Outsourcing Negotiations for the Real World

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Background

HfS Research is often asked to help prepare clients for their negotiations and renegotiations with outsourcing providers. Although there are scores of published, proven negotiation techniques, they do little to inform would-be negotiators about the nature of outsourcing negotiators. Clients are at a double disadvantage: both the provider (who negotiates dozens, if not hundreds, of deals per year) and their advisors and attorneys (who may be very knowledgeable but may also be motivated to prolong the negotiations) are generally more experienced at the negotiation table. One client described the negotiations process as a roller coaster ride: lots of highs and lows, scary moments, unpredictable human reactions, and uncertainty over when it all would end.

The buyer disadvantage is compounded by often over-dramatized expectations about being locked inside a law firm's conference room hashing out heated arguments for months.

This best practice report focuses on outsourcing-specific negotiation issues that will help clients earn a fair deal. It is not a review of negotiating techniques, though HfS believes would-be negotiators are well served by studying any of the published negotiation theory (the *Harvard Business Essentials Guide to Negotiation* is a good place to start) or attending a workshop. Unfortunately, theory, and even real-world negotiation experience, are a poor substitute for preparation.

What is different about outsourcing negotiations?

Relationships: The most important difference between outsourcing negotiations and buying just about anything else is that you are likely to have to deal with at least some of the people on the other side of the table on a *daily* basis once the deal is done. Many people try to apply what they have learned about negotiation when, say, buying a car, or an object, to buying complex managed services. These are often the deals that start off on the wrong track: Think of negations as one of the most important phases in building the relationship—it is part of a *process* and getting it wrong can have dire consequences in the future.

One of the largest outsourcing providers in the world routinely sends a professional negotiator to the deal table, heading up a team of solution architects, executives, and attorneys. The client has never met this individual before and will never see him/her again after the negotiations end. Although sometimes effective, this technique speaks poorly of expectations. Here are some of the implied admissions, free of spin:

- We expect it to get acrimonious and we want you to concentrate your anger on the guy who won't be around in order to preserve the relationship with those who will
- We've made this so complex that we need a full-time expert who does nothing but negotiate (who is this expert's counterpart on the client side?)
- We've also made this so complicated that no one person can speak for the whole company, thus we need a team of SMEs

HfS does not think clients should do deals on a handshake, but we've observed that most negotiations are longer, more complex, and more hostile than they need to be.

Ugly Divorces: A second major difference is the difficulty of extricating your company from an outsourcing deal. Sure, you can negotiate favorable termination terms, but the likelihood that even the most client-beneficial terms will ever be economically attractive is almost nil—there's too much invested. Why is this important?

- Because negotiating teams spend a lot of time on "exit", one of the least likely parts of the contract to be used prematurely
- Because talking about all the reasons one side or the other could exit makes one party very suspicious about the long-term intent of the other party, destroying trust and biasing the relationship before it begins
- Because, unfortunately, a divorce can become unavoidable—and in those rare cases what you negotiated *will* matter

It makes sense to protect yourself, but the time and energy devoted to certain issues must be commensurate with the likelihood of that issue arising.

We're not talking about widgets: Client teams often refer to back office services as "commodity" services, even assigning "commodity managers" to outsourcing vendors. HfS believes this is a fundamental mistake.

You can replace a barrel of oil with another one just like it overnight, but you cannot re-create the skills and experience of a developer who has maintained your HR system for the last two years (chances are most people won't care what brand of toilet paper is in the bathrooms, but they absolutely care who answers the phone when they have an A/R issue; the electricity you bought for your data center cannot pick itself and go work for a competitor, but the data center manager can).

To get in the right frame of mind for negotiations, clients should consider their transaction a "mass hiring" more than a "purchase," acknowledging the influence of human nature on the deal before, during, and after the negotiations.

Complexity: Another key difference to understand is the complexity. Outsourcing deals aren't the only complex negotiations in business (M&A comes to mind), but few transactions you will encounter have as many variables.

First, you must understand that a provider will only take a certain amount of risk at a given margin. There is nothing wrong with pressing toward that limit, but when you do, you must understand that that limited risk is spread over hundreds of terms and conditions. Clients often marvel at "how much Provider X came down to win the deal," not realizing that to come to that price, the provider restricted the risk it would take on services, or termination rights, or change control, or team continuity/seniority, or indemnification, or warranty, or some combination of all of the above plus any of about 200 other risk areas a typical outsourcing contract covers. The best negotiators have fantastic memories, and they consider how one concession could impact other deal points. For everyone else, keep a detailed list!

Reality check: No other pre-deal situation better simulates the future than negotiations. Does your team take it personally when confronted by the provider with unflattering evidence of past performance? Does the provider sulk over tenths of points on SLA metrics? Does everyone understand that both parties are enterprises that need to make a profit?

Many clients see negotiations as a hassle and a burden, but HfS sees them as an unrivaled opportunity to *model* what things will be like when the relationship is operational. Word choice, body language, emotion, pace, problem-solving approach, and cadence are all indicators of how well the relationship will work when services are performed and invoices are received.

What business case? The most often forgotten deal element during negotiations is that speed matters. Try taking this message to a CEO: "We will be delaying $40 million in bottom line benefits for two or three quarters, but it's all worthwhile because we'll end up with a great deal!"

Well, unless that negotiation is producing more than $40 million in benefits otherwise unattainable—and trust us, it isn't—this is a bad deal for the shareholders. One buying organization scheduled a full 12 months of negotiations on their ITO deal, compromising about 30% of their total business case.

Best Practices: Seven ways to set up for successful outsourcing negotiations

Negotiations do not have to be painful. There is no substitute for preparation, both theoretical (selecting a negotiating framework) and practical (understanding all your positions, and how they interrelate). But outsourcing negotiations have some unique nuances and consequences. Here is a good list to keep in mind

1. **Select the team carefully:** Too many clients are anxious to send in their "angriest" executive or their "meanest" procurement wiz to do battle at the negotiating table. In fact, the team should be constructed of firm, reasonable people with a wide variety of styles and agendas. Where advisors and attorneys are present, their agreements should be structured to align with your best interests. The deals that have the best chance at success are the ones that were negotiated by the people who will be in them day-to-day. Clients should demand that their delivery and account manager(s) be present. Likewise, on the buyer side, the person who will own the day to day relationship should be present. If the "deal" team and the "run" team are different people on either side, you've got a problem.
2. **Negotiate with two providers:** HfS feels this almost goes without saying, yet we still see too many deals which are negotiated exclusively with one provider. Client organizations often cite speed, complexity or exhaustion as the reason for taking the shortcut, but the leverage preserved by taking two providers to the negotiating table exponentially outweighs any benefits of not doing so. Counter intuitively, negotiating with two providers generally yields a conclusion faster than the alternative.
3. **Remove "commodity" from your vocabulary:** Not only can it be interpreted as insensitive, it suggests a terrible start to a relationship that will ultimately live or die by how well the two parties acknowledge human nature inside the business context.

4. **Go fast:** HfS believes sufficiently motivated parties can negotiate any size deal in 90 days or less. We do not believe, however, that negotiations should be subject to a deadline, as this compromises leverage. Buyer organizations should simply state that time is of the essence, that preserving the business case is part of deciding which provider to pick, and then get everyone to the table to craft a fair, workable deal.
5. **Use real examples to test the issues:** Take advantage of the opportunity to live a day in the life. What kind of a reaction are you getting to the possibility of wild volume swings? Do change orders feel like a fair and necessary process? Or do they feel like an "in" for scope creep and additional charges? How worried is the provider about their termination for change of control? The right attitude, of course, is "we're so confident in our services that we're not worried about being acquired—you will be a pleased customer either way". The less risk a provider is willing to take, the less confident you should be in them meeting your expectations.
6. **Listen for "no":** A real partner knows how to say no, firmly and politely. You will ask for things that aren't reasonable in their deal construct, not because you find it amusing, but because you don't know how they have set up their risk/price model. A strong business partner will be forceful but transparent "we simply cannot do that, and here's why". A bad business partner will say yes to everything and figure out later how to deal with your disappointment—or, worse yet, find ways to charge more for services you thought you were getting.
7. **Squeeze the balloon, but don't pop it:** At any given deal price, there is a certain amount of risk that a provider can take. Skilled buyer negotiators will align the risk profile with their strategy—remember the reasons you wanted to outsource to begin with? So when you squeeze one side, you are filling the other. If it's all about cost, then work hard for a low, firm price and understand that services will be very standard, and changes could be costly. If it's all about flexibility, expect to pay a little premium to get the ability to ramp up or down quickly and economically. If it's about positioning the business for a sale or divestiture, make sure you have the right termination/continuation terms, and expect to make the provider "whole" in exchange for their quiet departure. Capital Expenditure avoidance? Negotiate for no upfront costs, but remember that money isn't free. Doing a deal with too much risk for either side? Pop!

Outsourcing negotiations need not be painful, long, nor riddled with uncertainty. Solid negotiation fundamentals and good preparation are important, but so is understanding the realities and peculiarities of an outsourcing transaction. Many negotiators enter the room full of bravado and bluster while others may have some apprehension and fear. In the real world, outsourcing negotiations, conducted with care and candor, can be surprisingly pleasant and productive. HfS sees top practitioners learning about their deal throughout the negotiations, which are themselves just one step in the process of building a winning (or losing) relationship.

About Esteban Herrera

Esteban Herrera is Senior Vice President at HfS Research, the leading boutique research analyst organization covering global sourcing.

Esteban focus es on the issues and challenges of outsourcing buyers, ensuring they have the best insight to create and manage their outsourcing relationships. His responsibilities include providing outsourcing buyers with solid research that leverages both deep expertise and the power of social media.

Esteban has worked with Global 2000 companies in the United States, Asia, Latin America and Europe, helping them manage the entire lifecycle of back office transformations. He has lived and worked on four continents and is fluent in Spanish and Portuguese.

He has run outsourcing delivery organizations in India, North America, Latin America and Europe, and has advised on over 100 ITO and BPO transactions.

Esteban started his career at Accenture, delivering “offshore” enterprise solutions before that was a common term. At Infosys, he was responsible for delivery of services to major Fortune 100 clients. He has spent the last decade as an outsourcing advisor to global enterprises, founding and managing The Concours Group’s Outsourcing Advisory practice and most recently as a Managing Director with Alsbridge.

Esteban is a graduate of Babson College, where he majored in Entrepreneurial Studies and Marketing.

About Horses for Sources

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