Negotiating the Best Deal for Your Outsourcing Buck

- by George J. Atis

For a company considering an outsourcing transaction – IT or business process outsourcing (BPO) – there are ways to improve the chances of getting the best deal for your outsourcing buck. (By the way, I use the term “Client” to denote the company doing the outsourcing and the term “Vendor” for the outsourcing services supplier.)

Outsourcing involves a transfer of ownership of a function that may, in and of itself, cripple the Client if it is not executed properly, if the Vendor is lax in its delivery of the service or if the Vendor simply walks off the job.

This is very different from buying a service (i.e. “contracting out”) where the company retains control and ownership of the assets used to perform that function. If things don’t work out, the Client can usually substitute a new contractor quickly without great damage to the company. Consider the situation where the Client has outsourced its data centre from an on-site location using proprietary assets to an off-site facility (sometimes very far away) using Vendor-owned assets and Vendor-licensed software. If the Client has made a mistake in its choice of Vendor, it will be very expensive to unwind the transaction – assuming the best case scenario of a solvent Vendor.

Outsourcing versus M&A Transactions

My corporate lawyer friends argue that a large outsourcing deal is no different from a large merger deal. Although there are similar issues, the bottom line in a merger deal is that the “acquirer” can, metaphorically speaking, force the deal down the “acquiree’s” throat.

Not so in outsourcing where the relationship is intended to be a “partnering” relationship. Even though, as a lawyer, I hate the word “partnering” (because it is flogged so often in Vendor proposals in a way that misrepresents its true legal meaning), I really think it captures what better outsourcing lawyers try to achieve in the final agreement.

Outsourcing tends to work when the Vendor signs on as a partner in the Client’s business. In theory, this concept is beautifully simple but the issue is getting the meat on the bones in the outsourcing agreement to reflect “partnering” in a single deal when the Vendor’s raison d’etre is to service many clients.

© George J. Atis & Outsourcing-Canada.ca, 2003. All rights reserved.

In simple terms, in an outsourcing relationship, the client always has a gun to its head with the Vendor holding the trigger. I therefore see the Client-side mandate as making sure that the outsourcing agreement protects the Client in a way that if the Vendor pulls the trigger, it is signing up for a murder-suicide. (The analogy is probably a touch too graphic for the usual, stodgy writing styles of most authors in this area, but if you've ever read about (or worse, experienced) an outsourcing deal that has gone bad, then you will understand why it is used.)

By and large, this somewhat hard-ass approach has served me well since it seems to be one of the best incentives for the Vendor to keep the client's business interests close at hand as the relationship evolves over the life of the deal.

The Vendor's Approach to Negotiation

A major factor to consider before going with a certain Vendor is its approach to negotiation of the legal terms and conditions (Ts and Cs) of the deal. This is where an experienced, client-side and consulting-oriented counsel will make all the difference.

Many clients (and Vendors) underestimate the initial Ts and Cs discussion as a "lawyer thing," which explains why both parties have been content to let the tail wag the dog. The question that a Client's senior management needs to consider during this phase of the deal is: What does the negotiation process reveal about the Vendor?

This is literally a million (and sometimes a billion) dollar question because the approach the Vendor brings to the table in negotiating Ts and Cs may be a barometer of the approach that it may bring to dealing with problems that will arise during the term of the deal. I state that problems *will* arise because problems are an expected fact of life in the lifecycle of an outsourcing deal.

The first few face-to-face negotiating sessions provide an excellent forum to observe how Vendors will react to disagreement in a tense setting because this scenario is a microcosm of the many situations that are likely to arise over the course of an outsourcing term. Clients should be prepared to test the murky waters of disagreement in this setting – where the consequences of not seeing eye-to-eye are relatively insignificant – before rushing to sign on the dotted line.

The Ts and Cs discussion (usually a multi-day, face-to-face discussion using a "term sheet") is a tool that should be used to determine of the disposition of the Vendor. For example, I usually invite the client's legal and senior management team to the table so it can observe and assess first hand the Vendor's performance at the negotiating table. Basically, you want to watch the Vendor's responses to difficult questions and the ability (or inability) to propose business solutions to divisive legal issues.

© George J. Atis & Outsourcing-Canada.ca, 2003. All rights reserved.

The Term Sheet Approach

The "term sheet" approach is an extremely important part of the process and Clients should insist upon using one.

The term sheet process is nothing more than a condensed version of the outsourcing agreement, arranged in a table format. It sounds trite but it is marvellously effective in compartmentalizing issues and concepts and putting the Vendor to a second-round of "I Agree" or "I Disagree" responses in a live, face-to-face session. The point of this process is to corral the Vendor into conceptual positions that it cannot retract during subsequent contract negotiations, without a lot of squirming or trade-off concessions.

As a general rule, term sheet negotiations usually proceed more expeditiously than traditional contract-format negotiations. (You deal with issue and language – box by box.)

If the term sheet tracks the language of the actual outsourcing contract closely, the negotiation period to settle the latter document should be short and, in essence, only a perfunctory exercise to compare the language of each document.

The Importance of Dual Track Negotiations

I always recommend a dual-track, term sheet negotiation, which simply means negotiating with at least two Vendors.

Dual track negotiations allow clients to get a "real time" comparison of the differences in the legal positions of two Vendors. Sometimes, a seemingly well-priced deal by one Vendor is "clawed-back" by, for example, legal positions in the agreement that shift too many risks back to the Client.

The Client should commit to doing a dual-track term sheet negotiation on large transactions (anything over $50 million) before choosing the winning Vendor, if it intends to flesh-out the best deal.

The key to a dual track negotiation is letting the Vendor know that it is not the only horse left in the race – on the rationale that competition will breed a greater willingness to negotiate. Clients must manage ethical considerations when using this approach and I always advise Clients to take the high road.

If the deal is big enough, consider a multi-track negotiation with, perhaps, three or four Vendor-finalists rather than just two. Clients must bear in mind that anything greater than a dual track represents a large and exhausting effort. But if the deal is big enough, the legal team can do the negotiations and then summarize the positions of each

© George J. Atis & Outsourcing-Canada.ca, 2003. All rights reserved.

Vendor into a visually-pleasing, 20 minute PowerPoint presentation. This type of synopsis gives senior management the big legal picture that it can then incorporate into the grand scheme of all other factors of the deal and arrive at the final decision.

The Danger of a Single-Track Negotiation

The one cardinal rule for Clients that should be immutable is never, ever go down a long outsourcing negotiation with just one Vendor.

Obviously, economics often dictate whether this will happen. If you can't afford a dual track, make sure your management and your advisors to put on their best poker faces. Try to get concessions in the early rounds of the negotiation before the Vendors start to toughen up – and they always do.

I experienced a single-track negotiation recently. Fortunately, the Client still got an exceptional deal because we pushed very hard in the beginning before the point where the Vendor started pulling a Nancy Reagan on us. (For those of you who do not remember the Reagan years, the Vendor just started saying "no.")

Ordinarily, in a dual-track world, at the categorical "no" point, I am able to pit Vendor A's position with Vendor B's position and negotiate accordingly. Unfortunately, with a single Vendor, there is no where to go, especially if the Client really needs the deal. And, it's usually ineffective to attempt to reactivate a dormant proposal and get a quick response to a term sheet from Vendor B after several weeks of negotiations with Vendor A. By this time Vendor B usually knows that it is was an "also-ran" and is simply being used as a pawn to get a better deal from Vendor A.

The bottom line is that a single-track negotiation creates all sorts of problems for Clients.

The Checklist

I have an extensive client-side checklist of things that I make sure to cover during a term-sheet negotiation. This list includes several categories and parameters. Here are three very important ones that I look for in Vendors. (Vendors, I hope you didn't expect me to give away all my Client-side secrets.)

1. **Flexibility Index:** The overall attitude that the Vendor will bring to the table to fit its service offering to the prospective Client's needs.

© George J. Atis & Outsourcing-Canada.ca, 2003. All rights reserved.

2. **Risk Appetite:** The Vendor's understanding and ability to accept, up-front, the typical outsourcing risks allocated to it by the Client's form of agreement and its ability to propose creative and acceptable solutions to risks that it perceives as beyond its "risk appetite."

3. **Business versus Legal Propensity:** The willingness of the Vendor's management to impose a business solution on a legal impasse.

Execution of the Client-side negotiation plan starts many months prior to the actual negotiation sessions, beginning with a well-defined strategy. Success is largely a function of a team effort among the Client and its outside (including legal) advisors.

Top outsourcing lawyers (and IT advisors) will insist upon the Client implementing a scientifically-strict approach to the negotiation process.

Selecting an Outsourcing Lawyer

Given today's complex outsourcing deals, selecting a law firm to represent you in an outsourcing negotiation is just as important as selecting an outsourcing Vendor.

When selecting technology counsel, clients should retain a lawyer or a firm that not only "talks the talk" but also "walks the walk." Many high-profile national law firms have jumped on the outsourcing bandwagon and created an IT or high-tech practice with a pool of lawyers with limited technology law experience and then marketed the hell out of it. Accordingly, clients need to ask many questions about the experience and bench strength of a firm's so-called outsourcing practice.

In an outsourcing transaction, choosing a lawyer that has "walked the walk" many times is absolutely crucial because, in this area, there is simply no substitute for deep skills.

Typically, outsourcing transactions involve large dollar amounts and contemplate multi-year relationships between Clients and Vendors, so there is little margin for error. It is much easier, for example, to deal with a mistake in a software license than to re-negotiate or litigate a poorly negotiated outsourcing agreement.

* A slightly different version of this article was first published in the April 2001 edition of the outsourcing-journal.com. If you wish to use this article on your website, in a presentation, or to re-publish it, please contact **George J. Atis** through the contact page of www.Outsourcing-Canada.ca.

© George J. Atis & Outsourcing-Canada.ca, 2003. All rights reserved.