and remedies.

ESTABLISHING A BASELINE

In too many cases companies fall into the trap of allowing a potential outsourcing supplier to conduct their baseline study for them, When the potential supplier conducts the baseline study not only will he, in most cases, know more about your performance and costs than you do, but he will design the result to meet his needs. A few years ago, I was asked to conduct an outsourcing seminar and consulting to a large mid-western investment firm. During a break I was informed that their baseline study was conducted by a potential supplier, at no cost, and in return they would not have discussion with another supplier without the supplier's permission for six months. It was painfully obvious that they had compromised their ability to complete an acceptable outsourcing agreement. The baseline study must be conducted by an internal organization or a third party consulting firm which will not be affected by the results.

The baseline study will provide you with the information required to determine what will be outsourced, the current costs and the performance level of those functions. The information provided by the baseline study serves as the foundation of the Service Level Agreement. The Service Level Agreement will define the general and specific responsibilities of the parties.

It is important to remember that non-specific language in Service Level Agreements benefits the Supplier and specific language protects the Customer. Be very specific in describing the responsibilities of the parties or finger pointing will result. Although dispute resolution provisions are included in the contract, the less they are relied upon the better the service and the relationship between the parties. In addition to the responsibilities of the parties and a clear description of the services to be provided, provisions should be included to allow for supplier creativity.

There are three (3) basic provisions that must be included in a Service Level Agreement to provide a successful outsourcing.

SERVICE LEVELS

As has been previously stated, clear, concise and understandable service levels must be agreed between the parties. The baseline study will provide a guideline for the services to be provided by the outsource supplier. Incorporating wording that is subject to interpretation benefits suppliers and helps them achieve their goal and objectives rather than yours.

Performance standards should be equal to or better than what is being provided prior to outsourcing. There have been cases where performance has been degraded due to inadequate language addressing the expected standards.

Performance measurements and the metrics utilized to determine whether the desired results were achieved are critical to success. Incorporating good performance standards are useless unless they incorporate what is to be measured and what metrics will be used to measure performance. Too often the focus is on the cost of the service and not on the level of performance. The performance, measurements, and metrics have a direct effect on cost.

WARRANTIES

General warranties that are included in most supplier contracts provide little protection to the customer, especially in an outsourcing agreement. In addition, general warranties exclude "fitness for purpose" which can relieve suppliers of some responsibility for the services they are providing. In an outsourcing agreement, you are describing the result you require and they are providing the solution. Therefore, suppliers should be responsible for the desired result. In addition, a specific warranty should apply to each service to be provided. A "one size fits all" warranty is not sufficient to guarantee performance of each service to be provided.

REMEDIES

When all the performance standards, measurements, metrics and warranties are clearly identified, we must realize that it is the remedies that make them work. Suppliers typically respond with very non-specific remedies and refer to your ability to terminate as the ultimate remedy.

Termination may have a more negative effect on the customer than the supplier. The supplier, in fact, knows that termination is not an option in cases of non-performance or poor performance.

Remedies should be identified for each area of service described in the service agreement. A clear understanding of what and who triggers a remedy must be included. Remedies are not penalties and should be designed to get the attention of the supplier and encourage corrective action. Remedies may be monetary or non-monetary. If monetary remedies are included, they should be large enough to incentivize action but not so large that they could be interpreted by an arbitrator or court as excessive and therefore unenforceable. If monetary remedies are incorporated, they should be designed to have a definite impact on the supplier's margin or they will be ineffective.

Non-monetary remedies can also be a useful tool in getting a supplier's attention if they fail to perform. At a recent negotiation in which I was involved, the customer and supplier had reached a significant deadlock on the issue of remedies. In an effort to break the deadlock, I proposed a reduction in the monetary remedies and the inclusion that if a non-performance event occurred, the supplier's Vice President of Marketing would call the customer's responsible executive and inform him that they failed to perform to the agreed to service level. After a great deal of discussion, both parties agreed. I was later informed by the supplier that it was the most effective remedy in the contract. The supplier's Vice President of Marketing informed his organization that he better never have to make that call.

Remedies have a direct effect on cost and suppliers typically resist them. They define the level of risk the supplier is willing to assume and should play a major part in selecting a supplier.

CONCLUSION

Although there are many factors involved in determining success or failure of an outsourcing agreement, it all begins with the baseline study. The baseline study is the foundation of the agreement and if it is not complete, failure is very likely.

Maxelerate's goal is to help Sourcing, Procurement, Purchasing, Engineering, IT and other professionals in all industries and government agencies to get better deals from suppliers. We accomplish this by providing Consulting, Training, Seminars and Leadership Implementation.

To get more information about us and find out how you can get better results contact us at:



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