INSIDE SOURCING

The Newsletter of the Sourcing Interests Group

July 2001 **Volume 6 Issue 3**

Avoiding "Gotchas" in Business Process Outsourcing

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Many a practical joke ends with a joyous "gotcha." On the other hand, it's not what you want to hear from your vendor in the middle of a Business Process Outsourcing (BPO) deal. In fact, when you turn over a function like call center operations, logistics, human resources or energy management to an outside vendor, you want the contract to protect you against "gotchas."

Here's how you, as a BPO customer, can avoid six big gotchas:

Gotcha #1: "That's not in scope!" In a BPO deal, it's either "in scope" or it costs extra. To avoid this gotcha, you need to make sure that the scope you write in your contract is the scope you expect. That's hard to do, though. In BPO, you're generally outsourcing an undocumented process that's constantly changing. The vendor has no real incentive to write a scope that nails the vendor down. What can you do?

- Work hard (or hire a consultant to work hard) on a clear, complete, tight scope document
- Add "dragnet" clauses so that jobs that you forgot to describe are part of the scope, perhaps because they are incidental to or necessary for those services or because the people who formerly did those jobs were transferred to the vendor
- Prepare for change: Lock in pricing for out-of-scope services. Get commitments for "then-current" technology and best practices. Obtain, and use, the right to change the contracted scope when changes occur in your business or markets
- Shape the deal to align the vendor's incentives with your objectives. In this way, you can solve the problem of having the vendor's revenue and margin increase when you miss parts of the scope.

Gotcha #2: "Here's your new account team!" Try as you might, you won't get a scope document that requires the vendor to provide a smart, motivated, client-oriented account team that knows and cares about your business. What you can get, though, is the right to:

- Keep the initial account team – the one that said "trust me" at the sales meetings – on the job for a substantial amount of time
- Approve replacements for key personnel, and to require minimum levels of experience, education or other proxy for competence for some roles
- Require the vendor to replace personnel who break rules or fail to perform
- Regular meetings with the vendor's senior management where you can discuss personnel issues.

Gotcha #3: "We own that!" The intellectual property laws favor artists, authors, inventors and other vendors. Thus, as a customer, unless you say the right things in the contract, you won't be able to use what the vendor has created or improved. Those might include "your" data about "your" customers and the software and processes that run "your" business. What can you do?

- Agree in writing that you will own your data (at a minimum) and other property that the vendor develops or acquires to serve you.
- Own unique assets that are key to your business.
- Require the vendor to get consents from all third parties who might claim ownership.
- Get licenses to key vendor intellectual property for use in connection with the contract or after the contract ends.

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Gotcha #4: "You're not happy. So what?" Once you sign a BPO contract, you're generally locked into a long-term contract where your company's survival depends on the vendor's good performance. The vendor may have switched from "sell mode" to "margin mode." Very likely, you'll need a contract that gives you tools to motivate good performance. Here are a few:

- Reporting responsibilities and audit rights. You need to know what's going on, sooner rather than later.
- Defined service levels. Agree on easy-to-monitor metrics for how quickly, how well, and how often the services will be performed.
- Service level credits. If the vendor doesn't meet the service levels, the price of the services (and the vendor's margin) should go down. This aligns incentives.
- Right to collect damages. Most BPO arrangements include waivers of lost profits (etc.) and caps on direct damages. These have obvious effects on the vendor's incentives. The more you can share risk with the vendor, the more motivated the vendor will be to provide quality service without damaging your business.
- Right to partially de-scope. Avoid exclusives. The right to take away scope motivates good performance across the board.
- Right to walk away. You're a customer, not an asset. You need a short term with renewal rights, or a termination right, or some other mechanism that let's you out of the contract at a reasonable price when you're not happy.

Gotcha #5: "You can never leave!" A contractual right to end a contract may not, in practice, give you the ability to walk away. Outsourcing a business process is, in many ways, like getting a functional lobotomy. Your company will no longer know very much about the function you've outsourced. Yes, it was a non-core function, so you may never have been world-class at it, but within a year you'll have almost no ability to perform or even source the function without the vendor's help.

The trick is to get the vendor to agree to help you to make a smooth transition to a new provider. If you can't make a smooth transition, on a practical level, you're making this vendor your "perpetual provider." The relationship isn't going to solve this problem because you'll terminate when the relationship has gone bad. You'll want the vendor to agree, in the contract, to provide these types of transition services at your request

- Report on what it takes to run the business process
- Help to prepare the RFP for hiring the next provider
- Allow you to buy dedicated equipment, sublease dedicated space, license key intellectual property and hire key people
- Provide transition services, such as knowledge transfer and parallel testing
- Extend the contract term if it takes you longer than you expect to insource or obtain replacement services.

Gotcha #6: "We're walking out on you." Even with the best transition services, for you as a customer, ending a BPO arrangement is costly and fraught with peril. On the other hand, if the vendor underbid, the vendor might actually gain by terminating. Thus, you face the risk that the vendor you depend on will someday say that it wants to walk out, leaving you with a messy transition. The vendor may do that because it's losing money, or perhaps as a ploy to negotiate higher fees. To reduce this risk:

- In the contract, prohibit the vendor from terminating except for very limited reasons, such as a sustained failure to pay undisputed amounts. In the contract, require the vendor to continue to provide service while disputes are resolved
- Require the vendor to share in your expenses and damages if it repudiates or abandons the contract
- Give yourself alternatives, such as a secondary services provider that can pick up the slack.

In conclusion, this is a quick, customer-side summary of a big topic. It's not tailored for any particular deal, and will not answer all of the questions you have. However, you can find a much more detailed outline of outsourcing issues by pointing your web browser at www.mayerbrown.com/outsourcing and click on "Primer."

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