

From the Editors at Sourcingmag.com

Seven Tips from the Sourcerers

**Best practices to help you
plan, structure, manage
and succeed at your
next IT outsourcing project**

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Tackling the Unique Challenges of IT Outsourcing

Outsourcing in all its permutations has seized the global stage. You'd be hard-pressed today to find a company that isn't either outsourcing something or thinking about it (at least privately). That's hardly new—companies have relied on outside experts to handle tasks beyond their core competencies since commerce began. What's new is several things. One is sheer number of business processes, including IT, that are being outsourced. That creates noise and confusion among the many competitors for your business. Also new: The concept of drawing on the global marketplace for labor.

Those factors add to the already considerable challenge of outsourcing, which is hardly a natural function in the first place. As one of our experts for this paper, Dalip Raheja of outsourcing consulting firm The Mpower Group, points out, outsourcing isn't an instinctive skill in most companies. Organizations tend to want to create and build things, not have someone else do that for them. Mr. Raheja also says that we, as workers, often haven't a clue about how to manage an outsourcing project. Those put in charge of sourcing projects are often very competent at managing *processes*—and then suddenly, they're called on to manage *outcomes*. That calls for a radically different set of skills and different expected outcomes. And in fact, the better you are at managing processes, the more likely you'll be put in charge of a big new outsourcing project—and find yourself having to manage results instead.

To add to the challenge, sweeping changes in the market are constantly remaking the face of outsourcing. Companies hungry for the cost savings promised by outsourcing are driving a global scramble. Contenders come and go, jockey for position, and define themselves over and over again, all the time vying for your business. Already, the shape of global outsourcing is morphing drastically—Indian companies, for example, are now outsourcing some of their labor to China, where costs are cheaper.

In addition, the phenomenon of labor arbitrage is creating new markets—substituting cheaper foreign labor for more costly U.S. workers, essentially. According to Ben Trowbridge of the Trowbridge Group, a Dallas, Texas-based outsourcing advisory firm, offshore labor arbitrage is creating a fundamental shift in the outsourcing market. Clients are now eliminating the middle vendor and managing offshore labor themselves, forcing offshore providers to reinvent themselves in order to remain competitive. “It's huge,” Mr. Trowbridge says. “It's creating an underlying riptide in the outsourcing market that is pulling everything to lower-priced deals.”

Even without the offshore component, the very essence of outsourcing makes it a challenge. It's an attack on existing power structures, points out attorney Brad Peterson, who estimates he's worked on outsourcing issues for 15 years. The threat of outsourcing means that people within your own company may have a vested interest in watching the project fail. Outsourcing also means you're making yourself dependent, at least in part, on an outside company motivated by its own success, not yours, Mr. Peterson points out.

Given all these challenges, what can you do when you're on the team working on—or perhaps managing—an IT outsourcing project? One piece of advice that all our experts might agree on is to listen to others—including analysts and consulting firms that spend their days wrestling with these challenges.

To get you started, we offer a handful of tips from a broad, multifaceted group of outsourcing experts—the Sourcerers—each with advice on an area where they've seen clients stumble. With their advice, you can go into your next outsourcing project with eyes open, ready for not just the challenges, but the opportunities presented by this global change in business.

Tip No. 1: Pick the Right Sourcing Partner

“The selection process is so key, and yet it typically becomes adversarial, with lawyers and consultants... trying to drive vendors down to zero margins.”--Ed Agar, PrimeSourcing Advisors

Finding the right outsourcing partner for your particular project is like finding the right mate—the importance of a good match can hardly be overemphasized. But how do you approach the search so that you end up with just the right partner for your needs?

“There is no perfect provider out there,” according to Ed Agar, founding principal at PrimeSourcing Advisors. “They all have their limitations.”

Mr. Agar’s company uses an extremely granular, trademarked process it calls the PrimeSourcing Index to help companies evaluate potential sourcing partners. The process evaluates service providers using complex measurements that weigh not just a service provider in general, but granular data down to specific locations. The index narrows potential providers down to a few finalists, which the client company can then select from.

The PrimeSourcing system, which is meticulous in its detail, works with clients to carefully identify sourcing requirements, expectations and objectives before beginning. You’ll want to do the same as you undertake your search. As you begin looking for an outsourcing partner, start by viewing sourcing vendors as potential business partners. Most companies don’t do that, Mr. Agar says, but that single attitude shift alone can make a big difference.

“The selection process is key,” Mr. Agar says, “and yet it typically becomes adversarial, with lawyers and consultants involved, trying to drive vendors down to zero margins.” That creates an antagonistic relationship right at the start, which is exactly what you don’t want.

Instead, look for a partner that fits well with your company and philosophy. “This is a partnership,” Mr. Agar says. “In fact, this is a marriage. It’s a long-term relationship, and chemistry is very important.”

For example, focus on commitment to quality. Talk with potential outsourcers about processes and how they run their operations. Once you work with the provider to create service-level agreements (SLAs), manage the provider to those agreements. As with any relationship, stay on top of things and communicate. Don’t let the relationship with your provider slide. “You really don’t want to get to the point where you’re suing,” Mr. Agar says.

Keying in on specifics is a hallmark of PrimeSourcing. Information about outsourcing providers supplied by analysts, Mr. Agar says, is often way too general. Also, it doesn’t examine specific locations for outsourcing, which can be key. “It’s not unusual for a provider to have problems at a specific location [only],” Mr. Agar says, so his firm

examines specific locations with tremendous granularity--something you'll want to consider as you make your final selection.

Finally, Mr. Agar advises, keep in mind that not all of the best outsourcing firms are the biggest and most well-known. "There are some really terrific providers out there," he counsels, that aren't well known and consequently aren't on most company's radar screens. By looking beyond the obvious players, you can find a partner—and a location—that's truly the best fit for your company.

Summary: Go as granular as you can—even to examining a particular location—in picking your outsourcing partner. Keep the process from descending into adversarial discussions—this is a partner you'll be working with for a long time.

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Tip No. 2: Formalize Your Decision Process

“You can’t just sit back and say, OK, I’ll outsource this. That’s not good enough any more. You have to be able to figure out, on a global basis, where does my supply chain give me the most efficient return?” –Dalip Raheja, CEO, The Mpower Group

In business, sometimes the simplest parts of the process can be the most challenging. That can be true in outsourcing as well, according to Dalip Raheja, president and CEO of The Mpower Group, a professional services firm that helps Fortune 500 companies with sourcing in general, including outsourcing and offshoring.

The issue that can slow down the outsourcing process and cause the most problems: Lack of alignment of the decision process. “By far, that’s where we pay the most attention to our clients,” Mr. Raheja says. “By far, that causes clients the most anxiety and takes the most time.”

Companies wrestling with this issue—and that means virtually every organization—simply don’t have their decision process well thought out and structured, Mr. Raheja says. “It sounds like a basic, fundamental thing. But categorically, 99 percent of organizations have no clue how to approach [the decision process].” Why? Because companies simply aren’t used to structured decision processes.

The solution, simple as it sounds, is to try to formalize your company’s decision process. That includes clearly identifying the decision-makers, laying out the project in writing, communicating the scope to everyone involved, and getting all parties to agree—and to remember that they agreed. In some cases, Mr. Raheja says, it means “getting senior executives to sign off, so that two months later there’s no disagreement.”

“Absolutely, put it all down in writing,” he counsels.

During the project itself, Mr. Raheja says, many of The Mpower’s clients don’t understand the importance of the process. The light bulb tends to come on later, when the outsourcing project is humming along. “We couldn’t have done it without you” is often the reaction then, he says.

So is the fix as simple as the problem? Unfortunately not, although there are some issues you can address. Of course, hiring a good consulting firm that can help you with all this is one option. Based on his work, Mr. Raheja simplifies the process into these suggestions:

First, identify who the relevant decision makers are—and who they aren’t. The last thing you want to do is spend meeting and decision time with individuals who turn out not to have any power over the decision after all. And that’s more common than you might think, Mr. Raheja says.

Once you've identified who will be making decisions, get that list sanctioned by the project's top name—the CEO, if need be. “The ‘who’ is very important,” Mr. Raheja says. “Otherwise, the people who aren't going to make a decision will be trying to play an active role.”

Next, work to identify what parameters the outsourcing decision will be based on. What are the critical items that you'll use to make the decision? If it's cost, what are the numbers? Is it a percent, for example? What's acceptable and what isn't?

These types of decisions are much easier to get people to agree to before the data starts rolling in, Mr. Raheja stresses. “By getting everyone to agree to these decisions up front,” he says, “they can't manipulate it to fit what they want.”

That, in turn, avoids bottlenecks as the project moves forward. “We've seen it happen many, many times,” Mr. Raheja says.

Sourcing Insight: Think in Terms of Global Delivery Models

A global delivery model is emerging from the outsourcing movement, and you soon won't be able to distinguish between onshore or offshore providers. That's according to Dalip Raheja, CEO of The Mpower Group, who says successful companies will need to think in terms of global delivery models. “That means that you understand where the cost arbitrage opportunities are.... You can shift delivery of your goods and services to where the best arbitrage opportunity lies—with risk mitigation, of course.” If you don't do that, Mr. Raheja says bluntly, “your competition will.”

In other words, Mr. Raheja says, “The firm that you contract with will figure out where the best labor and other arbitrage is, and they will move the labor there.” The result will be transparent in many ways to the contracting company—your firm—which cares most about issues like price and quality, not where the labor itself is located. That means you might contract with a firm in India that offshores to China to bring down costs—meaning that the offshore outsourcer is offshoring.

That means that organizations need “to start understanding what a global delivery model is,” Mr. Raheja says. “We're moving toward virtual supply chains. I can be a competitor without owning any of the manufacturing myself.”

Summary: The process is critical for good outsourcing results. Take time to involve all the decision-makers, and get agreements in writing.

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Tip No. 3: Don't Make Price the Bottom Line

"We've got to get [outsourcing] off the zero-margin deals."—Ben Trowbridge, The Trowbridge Group

Does driving the absolute best deal possible always make your firm the winner? When it comes to sourcing, maybe not.

The hype around outsourcing has led to a feeding frenzy in which clients drive deals forward solely on expected cost savings, and suppliers desperately make concessions to land deals in a crowded market. That's not healthy for either side in the long run, says Ben Trowbridge of the Trowbridge Group, a Dallas, Texas-based outsourcing advisory firm.

In many cases, outsourcing consultants—and he candidly includes his own company in that group—can make the situation worse by helping clients squeeze every possible concession from the supplier. The problem? That creates suppliers who are working for next to nothing—making them a weak long-term partner at best.

Dynamics in the market "are driving established players like EDS [Electronic Data Systems Inc.] and CSC [Computer Sciences Corp.] into low-margin deals time after time," Mr. Trowbridge says. That's because small fringe competitors are bidding those same jobs with tiny margins and low overhead, often because they're using offshore labor or cutting their margins razor-thin.

As you shop for an outsourcer, Mr. Trowbridge counsels, remember that it's a buyer's market right now. Many of the companies competing for your business may have very little actual experience as outsourcers yet. "All sorts of companies are claiming they're outsourcing providers," he says, "while actually, very few of them even understand how to write a good outsourcing contract."

One way the Trowbridge Group helps companies align their relationships with service vendors is by sorting through the service level agreement (SLA) and simplifying it. In doing so, they help the client create a shorter list of indicators that really matter—ones that can be effectively monitored for compliance.

Rather than joining the race to the bottom line, Mr. Trowbridge suggests "aligning the relationship" by negotiating a truly fair price. It may seem counterintuitive, but if you're doing a large outsourcing deal, you need to focus on the overall balance of the deal—not just the price and what you're getting for that price. Looking at the contract with a broader view helps make sure your provider is going to stay in business and provide you with good service.

For example, as you negotiate, "make sure you know that the real cost to provide your services from that new location," Mr. Trowbridge says. Once you know that, don't push the contract price down to the range of a zero-margin deal. If the contract really is saving

you more than 50 percent, he says, consider the costs to the service provider. Where's their margin? And without a profit, what's their incentive to stay in business? Do you really want to be redoing this deal in 18 months after your vendor goes under?

Sourcing Insight: Design an SLA That Works

Service Level Agreements, or SLAs, are a universal document used in defining outsourcing deals. But according to Ben Trowbridge of the Trowbridge Group, a Dallas, Texas-based consultancy firm, they can make or break a deal.

Mr. Trowbridge cites a large wireless company, mired in a bad outsourcing contract, that came to his firm for help. The price was too high, the service level agreement was bad, and the client was locked in for years to come. In helping to renegotiate a better deal, Mr. Trowbridge says, one thing his firm helped correct was the SLA.

A well-defined service level agreement specifies a number of key performance indicators, or KPIs, that the sourcing company can be measured against. That's standard, but Mr. Trowbridge says a common problem is to include far too many KPIs in an effort to further control the deal. That makes it hard to monitor the important KPIs, of which there are probably only a few dozen.

Instead, Mr. Trowbridge would like to see outsourcing get back to the business basics of years back – with high-touch, high-customer-service relationships between providers and clients. “If you're doing a larger outsourcing deal, then focus on the overall balance of the deal with your provider. Make sure they're going to stay in business and are going to provide you with good service.”

He suggests viewing the relationship as a partnership in which no one wins ultimately if either side has a lopsided amount of power and control—in a way, he says, “like a marriage.”

“Don't have the purchasing agent mentality,” Trowbridge says. “When I see clients [acting like] that, I have to assume they're just not thinking.”

Summary: Don't drive your potential sourcing partner to the lowest possible price. Instead, consider it a partnership, where each of you needs to make a reasonable profit to stay healthy.

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Tip No. 4: Manage the Relationship

*“Let’s just say it... Users stink at outsourcing, so open your eyes before you get into it.”
Stan Lepeak, VP, Professional Services Strategies, META Group*

When it comes to the minefield of outsourcing, there’s virtually no area where companies do a particularly good job, according to Stan Lepeak, vice president, professional services strategies at consultancy META Group, Inc. “Let’s just say it... Users stink at outsourcing, so open your eyes before you get into it.”

From picking out a provider, to structuring the deal, to managing the relationship, to dealing with the distributed process, there are no areas where firms are consistently doing a good job, Mr. Lepeak says.

One big bugaboo he sees among many: failure to manage the outsourcing relationship. In project after project, Mr. Lepeak says, companies make the mistake of thinking that once the contract is signed, the deal is done.

“If you’re pursuing outsourcing strictly for cost savings,” Mr. Lepeak says, “you’re likely to have problems.” That’s because firms generally don’t save as much as they anticipate on outsourcing. More to the point, a climate of trying to save as much as possible means that firms tend to under-invest in doing outsourcing right.

“They don’t take the time,” Mr. Lepeak says. “They don’t have adequate talent involved; they don’t have the right people in place to manage the process [or] the ongoing relationship.”

Companies fall into the “Why spend money to save money?” trap, Mr. Lepeak says.

Typically, he sees firms rushing to consummate an outsourcing deal and sign the contract—and then consider it done. Actually, he says, “you’re just starting. You have to manage the transition, and you have to manage the ongoing relationship.” When cost is the main driver for an outsourcing project, as it usually is, that can be difficult to sell.

And don’t forget that you’ll need to determine how the company will function when a given process is no longer done within the company. For example, if someone else is doing customer care, that impacts your sales and marketing efforts, Mr. Lepeak says. If someone else is running your data center, that impacts how you develop new applications.

Ongoing survey work from META Group over the years, Mr. Lepeak says, shows that one of the most direct correlations to outsourcing satisfaction is how much money the company has spent on managing the relationship. In general, META numbers show, those who spend more than five percent a year are happier than those that have spent less.

Sourcing Insight: Escape the Relationship Management Trap

According to Stan Lepeak, a VP with META Group, outsourcing isn't an excuse to not pay attention. That's a common error. Instead, accept that the relationship will need constant management. "You're outsourcing the work, you're not outsourcing the responsibility that the work is performed well," he says. "It's still the user's responsibility to hold the outsourcer accountable."

Mr. Lepeak has seen a few clients manage to avoid the relationship management pothole. As an example, he offers up the tale of a large financial institution "involved in some very aggressive outsourcing" in which efficiency and a focus on core competencies, rather than cost, was the main driver. The company realized that although the tasks it wanted to outsource could be done well internally, there was no upside in doing so. Rather, they wanted to focus on revenue-producing tasks at which they could excel, such as integrating mergers and creating new financial products.

How did the financial firm do it right? Since cost wasn't the main driver, they were able to justify dedicating a significant amount of resources to the process. They also kept the CIO engaged in all aspects of the project. By using third parties for process benchmarking before the outsourcing began, "they knew how well they did it to start with and what their true costs were."

The financial firm continues to have a large internal team dedicated to the project, Mr. Lepeak says, including people with skills in relationship management and contract management. The cost of managing the deal: In excess of five percent, although that could drop as the project matures.

The lesson from the large financial firm and plenty of others Mr. Lepeak has seen: Recognize up front that you'll be spending significant money on the outsourcing relationship, accept it, and budget for it.

That's an average; a basic IT operational activity might cost less, but business process outsourcing or offshoring, in the early years, could be closer to 10 percent, Mr. Lepeak says. "But just generally, the firms that spend a little aren't very happy, and the firms that spend a lot are." If you're spending \$10 million a year with an outsourcer, Mr. Lepeak says, you probably should be spending five percent of that managing the deal.

Where is that money spent? Primarily the governance team, and on other expenses such as third parties you might bring in for benchmarking or re-interpreting contracts.

When firms recognize that signing the deal is just the start, they can then accept that they'll be managing the ongoing relationship from many aspects. That means the basics—have we set up a service-level agreement and is it being adhered to, and if not, what do we do?

Firms tend to forget that “you’re outsourcing the work, you’re not outsourcing the responsibility that the work is performed well,” Lepeak says. “It’s still the user’s responsibility to hold the outsourcer accountable.”

Sourcing Insight: Move the Focus Away from Cost

Companies that aren’t solely focused on saving money as the reason for outsourcing tend to do better, according to the META Group’s Stan Lepeak. That’s because they’re willing to spend what it takes to manage the project correctly.

Rather than focusing on cost as a driver, Mr. Lepeak suggests, companies might look at other reasons for outsourcing, such as getting access to skills and capabilities you don’t have internally.

“Most Indian firms are better developers than US IT operations,” he says bluntly. “They’re more consistent, they’re more thorough. They may not understand the business as well, but when it comes to coding, they’re better.” Given that, why should your firm struggle to maintain an internal staff and train them on new skills, when an outside service provider can do it as well or better?

The outsourcing driver then becomes, “to tap into the skills that you don’t possess internally, and ideally, tap into them at the outsourcer’s cost.”

Another reason beyond cost, Mr. Lepeak says, is reallocation of scarce resources to focus on core competencies. By shifting some work outside the company, you can reallocate skilled internal resources to something that needs to be handled within the company. “Or fire those people because they don’t have the right skills and hire someone else.”

For example, you might hire a service provider to handle basic application development work, while using more skilled internal people to plan a design what applications should be developed. Or, figure out the business sticking point that technology could solve and translate that into a development plan, but then go to a third party to do it. Or have someone else do your transaction work in finance and accounting so you can have the people analyze the results.

Summary: Set aside time, money and people with the right skills to manage the relationship. Outsourcing doesn’t end when the contract is signed, it begins.

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Tip No. 5: Communicate Up and Down the Chain

“If the focus of outsourcing for your organization is short-term and tactical, the benefits will be both short-term and tactical.”—Frank Casale, CEO, The Outsourcing Institute

The Outsourcing Institute, with CEO Frank Casale at the helm, has been around long enough to see plenty of outsourcing mistakes. Since 1993, Casale has been watching firms work at getting outsourcing right—and still get it wrong. One of the biggest errors he sees: lack of communication.

“An outsourcing engagement tends to be complex and far-reaching,” he says. “Oddly enough, even when a deal is done, most people don’t know, or can’t track, where it initiated from.” A CEO may see outsourcing as an interesting option; and passes the idea to the CIO. From there, perhaps it makes its way to sourcing and procurement or HR. “It’s almost like a game of telephone... “ Mr. Casale says, “where each person translates [the project] their way. When it finally gets to wherever it’s going, it very rarely resembles what the C-level executive had in mind.”

After all, Mr. Casale points out, 12 months or more might pass from an executive’s “I think we should outsource this” to signing the contract, depending on the deal. Because of the length and complexity of outsourcing deals, top executives are typically involved only in the first 10 percent and the last 10 percent, he says. “So that middle 80 percent is a dry time.”

The solution is as simple on the surface as this, Mr. Casale says: Throughout the project, keep communications open up and down the chain of command. Rather than treating the outsourcing project as a handoff in which the CEO has the idea, then hands it off to others to achieve, sustain the project with continuous communication with everyone involved, from the bottom up. Rather than a single exchange, Mr. Casale says, an outsourcing project is “more of a team dialog.”

Even when you’ve made communication is a priority, the C-level executive who initiated the project may not be active in the actual transaction or in the ongoing project itself. Still, he or she remains in the communication loop—and that’s crucial.

Keeping top executives informed means maintaining continual access to updated documents, including the project’s goals and missions. That, in turn, assumes there *is* good project documentation.

“When [a project] is documented early and at a high level,” Mr. Casale says, The Outsourcing Institute has found “that the ROI on the outsourcing engagement tends to be more strategic in value.” That’s because the CEO or CFO tends to focus on cost savings, but not at the exclusion of other benefits, like time to market.

How often does Mr. Casale see a company pull off an outsourcing project with good communication? “Rarely,” he admits. Instead, companies continue to focus on cost savings.

Fortunately, however, experience is a good teacher. “As companies get through their second or third outsourcing deal,” he says, they “start to realize that [it’s not all about] pricing.”

In The Outsourcing Institute’s most recent outsourcing index, Mr. Casale’s institute surveyed 1,900 buyers. In response to a question asking member companies why they outsource, “cost savings” ranked high, but “strategic reasons” was creeping up the list from previous surveys.

“So it’s moving in the right direction,” Mr. Casale concludes, “but it’s not there yet.”

Summary: Keep everyone apprised of progress as the outsourcing project moves along. That includes the CEO, the primary managers, and anyone else affected. Good communication is key.

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Tip No. 6: Move from Tactical to Strategic Sourcing

“Don’t do outsourcing as a knee-jerk undertaking. Do your homework. Do it in steps. Really understand the motivations for outsourcing.”—Robert Brown, Principal Analyst, Business Process Outsourcing, Gartner Research

If you’re working for a small to midsize company rather than a large one, the outsourcing tide has been slower to reach your doorstep. That’s how business process changes work—the biggest firms push them forward, buoyed by more money to spend and bigger savings to realize.

So far, midsize businesses make up a fairly small portion of the outsourcing pie—just 20 percent of the market overall in 2004, according to IT research and analyst firm Gartner Inc. But outsourcing is moving down through the food chain, according to Robert Brown, a principal analyst for Gartner who studies business process outsourcing.

If your small to mid-size company is contemplating outsourcing a business process, many of the same tips that apply to larger companies apply to you. A key one is this, according to Mr. Brown: You’ll want to check that you’re thinking strategically about outsourcing, rather than tactically.

“Often, the natural tendency is to immediately start issuing requests for proposals without due diligence on the front end,” Brown says. Instead, be sure you’re looking at your long-term strategy, keeping your business objectives in mind at all times, and working to cement a long-term strategic relationship with your chosen vendor.

For starters, “the enterprise needs to understand its motives for outsourcing in the first place,” Mr. Brown says. “It can be as simple as, the CEO has played golf with the executive of an outsourcing company—which isn’t the best ingredient for a strategic sourcing decision.” What Gartner advocates instead, Mr. Brown says, is a carefully thought-out strategy that starts with involving everyone. Once you understand the motivations for outsourcing, Mr. Brown says, you can go to the table with all the stakeholders giving their input.

To be strategic, consider questions like these: Where can we reasonably find areas that are acceptable for outsourcing? What areas of the business are good candidates for outsourcing? Can we get buy-in from the C-level executives? Can we get buy-in from the mid-level managers involved, including those in IT? Answers to those often-tough questions come from meetings and discussions that include all the business units involved.

Once you’ve done your homework, Mr. Brown says, you’re ready to go out into the marketplace and collect bids from companies that can meet your specific needs.

Finally, it may help to try to envision the end state once you've done the deal, Mr. Brown suggests. "Two or three years in the future, what would the ideal output look like?"

Summary: Resist the push to rush into outsourcing by working strategically. Decide what you're outsourcing and why, meet with everyone involved, and make careful decisions before issuing any RFPs.

Sourcing Insight: Match Company Sizes

"We often find in our discussions with SMBs [small and medium-size businesses] that they want to be the outsourcer's most important customer," says Robert Brown, a principal analyst with Gartner Inc. But if you're a smaller company who chooses to work with one of the largest outsourcers, that probably won't be the case. "If you're an SMB and all you require is things like guaranteed availability and a good price point, you can get that from larger vendors," Mr. Brown says. But if you anticipate needing high levels of hand-holding during the relationship, or lots of change orders, a larger vendor probably won't be able to supply that for a smaller client. A better strategy, Mr. Brown says, is to find a smaller vendor, closer to the size of your company, and perhaps one who is local and works in your market—whether that's Southern California or the New York area.

Surprisingly, Mr. Brown says you don't necessarily increase your risk by working with a smaller, less well-known provider. "A lot of the smaller outsourcing vendors that I've had occasion to work with are fairly solid companies," he says. Again, the big advantage to you: "The smaller guys can bend over backward for your business and will really cater to you."

A final point about larger vendors is that many of them have shifted to reach down into the midsize market in today's economy. When the market picks up, Mr. Brown suggests, "There may be a tendency to retreat to their bread-and-butter clients after having dabbled in the SMB market, leaving their SMB clients high and dry."

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Tip No. 7: Craft an Exit Strategy

“You often see clients who are more ready for their data center burning down than for their outsourcer going out of business.”—Brad Peterson, Mayer, Brown, Rowe & Maw LLP

Just as your firm has a disaster recovery plan that you review yearly, so should you have an exit plan for any outsourcing deal you make. That’s the advice from Brad Peterson, a partner with Chicago-based Mayer, Brown, Rowe & Maw LLP, the tenth largest law firm in the world and a global leader in outsourcing law.

“People generally spend far more time getting into these things than on [planning] how they’d get out,” Mr. Peterson says. That leaves companies trapped when a relationship goes bad, the supplier disappears, or a series of breaches forces you to terminate the contract. Now what?

“Outsourcing a business process is in many ways like getting a functional lobotomy,” Mr. Peterson wrote in a paper on outsourcing. “Your company will no longer know very much about the function that you’ve outsourced.” That transfers a lot of power to the provider, and can leave you helpless and trapped if things go south.

Instead, Mr. Peterson suggests planning ahead, specifically about these issues:

First, if the current relationship were to end, think about where you’d go. Would you find another external provider, or move things back in-house? In either case, what would you need that only your current provider has? It might be hardware, software, people, or unique knowledge. Maybe it’s written down; maybe not. In any case, you want to make sure your contract with the provider specifies that you have the right to all of that information, Mr. Peterson says.

Second, maintain the relationship on good terms. That means that even if you end up ending the contract, the supplier will be more likely to be motivated to treat you professionally—just as you’ve treated them. You also want a contract that specifically helps you negotiate a smooth transition. If you don’t do that, you risk making the supplier a perpetual partner.

Also, Mr. Peterson suggests maintaining enough internal knowledge that you *can* exit the relationship should you decide to. One way to do that, he says, is with an exit plan that you check yearly to make sure that you’re retaining some internal knowledge.

For example, he’s has been working with a client who was moving to a new outsourcing provider. Once his client decided to leave the current provider—for financial reasons, poor performance, and lack of promised technical skills—his client began to quietly work with other vendors to identify another provider without spooking the current one.

Next, with Mr. Peterson's help, they began to build a case for leaving that contract without paying heavy termination fees. "They analyzed the [contractual] breaches to be able to prove they should be able to get out for default," he explains.

Next was what Mr. Peterson calls "a detailed and very difficult analysis of how to exit from the relationship." Concurrently, they began negotiating a new outsourcing relationship with a new provider. Finally, they made the transition.

In your planning phase, realize that this sort of change takes time. In this example, the span from deciding to switch to the actual transition was about six months, Mr. Peterson says, "and [we] were moving very quickly."

What the client might have done better, Mr. Peterson says, is to spot the issues more quickly and realize there were problems. "One thing that people often don't realize about outsourcing deals," he says, is that "the longer you go, the deeper in it you get. In outsourcing relationships, problems tend to fester and grow rather than diminish if you don't pay enough attention to them."

His standing advice: "Manage close to the contract, of course. Be hard on the substantive issues while soft on the people to preserve the relationship, while also maintaining the contractual relationship." But his focus in talking to clients is often this: "Don't spend so much time hoping the situation gets better. Things rarely get better without real action."

Summary: It's critical to plan how you'll get out of an outsourcing contract should the need arise. Make sure your rights are explicitly spelled out in the contract by imagining what might happen if the relationship ends. What would you need to walk away? Meanwhile, maintain the relationship by addressing problems when they arise.

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