

# NO BETTER TIME TO RENEGOTIATE YOUR OUTSOURCING CONTRACT?

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*Armed with data and a sense of the incumbent provider, an outsourced customer can achieve better contractual terms while still maintaining a mutually beneficial relationship with its provider.*

The renegotiation of outsourcing contracts has been going on almost since the inception of the industry. Why, then, does there seem to be such a recent surge of interest in renegotiating business processes outsourcing (BPO) agreements?

Several factors, when taken together, have created an almost "perfect storm" of motivation and opportunity for customers to renegotiate their BPO contracts, potentially making 2009 a banner year for renegotiations. The first is that many earlier-generation BPO agreements are in their final contact years. Compounding this situation are the recent global economic downturn and the widely publicized accounting scandal at Satyam, the fourth largest Indian outsourcing firm. The combined effect of these forces on the industry has been so significant that, according to industry consultancy A.T. Kearney, some outsourcing providers are shaving as much as 10 to 15 percent off existing contracts to retain their customers.

In light of this recent phenomenon, it may be helpful to reexamine some of the basic tenets of renegotiation and perhaps cover some new ground based on our direct experience, both historical and recent, with respect to this key chapter of the outsourcing playbook.

As the end of an outsourcing contract's term approaches, the customer needs to begin the process of deciding whether to renew or restructure it with the incumbent provider, recompetite the work, or take the work back. It is not surprising that many customers choose the renegotiation/restructuring approach; it is generally cheaper, faster, and less disruptive to the business. Few companies, once they have made the decision to outsource a back-office function and gone through the often difficult process of divesting themselves of the personnel and infrastructure to perform that function, have the appetite to reconstitute the outsourced function in-house, and for good reason. It is somewhat less rare, but by no means common, for outsourcing customers to change service providers. While doing so may not be as expensive or time-consuming as in-sourcing previously outsourced functions, it's not exactly a walk in the park.

The sources of customer unhappiness with their outsourcing relationships are legion and include technology issues, service performance issues, relationship failures at the account management or operational levels; perceived or real pricing asymmetry with “the market”; and perceived or actual lack of attention from the provider. Any one or a combination of these factors can and does drive customers to call for a new deal, literally.

Bear in mind that we are talking about a circumstance where these relationship problems are not severe enough or chronic enough to propel the customer to abandon the relationship. Although a significant percentage of outsourcing customers cite some degree of dissatisfaction with their outsourcing relationships, it is very rare for the relationship to be irretrievably broken or to have wholly failed of its essential purpose.

More often, outsourcing customers concede (even if reluctantly) that the service provider is doing an adequate job of performing the core services, while complaining that it isn't seeing any added value or is being overcharged for certain aspects of the services.

It should not surprise anyone that outsourcing contracts have a tendency after a few years to get out of alignment with the customer's business imperatives or current market conditions. After all, outsourcing contracts are based on prevailing business and market conditions at the time of signing. Try as we might to infuse outsourcing

contracts with mechanisms specifically designed to address change, it is nevertheless exceedingly difficult for an outsourcing contract to strike just the right balance between definitiveness on the one hand and dynamic flexibility on the other. The simple truth is that many legacy outsourcing contracts have been overtaken by unforeseen intervening events.

While the reasons why a customer might wish to renegotiate a BPO contract midterm are self-evident, what, you may ask, would motivate the service provider to agree to a midterm renegotiation? The fact of the matter is that outsourcing customers typically have more sources of renegotiation leverage at their disposal than they realize. First, many outsourcing contracts contain a number of provisions that give the customer a right to re-open the contract (or at least the service provider's prices) under various conditions or even to terminate some or all services. In other cases the service providers are undergoing the same sorts of business and economic upheavals as their customers and, as a result, they, too, may be interested in a mid-term renegotiation. However, even in cases where the above factors do not create a compelling basis for renegotiation, the more savvy providers will realize that an unhappy customer will not remain a referenceable customer for long. For that reason, they will be motivated to cooperate with a customer-initiated renegotiation if they have reason to believe it will be conducted in a fair and principled manner.

### Steps for Success

So, what makes for a “fair and principled” renegotiation? For starters, it means that the customer cannot approach the renegotiation as solely an “I take, you give” proposition. The old adage, “You can't get something for nothing” applies with particular force to renegotiations. The customer will likely need to find some way of creating additional value for the service provider as an inducement to agree to concessions. In other words, the customer needs to approach the renegotiation process as a true “win/win” opportunity for both parties.

For example, in return for asking the service provider to reduce its prices for the remainder of the contract term, the customer might offer to expand the scope of the services or extend the contract term for several more years. As a result, while the service provider's margins on the customer's existing book of business may decline, its aggregate revenue stream will actually grow. A successful renegotiation is one in which each party walks away from the process feeling that it has both given and gotten something of value and that the contractual relationship has been recast on a footing that is both fair and sustainable.

There are a number of steps a customer can and should take before initiating a renegotiation with its incumbent provider to help ensure a successful outcome.

- First, update and, as necessary, clarify your vision and objectives for the relationship, both near-term and longer-term.

- Second, assess as objectively as possible the ways in which and degree to which the existing outsourcing contract and relationship are contributing to and impeding the achievement of your vision and objectives. In other words, make the effort to identify both what is working well and should be preserved in the renegotiated deal and what is not working well and should be clarified, restructured, or scrapped.
- Third, gather relevant data, especially data comparing your existing deal to prevailing market conditions and practices. Take the time to understand whether the technologies being used to provide services to you are up-to-date and take advantage of recent productivity improvements and innovations. Research current market prices for similar services to gauge the competitiveness of your current deal terms.
- Fourth, treat the process seriously. Get senior sponsorship and buy-in from the key stakeholders within the company. Form the right team and manage the renegotiation process as an important initiative.
- Fifth, approach the renegotiations with an open mind: Consider all aspects of the existing contract and relationship that are on the table. That means paying attention to relationship governance and management issues, as well as the commercial and contractual issues. Don't assume that all problems have contractual solutions or that a strained relationship is entirely the fault of your provider.

It is important to remember that companies and individuals only ever act in what they perceive to be their own best interest. What this means is that you cannot reasonably expect your service provider to do (or refrain from doing) something that is not in its interest just because the contract says so. You are much more likely to receive the behavior you desire if you can find ways of creating mutual alignment between your interests and those of your service provider. To accomplish this, don't bring the most guns to the table; bring the most data, the most ideas, and the most open mind. This applies to both customers and providers. Return openness and creativity with the same.

As the customer, if you are not seeing your best efforts reciprocated, it is a good sign that you may need to re-compete the contract. Don't seek to take unfair advantage, but if you

sense that you are being taken advantage of, do not hesitate to broaden your vision and shop around for a better relationship.

Renegotiation is a major fact of life in the outsourcing industry. It is important to realize that the same "art of the deal" in contract structuring and negotiation applies to renegotiation as well as first-time negotiations. Renegotiation, in some ways, is more challenging because the parties usually know each other well by the time of the renegotiation. There is more information to work with, historical data, knowledge of cultures, interests, and orientations of the parties.

Successful renegotiation is the process of leveraging what has been learned in the past to build a future relationship that will best align the goals and interests of both parties to create continuous value for both. Don't miss the opportunity to make a renegotiation more than an exercise in renewal of vows. At its best, a renegotiation is an opportunity to extend and most importantly to make a good relationship more flexible, transparent, resilient, and valuable to the parties. If so, renegotiation holds the promise of creating a "built-to-last" relationship between the customer and service provider.

