
Edited Transcript of the Panel Discussion at the Latham & Watkins Outsourcing Masterclass on Thursday, 25 March 2004
RUNNING A SUCCESSFUL OUTSOURCING PROJECT: THE KEY? PROCESS, PROCESS AND MORE PROCESS....

Edited Transcript of the Panel Discussion at the Latham & Watkins Outsourcing Masterclass on Thursday 25 March, 2004

Although this paper may provide information concerning potential legal issues, it is not a substitute for legal advice from qualified counsel. The paper is not created or designed to address the unique facts or circumstances that may arise in any specific instance, and you should not rely on this content as a source of legal advice and this seminar material does not create any attorney-client relationship between you and Latham & Watkins.
# TABLE OF CONTENTS

INTRODUCTION...........................................................................................................................................1
  Transition .............................................................................................................................................1

MOBILISATION ........................................................................................................................................2
  Where do you start? ...........................................................................................................................2
  Who needs to be involved? .............................................................................................................3

DATA GATHERING....................................................................................................................................3
  How do you Approach the Data Gathering Exercise? .................................................................3
  Is it worth putting out an Request for Information (RFI)? ......................................................4

DEFINING THE SOLUTION................................................................................................................5
  How prescriptive should you be in your Request for Proposal (RFP)? ..................................5
  How much help will the suppliers need? ....................................................................................5
  Should you disclose your base case to the suppliers? .............................................................6

CLARIFICATION AND NEGOTIATION................................................................................................7
  Can you sole source successfully? ................................................................................................7
  Does competitive sourcing take longer and cost more? ..........................................................7
  Choosing the preferred supplier – When is the right time to down select? ..........................8

THE CONTRACT PROCESS .................................................................................................................9
  Do term sheets work? ....................................................................................................................9
  Whose paper should you use to document the deal? ...............................................................9
  When should lawyers become involved in an outsourcing transaction? ................................10
  Service Levels – At what point after contract signing should the supplier be made accountable? ...................................................................................................................10
  How long should an outsourcing deal take to complete? ......................................................11
  Is post-contract due diligence ever a good thing? ................................................................12

TRANSITION AND GOVERNANCE................................................................................................12
  Extracting a detailed transition plan from the supplier ..........................................................12
  Governance and the Retained Organisation .............................................................................13
  Can the contract be an effective tool to manage the supplier? .............................................14
  How do you manage the transformation from a project team to a governance structure? ....................................................................................................................14
  Why you need to do the hard work up front..........................................................................15
RUNNING A SUCCESSFUL OUTSOURCING PROJECT: THE KEY? PROCESS, PROCESS AND MORE PROCESS....

Edited Transcript of the Panel Discussion at the Outsourcing Masterclass on Thursday 25 March, 2004

Panel Leader: Andrew Moyle (Partner, Latham & Watkins)

Panel:
Alex Hamilton (Latham & Watkins)
Richard Herbert (Independent Consultant)
Craig Hughes (m.a.Partners)

For further information on any of the topics discussed in this document please contact Tracy Beckett at Latham & Watkins on +44 207 710 1869 or email at tracy.beckett@lw.com.

INTRODUCTION

The outsourcing process can be broken down into 5 phases:

Mobilise

Initiating the project, identifying the project team, agreeing objectives and the process to be followed.

Gathering Data

Collecting the necessary data to enable you to describe the in-scope environment that you are proposing to outsource.

Defining the Solution

The process of evaluating the supplier’s solution in response to your requirements.

Negotiate

Finalising the contractual relationship between yourself and the preferred supplier. This will often involve conducting a parallel negotiation with two suppliers until a clear preferred supplier is identified and key commercial, legal, technical and financial terms are agreed.

Transition

Preparing for operational handover to the preferred supplier and the execution of that handover. This will also involve the customer developing internal governance model and identifying the retained organization to manage the outsourcing relationship.
The diagram below shows that there is an overlap between the phases, particularly once the solution definition phase has commenced.

**MOBILISE**

**Where do you start?**

Richard: Getting the project properly set up at the outset will go a long way to setting up the project for success. You must:

- Define the opportunity, benefits and work required
- Get the scope, cost, and compliance approved
- Get organised, plan, appoint key roles and resource
- Have clear Scope and Plan
- Have an approved Project Cost
- Compliance with strategies
- Appoint Sponsor, Manager & Steering Committee
• Structure and resource the team

This needs to be documented in some form of Project Initiation Document (PID) or Terms of Reference (TOR). This document gives the basis for making contextual decisions during the lifetime of the project. It should be signed off and agreed by the appropriate stakeholders – the format of this may differ based on the level of detail required.

Who needs to be involved?

Craig: It may slow you down a lot to start with but it is beneficial to have broad involvement from specialist areas who have accountability for elements of the enterprise that will be affected by the outsource. Your team will therefore be multidisciplinary. It will consist of people from the business line who have never done an outsourcing project before, technical and operational people who have strong vested interests in the subject matter to be outsourced. You will be relying on internal and external lawyers and you may have external consultants from more than one consulting firm.

It’s critical to get everybody on the same page, to make sure they are all pulling in the same direction, and that they all understand the objectives for the deal. I also think one of the important things is to think about is receiving a bit of training before you start the project. There’s a lot of jargon around outsourcing, and you need to bring everybody up to speed on the process you are going to follow and the issues you are likely to face.

GATHERING DATA

How do you Approach the Data Gathering Exercise?

Andrew: As the customer you have to know in detail what functions or operations you are outsourcing, so that you can then determine the services you need to buy back from the outsourcing supplier. The intent behind data gathering is to be able to provide the supplier with the most comprehensive and detailed description of your in-scope environment as possible. But data gathering is never an easy exercise and it can be extraordinarily time consuming particularly where organisations have decentralised operations in scope.

Craig: Unfortunately, when it comes to data gathering, nothing really beats the hard graft. Sending out questionnaires and e-mails for requests for data don’t tend to work. What you need to do is actually find the people in the organisation who have the data, go and interview them, document their responses, and then feed it back to them to confirm it is correct.

Where you have a geographically dispersed organisation, then I think it pays to have people do that locally. Don’t rely on e-mails out of New York to get the answers.

Quality here is king. If you have the wrong information going in, the wrong baseline, the wrong inventories, you are going to come up with the wrong answer at the other end.

Data breaks down into five broad categories:
(i) **Technology:** What hardware do you have, what versions of that hardware, what software is running on it, what versions of that software;

(ii) **Process:** What did the people do, how did they do it, what are the key performance indicators (KPIs) that they are using, in order to measure how well they are doing;

(iii) **Organisation/HIR:** Who is doing it, where are they, what roles do they perform, what are the terms and conditions that they are employed under, what are their salary structures, what’s the severance structure;

(iv) **Legal:** Any organisation has a number of contracts out there which will be affected by the current outsource. Finding these and understanding their impact never seems to be a straightforward task. So start the exercise as soon as possible. Bring in your lawyers to find out what your in-scope contracts say and what flexibility you have in respect of those incumbent supplier relationships if you do outsource;

(v) **Financial:** This is key because at the end of the day most outsourcing decisions are based on the financials as well as how well the supplier can operate. What does it cost you today to do the job that you are about to outsource? What are the drivers around that cost and who pays for it? There may be business direct expenses that you need to factor in, that will be paid directly by the business.

I think in almost every one of the deals that I’ve done, the postings have actually been incorrect at the going in point. So, what you actually think is the cost of the in-scope area, isn’t necessarily in-scope. There’s an element of having to fix something first, so that you can be sure that you’re actually looking at the in-scope area from the financial point of view in the correct way.

Collecting financial data to create your base case is always tricky. You can mix the top down approach where you just look at the budgets or the bottom up approach looking at the invoices. Either way, you have to make sure that the two actually reconcile, and that the baseline that you have is actually for the services that you are thinking of outsourcing, and that you don’t have erroneous items that aren’t part of your scope included in the baseline, or that you’ve missed things that are part of your scope.

**Is it worth putting out an Request for Information (RFI)?**

Craig: I think it depends on how mature your market is, how mature your organisation is, and how readily available the information is on both those points. If it is a new area that you haven’t been looking at before, then I would definitely think about doing it. The thing to recognise is that an RFI is an indicator. It will help you define perhaps an early target architecture or a target architecture hypothesis. But it won’t deliver you the final solution.

Alex: I agree. If you’re unclear about what the scope of the services is going to be you really ought to know by the time you get to the end of the RFI process, and the RFI can help drive those answers. We’re going to be coming on to RFPs (Request for Proposals) next and it’s simply not practical to use the RFP process to go out and experiment with a whole range of different offerings. So any real experimentation with choice needs to be ironed out through the RFI process.
Andrew: I think that sometimes customers can place too much reliance on an RFI to produce a definitive outcome. At best you’re going to get some broad indicative pricing, but, provided you acknowledge the limitations of an RFI, it can be a very useful tool in determining what types of solutions are out there and whether there is the capability to actually deliver them.

DEFINING THE SOLUTION

_How prescriptive should you be in your Request for Proposal (RFP)?_

Andrew: Ten years ago when outsourcing was really beginning to kick off, an old style prescriptive procurement approach was often adopted by customers for the tendering process. It then swung to the other end of the spectrum in the late nineties where it was almost what I call a “free love” approach to tendering. The thinking behind this was, we’re outsourcing this because the suppliers know how to do it better than us, so let’s not constrain their proposals in any way. I do not believe either approach works well in outsourcing. We’ve always practised a process that falls somewhere in between. A process that does not pre-empt the supplier’s solution but is prescriptive in identifying the services it requires from the supplier, disciplined in how it requires the supplier to respond and as detailed as possible in the information it provides the supplier about the customer’s in-scope environment.

Alex: Your RFP should tell a story about your existing environment and what you require in the future. You should try not to second guess the supplier’s solution. You’ve got to define the scope of service and you have a pretty good idea of the kinds of service levels you’re going to require. Are you asking for a Rolls Royce, a mini, or a comfortable family sedan? You also need to specify your key commercial and legal terms.

I think the principle behind it is you should be telling the supplier everything relevant that you know and you should also be identifying in the RFP what important points you don’t yet know.

You don’t want to drive the supplier to one answer which may be ultimately the wrong answer for you because you don’t understand their solution as well as they do. But you do need to be driving them so that at the end of the RFP process you have an “apple to apple” comparison between supplier bids. And, the “free love” approach doesn’t get you there, because each supplier is going to come back with a completely different expectation of what they think they are required to deliver.

Richard: I think a large part of the learning curve has been that, regardless of how tight you think you’ve made that RFP, if you’ve got five suppliers they will all interpret it in a different way and you are in grave danger of getting five different answers, which are not directly comparable by way of apple to apple comparison.

_How much help will the suppliers need?_

Alex: There is sometimes a tendency to treat RFPs like exam questions, but you’re not trying to catch suppliers out. Sure you can ask exam questions around your environment, to make sure that they can play back to you what it is that you actually do and to make sure they really understand it and they’re not just offering you another commodity solution that may have little relevance.
But it’s also hard to get the suppliers to be innovative, and, in our experience, they rarely are. It takes a lot of work to extract something other than a standard solution. I think there is a useful process you can run during the RFP of regularly meeting with the suppliers after the RFP goes out to make sure that everyone understands exactly what you’re talking about. You should allow for and encourage a series of meetings with them during the RFP process to help build a solution that fits with your requirements. They should be encouraged to test their solution and ideas on you, so you can actually give them a steer before they submit their proposal.

Richard: The more help that you can give to suppliers, the better the fit of the solution will be to what you want, and the quicker that you will get to the right solution for what you want. So if you simply throw stuff over the fence, you are going to end up churning, churning and churning. But if you provide lots of help, lots of support, you will get to an answer that you want, quicker.

Alex: There’s a recurring theme that comes through this discussion. It’s about doing the work up front. And, the premise behind it is, there’s a lot of work you’ve got to do in an outsourcing deal, particularly in terms of getting your arms around your own environment, and really understanding what it is you do and what you want the supplier to do in the future. You can either do that work at the beginning, which we would strongly recommend or you can do it later in the process. But if you do it later, the whole process is kind of running a little bit out of control by then and you may not have the time and the resources to regain the initiative.

Should you disclose your base case to the suppliers?

Alex: I genuinely believe that you should be as open as possible with the supplier and it ties back to you’re not trying to catch the supplier out, you’re trying to help the supplier. I think giving the base case to the supplier can be extremely helpful for two reasons. First, they will test that base case, and they will ask some fairly penetrating questions around it, and you will have a better base case at the end of that process. There is of course a danger of over focus by the supplier on trying to raise the base case rather than reducing their price. But managed carefully this scrutiny can be a good thing. Second, it is also the sanity check for the supplier. It gives them another view of your environment, another view of how you do things right now. And it may mean that they don’t miss an area when constructing their solution which they thought was very small and in fact you have a lot of resources devoted to.

Richard: I think at some point during the process you are going to have to disclose the base case. I think the real decision is when you disclose it. I would go further in that I would draw a distinction between “base line” and “base case”. By “base line” I mean the current in-scope cost for the in-scope area. Effectively a year zero or a year one financials. I prefer to disclose that earlier rather than later, because I think it really is a good way for the supplier to validate the environment that you’re asking them to take on, and I think, regardless of how detailed we make the RFP and the information that we provide to them, suppliers have proven time and time to me that they find it very difficult to fully understand the complexity of the environment. I think if you are giving them the financials to underpin that, then that is a mechanism which they can use to support their understanding of your environment and, therefore, their solution.
I think the “base case” in terms of what your project costs would have been over the term had you not outsourced is something that you might want to hold back a little bit, because as, Alex says, you may find the supplier tries to affect that base case to make their financial projection look better. But fundamentally I agree that you should be disclosing it.

CLARIFICATION AND NEGOTIATION

Can you sole-source successfully?

Richard: I want to believe that you can. But the key is that you've got to maintain leverage over the supplier and this is always more difficult in a sole-source situation. If the supplier believes that you will walk away and you won't do a deal at all, I think that probably is sufficient leverage, but that has to be truly what you would do. Try to fake that leverage and it will be no leverage at all.

I did a sole-source deal where we lost all our leverage completely over the supplier. And the supplier believed, incorrectly, that we had to do a deal. The result was no deal because the supplier would not play ball.

In contrast, on one that I've run more recently, we down-selected very early, and I believe that the supplier did stay very tightly engaged. They were very receptive, because I believe they knew that we would potentially walk away from the table if there wasn't a deal.

Alex: I think it’s very rare, (certainly outside the public sector) to take a competitive process all the way through to contract. So in every deal you would typically down-select to a single supplier at some point before signature. But I'm really passionate about competition, I think it’s unbelievable in how it drives a better price, I think it’s unbelievable in how it moves suppliers on positions that they say are impossible to move on.

So I don’t like sole-sourcing. I don’t think it’s impossible to do a good sole-source deal, I think there are many situations where a team will be put in a position where it has to sole-source. It’s not always in your gift and it’s not unknown for handshake deals to be done on golf courses with the team then picking up the pieces afterwards. But, as Richard says, if you are going to do one successfully you’ve got to maintain leverage and that’s about convincing the supplier of your ability to walk away if the deal is no good.

Andrew: Sometimes you may be forced to do sole-source because the incumbent is so dominant within the customer organisation that other suppliers will simply not bid. They see it as a beauty parade. It’s always those deals that I think are really tough and a really hard grind for the customer’s project team to extract a decent result.

Does competitive sourcing take longer and cost more?

Alex: Well I declared myself to be a fan of competition, but this is a fair criticism. Does it cost more? From a total cost of ownership of the deal point of view it does not cost more. You’re going to be doing a deal with a term of something like three to ten years and the amount of savings you can make over that period and the quality of the deal you can get through competition, means that overall you’re not going to spend more. The cost of actually doing the deal
should be relatively insignificant when compared to the additional savings the deal should achieve.

In terms of resources on the deal, there are periods where, yes, you’re going to be using a lot more internal and external resources during a competitive process because trying to run parallel streams is hard work and it is resource intensive. But I think you’re going to get a lot out of it. I think also that you can actually do these deals faster than some of the equivalent large scale sole-source deals, because you’re not having to fight trench warfare with a supplier that is confident they will get the deal. You really can move suppliers to closing positions much faster, but there are bursts of very intensive resourcing requirements. And yes, that’s going to cost you. But overall, you can do competitive deals more quickly and get a better deal for it.

Andrew: I think that’s an important point, you can obviously do a deal as quickly as you want to do a deal, it just depends on what you’re prepared to sacrifice in the process and whether you are basically prepared to accept what the supplier is offering. But, I do think if you are looking at a quality deal then a competitive process will drive an outsourcing transaction to a conclusion faster.

Richard: The point I’d like to make is that if you are running competition it needs to be real. And, on a couple that I’ve done, because of resourcing constraints, we’ve tried to keep one warm and one hot. It doesn’t work. The suppliers always know. They know what’s going on and they know where they are in the pecking order. If you are running a competitive process then you need to treat each supplier in as similar a way as you possibly can. I think you have an obligation to go through a fair and equitable process with the suppliers.

Alex: You also have to be pragmatic. You cannot run a proper competitive process with more than three suppliers at one time. You can, of course, move from an RFI list which is 10, 15, and use the RFP to get down to four or five very fast. I think you then need to use the suppliers’ responses to the RFP to again move quickly down to two or three suppliers. We like competition but we recognise the fact that its also expensive for the suppliers, so speed and thoroughness are equally important.

**Choosing the preferred supplier – When is the right time to down select?**

Alex: When you’re looking to down-select to your preferred supplier then you need to do that from a position of power and a position of clarity. That means you need to know that the supplier’s prices are robust and stable that you know exactly what services you are getting for that price and the supplier’s capability of delivering those services.

To ensure the supplier’s offering is solid you also have to have given them the opportunity to understand your environment, and they should have completed at least their initial due diligence on your environment. From a contractual point of view, we’ll discuss this further when we talk about term sheets, but, at the very least, you need to have agreed the key commercial terms of the contract. Now, whether that’s agreed in principle or agreed in actual contractual language is a moot point, but, at the very least, you need to know that the large sticking points (e.g. the liability clause) have been agreed, and you are not going to find yourself fighting trench warfare with the one supplier for many weeks after the down-selection decision was made.
THE CONTRACT PROCESS

Do term sheets work?

Andrew: Term sheets can be a useful tool to drive “sales pitch” supplier responses to firm commercial positions. The RFP typically produces hundreds of requirements so the term sheet can be a valuable interim step in the clarification/negotiation process that enables you to take a subset of those requirements and create a side-by-side comparison against the suppliers’ responses. Used in landscape, it can be a useful tool for further clarification and agreeing firm commercial positions from suppliers on key issues.

Alex: I’ve seen deals where they have worked and I’ve also seen some disasters with term sheets. And, I think you have to use them carefully and recognise their limitations.

The disasters I’ve seen with term sheets is where the customer tries to do too much with them. You basically re-state the whole contract in a tabular form, and then you negotiate it, except you haven’t put the full wording in there, it’s at a principled level. A lengthy negotiation happens, you go to contract, and everything gets re-opened again.

Richard: Right now I’m very sceptical of term sheets. And that’s on the basis that in my last two transactions we did use a term sheet and I think the result was that we ended up negotiating the contract twice. Once in the term sheet and then once when we got to contract language. Now part of that might have been a product of going to too much detail in the terms sheet. It might also have been a product of the lawyers that we had on the other side who weren’t prepared to commit and insisted on revisiting a number of things when we got it into the proper contract language.

Craig: I’m a fan of term sheets but I think they have to be used correctly. If they are done right and they are written right, they are very useful tool for pulling out the key issues and allowing you to actually escalate those issues up the sponsorship tree.

Where I have had a poor experience with term sheets was actually where we moved off the term sheet too early, and we went into contract language, without having agreed in principle a number of key positions. Had we kept on negotiating and agreeing the key elements on a term sheet level, I think we would have agreed to contract language far more easily and progressed to a successful end result far more quickly.

Alex: I would advise on doing a term sheet that is no more than twenty pages of high-level key issues. You should acknowledge they are high-level issues, and discuss them with the supplier, recognizing that the supplier is inevitably going to try to re-open some of them when you go to contract. But, if you can put a contract out there for one round of negotiations before you down-select, then typically you should be able to recover those positions.

Whose paper should you use to document the deal?

Alex: Always the customer’s. You will lose 10 or 20 percent of the negotiation points automatically as soon as you go on to the supplier’s paper, because it’s set up to their way of seeing the world rather than yours and because the dynamics of a
negotiation are such that you can only win so many points and a lot of those points will be used up just trying to get the contract back to an even keel. You will also have a very difficult negotiation because a lot of the key issues that you need to protect the customer won’t be in the supplier’s document which will be set up in a completely different way, and you will have to fight point by point to get a good deal. So emphatically the customer’s. And that’s throughout the documents, all the schedules as well.

Richard: I think there are situations where it is warranted to at least look at what the supplier has to offer. But, I think the bigger the deal the more control I would probably want over the contract, so, as you go up the size of the transaction I would be much more inclined to rest that initiative and control the paper.

Andrew: What I think people underestimate is that control of the paper is a really powerful process issue for a customer. Particularly once you have down-selected to a preferred supplier. At this point you need all the leverage you can get, and controlling the paper, the drafting of the contract and schedules, and the redrafting of those documents following negotiations undoubtedly helps you maintain leverage over the supplier.

*When should lawyers become involved in an outsourcing transaction?*

Alex: Your in-house lawyers should be involved at the point where you’re kicking off the project, and that’s really important, they’re a key member of the team, and they need to be brought in right at the beginning. For external lawyers, my recommendation is that at a minimum you involve us at the point where you’re starting to pull together the RFP. And it’s not about necessarily having a whole team engaged, it’s about adding value in terms of getting strategic advice on setting up the proposed deal structure. This is because from sheer experience, we do have a very good idea of where the deal will end up in terms of a contract. And there’s some key groundwork you can do upfront to point the process in the right direction.

Richard: It is very important to involve your specialists upfront, and I would include in that lawyers who understand outsourcing. I think they are very helpful in advising you before you begin on the regulatory and legal environments that you might be operating in as well as on the construct of a lot of the documentation in the RFP.

With Andrew’s legal team (who specialise in outsourcing) the distinction between lawyers and consultants has become blurred. We’ve actually had his lawyers primarily responsible for the statement of work, the pricing schedule and the service level schedule. Now, obviously one of the concerns as a project manager, wearing your project cost control hat, is that these guys can tend to be a little bit more expensive than consultants, but my experience, particularly with Andrew’s team, has been that you can actually get the right result much quicker. And I think certainly by doing some of that work in the RFP phase, you can get a level of re-use when you get to the contract.

*Service Levels – At what point after contract signing should the supplier be made accountable?*

Andrew: Typically the supplier will look for a grace period after operational handover, before the customer can hit the supplier with service credits or service penalties for failure to achieve service levels. One of the reasons suppliers cite
for this stance is that the customer has been unable to provide the supplier with detailed service level information before contract signing. Craig, should a supplier be given a grace period from non-performance, once it has taken over operational responsibility?

Craig: I think I’m very much on the fence here. I think it depends on what it is you’re outsourcing, and the transition approach that you have taken. If you are transferring something to a fairly mature outsourcer and you’re moving all the data onto their system etc then that will be an example where I think the supplier should comply with services immediately on operational handover.

On the other hand, if the supplier is taking over and then transforming and you’ve asked for an improved service level regime on what you had before, then it seems a bit unfair to penalise them for failing to achieve the improved service levels straight away.

Richard: I have tended to harden on this one. My current position is that I would not really be prepared to give them any relief from the agreed service level regime.

I work primarily in investment banks, and although we talk a lot about cost reduction, it is a very high service level or high service-provision environment, and nobody will thank you in the business community if you implement a regime which leads to service degradation and you’ve got no comeback on that.

Alex: I think I’m hardening on this one too. On a fairly recent deal the client agreed that service levels applied from day one but the service credit regime didn’t kick in for six months, and it was a remarkable fact that the first month in which the supplier actually met the service levels was the month in which the service credits kicked in!

How long should an outsourcing deal take to complete?

Andrew: In the last few years we have seen that speed to market has become more critical, people want to do these deals quicker but still expect the same rigour to be in the deal.

Richard: As a project manager I fundamentally believe in left to right planning, so you have to work it out on a case by case basis. I do have in my mind nine to twelve months when somebody picks up the phone and says, you know, we’re going to look at this deal. But, it depends obviously and let me give you a couple of examples. I did a deal about five or six years ago which was a transatlantic data centre outsource, the annual in-scope area was about 40 million dollars. We started it on the 20th of June and we were going to sign the contract on the 1st of February. We were ready to sign but we killed it on the 31st of January. So that was basically a seven month project. There was a large in-scope population and we had all the typical ARD issues.

We used Andrew’s team, we had a very comprehensive contract, and contract negotiation. We had a really good mobilisation. I started mobilisation on the 20th June and I had a full team by the 1st of July. That was a sole-source deal, and I didn’t have leverage over the supplier, so a lot of the contract negotiation was difficult, and painful. Also, some parts of that project we had tried to
outsource before, and so our data gathering was relatively straightforward. But it was about seven months in all.

A deal I completed recently was basically an 18 month change programme, so there were about 15 separate individual streams, some of them were internal, some of them were external. Part of that was a managed service contract which again was transatlantic so it was UK and US and so we had TUPE issues here on the HR side. Size of that one was about 35 million. And again that took us about seven months. We went from October to signing the contract on the 1st of May. Mobilisation was dreadful because the client had 15 other projects on the go, and it was very difficult to actually get the necessary focus.

**Is post-contract due diligence ever a good thing?**

Andrew: You sometimes see in the market place outsourcing deals where it is claimed they have been completed in three months. Almost inevitably the reason for this shorter time period is that the suppliers’ due diligence of the customer’s environment was only partially completed by contract signing or even deferred until after contract signing. The result is that you enter into a contract as a customer without an agreed price and with no leverage because control has already been handed to the supplier. Can I just get an emphatic response from the panel on whether it’s a good or bad thing to allow post due diligence by the supplier after contract signing.

Richard: Bad.

Craig: Bad.

Alex: You won’t have a price. You’re kidding yourself. Everything will be opened up again afterwards.

**TRANSITION AND GOVERNANCE**

**Extracting a detailed transition plan from the supplier**

Andrew: Transition of the in-scope environment to the outsourcer is arguably the most critical and high risk phase point in the life of an outsourcing deal. The transition plan should be a key indication that the supplier understands your environment and, at least on paper, is capable of taking operational control of your environment. However, it always seems to be extraordinarily difficult to get decent transition plans out of suppliers and customers are often so focused on just trying to complete the transaction that transition as a project task is often neglected or left too late in the process.

Craig: You can’t run any project on one piece of powerpoint. You need to have the detail in there (the Transition Plan). You will also need to know the key tasks and dependencies that you, the customer, are contractually responsible for.

In terms of getting a decent transition plan out of suppliers, similar to when we were talking about data gathering, it is an exercise of hard graft and hard grind, of running a series of planning workshops, documenting outcomes, playing it back, agreeing the process, the procedures and the timelines.

You need to really think about this very very early in the process (not just before contract signing), and ensure that you are clear about how you’re going
to do it, who is responsible for it, and how long it’s going to take. The simple rule of thumb is that you can never start transition planning soon enough.

Richard: You have to have to have a separate task-based transition plan in your project organisation.

Anywhere on a project you need single points of authority and responsibility. Only one person can actually be responsible for this. And the way I tend to think of it is the supplier really has to own transition. They are the ones who are going to take over your environment, take over what you’re currently doing, and absorb it into their organisation.

You also need to be clear on what restrictions you want to put on the supplier when they’ve taken control of the environment in terms of do they have to run it under your current operating model, how long do they have to do that, how much do they have to demonstrate to you that they’ve caught the ball before they’re allowed to start going through their own transformation and so on.

Those sorts of things are really important because they will drive part of the construct of your solution. They will also drive the price big time. So, if you have a mismatch in terms of your expectation of how they are going to implement it, then you’ve got a problem.

Unfortunately the supplier’s transition skills, in terms of actually planning the transition projects, might not be that great and you need to be prepared to support them in that activity.

Alex: There’s no such thing as joint responsibility in the contract. It’s really important that you agree on and spell out what your customer’s obligations are during the transition and then everything else is the responsibility of the supplier, not the other way round. You must clearly spell out who is responsible for what.

**Governance and the Retained Organisation**

Andrew: This is another area that too often is neglected because everybody is in deal frenzy mode. Richard, what skill sets and roles do you think should occupy a retained organisation?

Richard: What is true about governance of a retained organisation is that the people who will be living with the deal that you’ve done are, with all probability, different skilled people to the people that you currently have in your organisation. Now you might have some, but you’re moving to a much more formal environment, one where you need much more commercial capability and contract management capability than perhaps you have in your current organisation.

From an investment banking and wholesale banking perspective, which is really where all my experience is, everything from an internally provided service is all about service. It’s all about that quality of service. If a trader says, jump, you do jump. If you’re moving into a contractual environment, where in all probability the objective for the agreement is around cost containment or reduction, then you don’t necessarily want that level of behaviour. So the people who sit between the real users and the supplier who’s providing the
services I think are quite different. You do need to involve them very early in the process and they need to go all the way through the contract negotiations.

Alex: I can’t emphasise too strongly what Richard just said. You’ve got to have people who understood what was discussed in the negotiation room and you’ve also got to have people in your project team who can’t just walk away but have to live with the result of the transaction.

**Can the contract be an effective tool to manage the supplier?**

Alex: Your contract has to be your key management tool. The fact is that any leverage you had before the deal will evaporate when you sign the deal. You will therefore need to place considerable reliance on you contract. You’re locked into a supplier for three to ten years. If your contract doesn’t clearly establish what your points of leverage are and the methods by which you can help run the governance of the deal, you’re in real trouble.

Historically there has been a real problem with lawyers driving the structure of outsourcing contracts. Their concern is to have everything in one place at the time of signing. It typically means a front-end contract of 100 pages with 50 schedules at the back. It also means a jumble of legal, commercial and technical issues and an unwieldy structure that does not in anyway reflect the fact that the document is meant to help the parties grow a relationship that must last three to ten years.

At Latham & Watkins we have completely re-evaluated this traditional legal structure and way of doing it because, from a project management perspective, we think current outsourcing contract constructs are fundamentally flawed. They are built the way lawyers want them built and not for contract management. We have developed a contract that is project management friendly – it really has become a management tool. So yes you need to train the retained organisation after you sign it but you also need to set up a contract so it’s actually manageable, and that I think is key as this industry evolves.

**How do you manage the transformation from a project team to a governance structure?**

Craig: The key here is for the project team to include many of the same people who will at the end of the day also be part of the governance structure and running the contract. There are examples where on Friday you sign the contract and then on Monday the whole customer team has gone. No one can actually remember what the base case looked like, no one can remember what actually that clause was in the contract for, and in the first days of transition that can become very difficult because you’re spending all your time trying to work out from the contract what exactly you can and cannot do. I think this particularly important during the transition phase. So you need to have the people who were on board during the negotiation, living and breathing the deal post-signing.
Why you need to do the hard work up front....

Richard: I normally refer to this picture as the hassle curve. And the truism of projects unfortunately is that there is hassle. There is always pain, and grief somewhere in the process. But you can choose where you take that pain.

The green line clearly is the lesser pain and in my opinion the better way of doing it. It basically says, you define upfront exactly why you’re trying to do it, exactly what you’re going to do, how you’re going to do it. And you resolve those issues which may require involvement from lots of different people across your organization, regulators, audit, security, HR etc.

But by doing that upfront then you have a firm foundation which you can base the project. That work may also have a significant impact on the solution you choose. Back end that work and the typical result is that you will have to make changes that can have a significant impact on that solution and the credibility of the deal.

So, what this graph is arguing is try and front-load as much of your investigation and analysis as you possibly can. Get it written down, get people to sign it off. Use that as the basis of communicating it around the organisation, so that there is no misunderstanding. Unfortunately it’s a fact of life in these projects that there will be misunderstanding. But then at least you will have something which you can bring out later in the process, which will be a point of contact from which you can resolve those misunderstandings.

Andrew: The “hassle” curve is a really powerful illustration of process leverage. The more work you do upfront the more you will learn about your existing environment. And the more you think about what you want to achieve from the outsourcing the better prepared you will be in the “heat” of the process when you are running parallel streams of activities (pricing, technical, legal, HR etc) to close the deal. Leave that hard graft to the end and your capacity to be able to try and fix things or understand the necessary detail is going to be greatly diminished. That’s when you lose leverage and that’s when you will strike a bad deal.
Office locations:

Boston
Brussels
Chicago
Frankfurt
Hamburg
Hong Kong
London
Los Angeles
Milan
Moscow
New Jersey
New York
Northern Virginia
Orange County
Paris
San Diego
San Francisco
Silicon Valley
Singapore
Tokyo
Washington, D.C.

www.lw.com