

Renegotiating outsourcing contracts: Play hard ball or win-win?



Companies these days aren't waiting for outsourcing contracts to expire before they renegotiate, and with good reason. Opportunities to improve their positions are significant – up to 25 percent on larger outsourcing agreements. But what's the best way to renegotiate a contract? Should you start with benchmarking and play hard ball – or does it make sense to work with suppliers to review the whole service delivery model?

Here's the debate:

| | Point | Counterpoint |
|--|---|---|
| <p>Play hard ball.</p> <p><i>Benchmarking, backed up with hard-nosed negotiation, is the tried-and-true approach.</i></p> | <p>Benchmarking and tough negotiating are well understood by everyone. Sure they can be contentious, but that's life.</p> | <p>Contentious indeed. With benchmarking, you'll spend months debating whose numbers are "right" and still not reach agreement. And making unilateral demands is even worse. You might get a price break in the short term, but suppliers will find a way to claw back their margins.</p> |
| | <p>This is quick and easy. Just hire a benchmarking company to provide the details. Or simply throw down the gauntlet and demand price concessions. In this market, most suppliers will go along.</p> | <p>It's quick only if you don't take the time to understand the full range of savings and improvements possible. The flipside is a long, hard slog – without much to show for it.</p> |
| | <p>Any decent procurement team can renegotiate an outsourcing deal. Negotiating is one of your core competencies – right?</p> | <p>Do your team members know market rates for different kinds of arrangements – with a clear understanding of the cost-value balance? Do they know how much suppliers can afford to give up? Do they typically produce savings in excess of 25 percent by addressing more than just cost?</p> |

| | Point | Counterpoint |
|--|---|---|
| <p>Go for win-win.</p> <p><i>Revisiting the service delivery model will lower costs and strengthen relationships.</i></p> | <p>There's only so much you can squeeze from a supplier. Real cost breakthroughs come when you step back and take stock of the entire service delivery model.</p> | <p>That sounds complicated, expensive, and time-consuming. Besides, it's a buyers' market. If you demand concessions, you'll get them. And cost is the priority anyway.</p> |
| | <p>This approach uncovers hidden inefficiencies that can plague even the best outsourcing agreements. Isn't that what you really want in the long run?</p> | <p>Your people are good at contracting. They already get everything you can expect on big contracts – and then some.</p> |
| | <p>Win-win is always better. Granted, suppliers will likely take a hit on total revenue, but at least they'll maintain or improve margins – and get the benefit of a long-term lock-in. Plus you'll have built a stronger relationship.</p> | <p>Procurement organizations are supposed to be tough and street-smart. "Share the gain" doesn't work because supplier and buyer positions are naturally opposed. Not only that, nobody in procurement wants to look like a pushover.</p> |



My take

Stephen Dunn, Director, Deloitte Consulting LLP

In a normal business environment, large outsourcing contracts come up for renewal every five to seven years. But there's nothing normal about today's high-pressure marketplace, which is why so many companies are looking to renegotiate agreements long before they're due to expire. With almost \$200 billion in contracts up for renegotiation in any given year, the stakes are high – and so are the opportunities for savings.

Unfortunately, many companies settle for far too little when renegotiating. That's because they rely on win-lose approaches that simply don't deliver the desired savings. In benchmarking, for example, not only are there technical challenges in comparing different outsourcing contracts, the process itself is contentious from the outset. Instead of working together toward significant cost reductions, parties spend months arguing about whose benchmarking numbers are "right."

Another adversarial approach – making unilateral demands – can produce the illusion of savings in the short term, but the results rarely stick. Suppliers are typically better at playing the negotiating game, and often manage to claw back their revenues over the long term.

In my experience with clients involved in large-scale outsourcing, a more effective approach is to revisit the service delivery model itself. That approach often uncovers opportunities for fresh thinking around efficiency, demand management, and pricing mechanisms – which can lead to dramatic savings. Here's how.

Efficiency. Most contracts don't give suppliers any incentive to invest in performance improvements. In fact, the opposite is often true. By putting efficiency on the negotiating table, both parties have an opportunity to ask what can be done differently to reduce the overall cost of an agreement. Suppliers will accept reductions in gross revenues if they can improve margins through efficiency gains.

Demand management. As with efficiency, suppliers rarely have good reason to help their customers drive down demand. But what if they were motivated to think outside the box? For example, no call center supplier is going to suggest redirecting inbound inquiries to web services or IVR unless they have an incentive to do so.

Pricing mechanisms. This area is key to delivering continuous improvement in outsourcing. It requires shifting the pricing model from an input basis (such as pricing per transaction) to an output basis (such as pricing for overall performance or coverage).

Companies that engage in adversarial approaches to contract negotiations may think they're getting a deal, but all too often, the benefits aren't real. This is especially true in complicated agreements with lots of moving parts. You may win a concession on one hand, only to find the benefits taken away by another.

Final thought. One CIO I worked with was convinced that the best he could get from a renegotiated contract was a few percentage points. Four weeks later, we had helped him identify approximately 20 percent cost reductions by adopting new more effective practices (most of which weren't even envisioned four years ago when the contract was signed). That's what we mean by win-win.

A view on call center contracts

Hobart Harris, Specialist Leader, Deloitte Consulting LLP

In my experience, most call center contracts focus too narrowly on unit pricing, failing to take advantage of other aspects of value in outsourcing relationships. That's unfortunate, because there are lots of variables you can work with – everything from training and materials to reporting, contract duration, performance incentives, and more. If you're not looking at all the moving parts, you may get a low price – but not necessarily a good deal.

As more and more elements come into play, however, the language in contracts becomes super-critical. Don't gloss over anything – and keep an especially sharp eye on what's in scope and what's not, what kinds of technology will be used, and how performance gets improved. Depending on how you handle each element, the overall contracted outsourcing cost can shift dramatically.

One client we worked with recently had limited its ability to negotiate by having two separate vendors – one for IVR and one for call center. As a result, the client had little leverage to drive increased IVR utilization and reduced call center costs. We recommended renegotiating the contracts to create incentives for cooperation between the vendors. Each call that could be shifted from a live contact to IVR would save the client 90 cents – which really adds up when you're talking millions of calls each year.

Can every renegotiation result in these kinds of savings? Not necessarily – but it's definitely worth taking a quick look at your call center agreements to see what you might be missing. Rate is important, but it's not the only thing that matters.

A view on technology services contracts

Peter Blatman, Principal, Deloitte Consulting LLP

Hard-nosed negotiations have a place in any business environment, but when it comes to critical relationships with long-term service providers, I've found that win-win works better. Sure you want to strike a good deal, but you also want a motivated vendor. Squeeze too hard and your great price could come back to haunt you.

While there are lots of variables to consider, I believe the "big four" are: level of service, length of service, price, and scope/bundling. They're all part of the mix, and if you push your supplier to the breaking point in one area, you'll probably have to give in another. Because no matter great a deal you think you're getting, it has to be sustainable for your vendor. I've been on both sides of the fence, and trust me, the last thing you want is a provider who cuts corners to recover margin they sacrificed when you drove that hard bargain.

In one deal I saw recently, the contract called for 24/7 customer support. With the vendor pressured to accept a rock-bottom price, that "support" gradually devolved into a voicemail box that was checked once a day. Not exactly what everyone expected from round-the-clock customer care.

Here's one other thought to keep in mind. Even though your purchasing and procurement people are great at what they do, they may not always be able to evaluate the full impact of added value across the organization. This is especially true when vendors bundle services to sweeten deals. Make sure you keeping an eye on the total value proposition, not just the unit price.

For more information, please visit: www.deloitte.com/us/Debates/OutsourcingContracts.

For further information about this debate, please contact:

Stephen Dunn

Director
Deloitte Consulting LLP
sdunn@deloitte.com

Hobart Harris

Specialist Leader
Deloitte Consulting LLP
hharris@deloitte.com

Peter Blatman

Principal
Deloitte Consulting LLP
pblatman@deloitte.com

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