Saving Money in Sourcing Contracts and Other Outsourcing Issues

Houston Energy Conference

May 2009

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Outsourcing: Ways to Cut Costs in Troubled Times

10- Recommendations on proven ways to optimize and reduce costs under existing outsourcing arrangements

4- Recommendations on strategies to reduce costs through new outsourcing initiatives

Existing Outsourcing Contracts:

Proven Ways to Optimize the Arrangement and Reduce Costs

Recommendation 1: Reduce Provider Cost of Service Delivery

- Work with the provider to identify ways to reduce the cost of service delivery and pass through the resulting savings to the customer
  - The provider understands its underlying costs and is in the best position to identify cost-cutting opportunities
  - Many contracts have provisions requiring the provider to cooperate with such an exercise
  - Even without such a provision, the contract and governance process typically offer leverage to obtain such cooperation

Recommendation 2:
Relax/Eliminate Contract Requirements

- Relax or eliminate contractual requirements that are increasing the provider's cost without delivering commensurate value, such as –
  - Equipment and software refresh requirements
  - Service Level requirements
  - Volume/capacity requirements
  - Prescriptive equipment/software standards
  - Staffing requirements, including open-ended project resource commitments
  - Customer-specific deviations from the provider's standard service delivery model
  - Open-ended provider commitments

Recommendation 3: Offshoring

- Permit the provider to move additional services to offshore facilities
  - Leverage labor arbitrage to achieve immediate cost savings
  - Do your homework – the type, size and complexity of services capable of being offshored has grown rapidly in recent years
  - Risk mitigation strategies are available
  - In addition to India, consider South America, China, Latin America, Eastern Europe, Philippines and other offshore venues

Recommendation 4: Reduce/Eliminate Provider Risk

- Reduce or eliminate risk for the provider in exchange for price reductions.
  - Consider assuming more risk in areas such as COLA, currency fluctuation, post-signing adjustments, etc.
  - Obtain lower pricing now in exchange for increased pricing risk in future years
  - Consider relaxing or eliminating contractual rights, such as benchmarking, termination for convenience, etc, on a temporary or permanent basis
  - Also look for protections that seem less valuable now that you know the provider

Recommendation 5: Optimize Scope

- Optimize the scope of the services to be delivered
  - Increase the scope of the contract to include additional functional areas where savings are possible
  - Increase the scope to permit the provider to further leverage its dedicated resources or amortize its one-time costs
  - Implement cost cutting measures, e.g., application rationalization to reduce the number of supported applications
  - Reduce the contractually mandated level of service to the minimum level required by each region, business unit or user group
  - Implement gold, silver, and bronze service offerings to allow business units to select the value/cost for their business

Recommendation 6: Optimize Financial Terms

- Re-negotiate the timing of invoicing or payment
  - The optimal timing of invoicing and payment depends on each party's time-value-of-money calculation
  - The credit crisis dramatically changed the cost of capital, especially for debt-funded companies
  - Consider paying more quickly or slowly, pre-paying or amortizing costs for equipment, transition, transformation, modifying pricing in current and future years, etc.
- Implement gainsharing opportunities to incent the provider to deliver desired cost savings
  - Gainsharing offers mechanism to fund investment with future savings
  - Do not limit to savings opportunities involving in-scope services
  - Take care to avoid overlap with existing in-scope commitments or savings that would have occurred without provider investment

Recommendation 7: Use Contract Rights and Levers

- Take full advantage of the rights/levers available in the contract, e.g., -
  - Exercise audit rights to find overcharges and with a directive to identify cost reduction opportunities
  - Use benchmarking or the possibility of benchmarking as a lever to negotiate lower pricing
  - Invoke the “extraordinary event” clause if volumes have changed

Recommendation 8: Initiate Re-Negotiation

- Initiate the re-negotiation of some or all of the contract -
  - Especially if it has been some time since the last re-negotiation, or
  - If provider breaches create bargaining leverage
- As part of such a re-negotiation, consider extending the term of the existing agreement --
  - In return for immediate cost reductions, or
  - As a means to facilitate the further amortization of one-time costs

Recommendation 9: Selectively In-Source, Re-Source, and/or Terminate

- Use the right to in-source or use third parties to perform in-scope services
  - As a means to obtain the same services from a lower cost provider, or
  - As a lever to negotiate lower prices with the incumbent provider
- Selectively terminate services or contracts that are no longer required or are not considered critical
  - Consider all associated costs, including in-house and/or alternative provider costs

Recommendation 10: Performance Verification

- Verify that the provider is providing all of the promised services at no greater than the promised prices
  - Providers may respond to economic pressure by reducing headcount, underperforming, and/or taking strained contractual positions
  - Familiarize yourself with the provider’s contractual commitments and evaluate its performance as to each
  - Use available contract levers/remedies to compel performance, or
  - Consider relaxing or eliminating contractual commitments in return for pricing concessions
- Verify that the invoiced charges are correct and that all credits and setoffs are included
- Address problem contracts and providers quickly as the costs of a troubled arrangement tend to grow

New Outsourcing Initiatives:

Strategies to Reduce Costs and Deliver Measurable Value

Recommendation 1: Cost-Saving Initiatives

- Reduce headcount, leverage labor arbitrage and convert fixed operating costs into variable pricing by outsourcing non-core IT and business process functions
- Pay particular attention to the cost reduction opportunities available through offshoring
  - Remember, the type, size and complexity of the services capable of being offshored has grown rapidly in recent years
- Also, explore the opportunities available through the use of best-of-breed providers, rather than a single provider

Recommendation 2: Value-Based Initiatives

- Consider outsourcing opportunities not based simply on reducing the cost of performing the sourced function
- Customers can also leverage outsourcing to reduce third party expenditures, achieve greater operating efficiencies, increase corporate sales and collections and/or obtain other measurable, strategic and tactical advantages

Recommendation 2 cont'd

- Consider the cost reduction and other measurable benefits available through the outsourcing of critical business functions, such as –
  - Facilities management
  - Procurement
  - Supply chain
  - Revenue management
  - Knowledge management
  - Recruiting
  - Customer relationship management
  - Business intelligence

Recommendation 3: Monetizing Assets

- Monetize non-core assets, by selling corporate capabilities, such as
  - Call centers
  - Captive IT centers
  - Product distribution systems
  - Manufacturing facilities, and
  - Other such capabilities
- And, entering into long-term outsourcing contracts with the purchasers

Recommendation 4: Multi-Supplier Sourcing

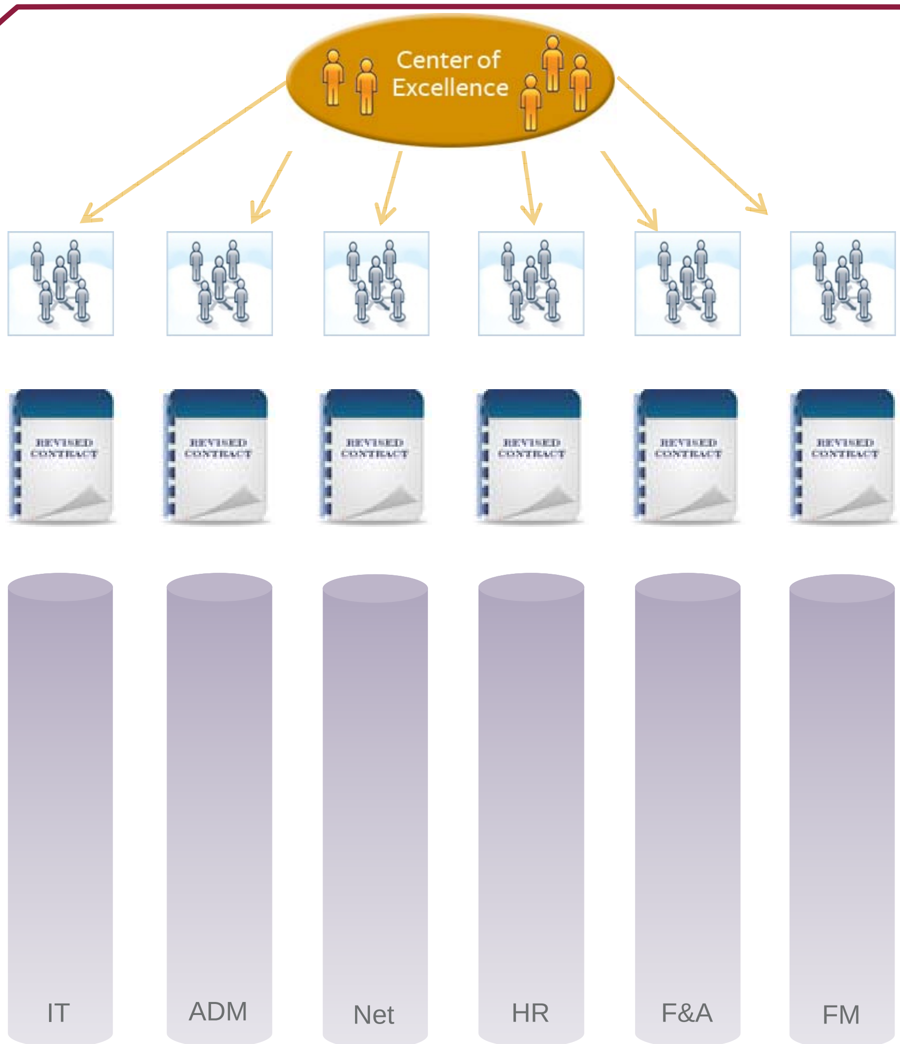
- Implement a multi-supplier sourcing strategy to
  - Use competitive leverage to reduce costs,
  - Reduce the time to contract and cost of future contracting,
  - Achieve supplier redundancy and risk mitigation, and
  - Obtain access to a broader and deeper pool of onshore and offshore resources
- Make more efficient use of existing multi-supplier environments

Multi-Supplier Sourcing

Client Governance Organization

Sourced functions having governing contract

Multi-Supplier Sourcing



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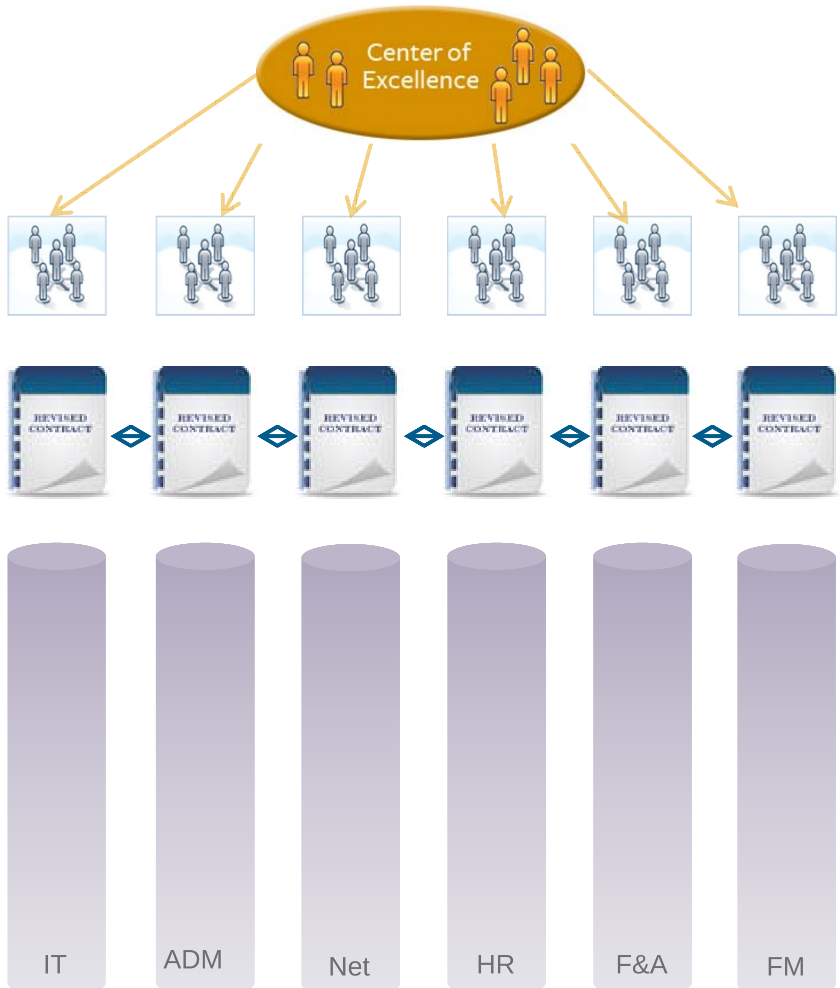

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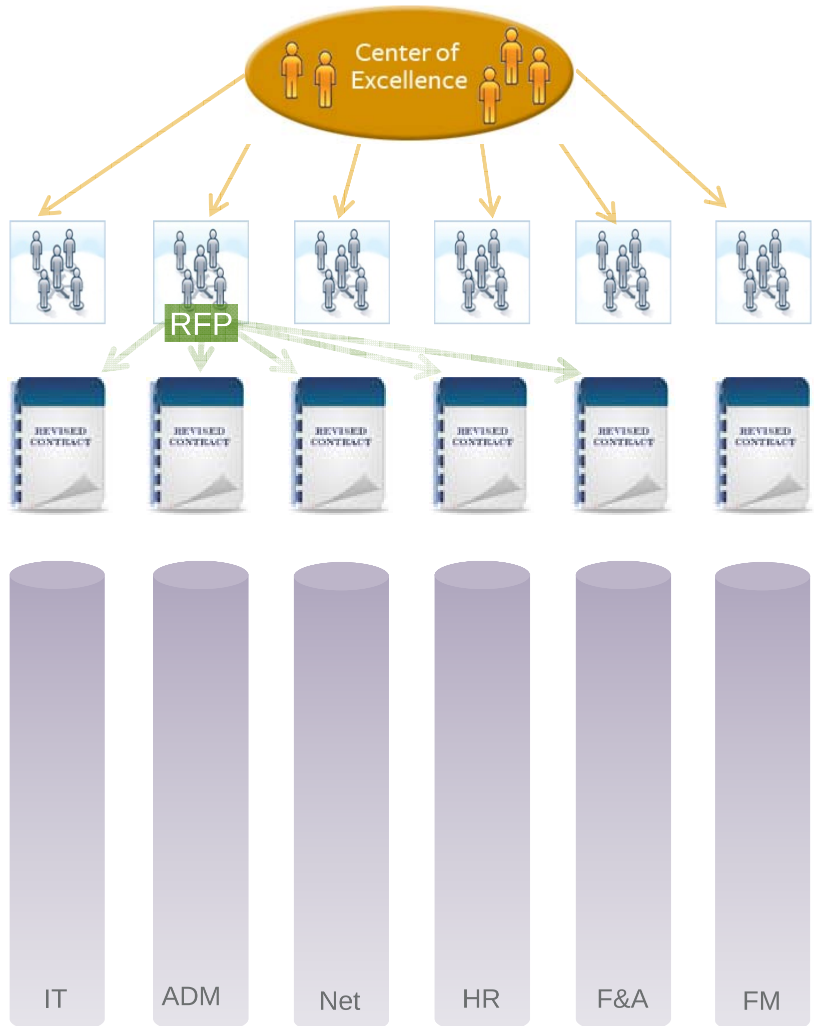

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Questions?

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