ROSEWOOD PARTNERS, LLC

# Exit Strategies for Outsourcing Contracts

With more than half of firms terminating or renegotiating outsourcing contracts before the contract term is finished, it is imperative that businesses have an exit strategy in place. Many companies are not prepared to terminate a contract. They become disillusioned with the idea that an outsourcing contract will last forever, or quickly start a contract for a short-term cost reduction without looking at the long-term effects. Successful businesses recognize the need to plan and prepare for terminating an outsourcing relationship before it begins. This termination may come prior to the term agreement, or at the end of such an agreement. Many of the ideas discussed in this article can be applied to either situation. Exit strategies are composed of three phases: the contract agreement, contract fulfillment and contract termination.

## Contract Agreement

Ensuring that outsourcing contracts include clauses to renegotiate or terminate services is essential. During the life of the contract, many things can change for both the client and the Outsourcing Service Provider (OSP). Technologies, prices, and desired services can be impacted by business climate changes, technology changes, even economic changes can impact the viability of OSP agreements. Provisioning renegotiation procedures in the contract will allow your business to better handle the unexpected deviations that do occur.

The contract must include clauses allowing both parties to terminate and or modify the agreement. Common reasons for contract termination include the failure of the vendor to provide services, failure to perform to the service level agreement, or failure to meet other service obligations as outlined. The option to terminate based on the perception of future services to decline may also be included. These situations may include the vendor’s stock declining rapidly, vendor’s employee turnover the vendor is purchased by another company, or other financial problems arise alluding to poor performance. Experts advise and recommend a three to six month no-questions-asked bailout to ensure that both parties are satisfied with the partnership. Clients must be fair and reasonable in negotiating contract terms. An OSP must protect itself as well. A common clause for the OSP to terminate an agreement is when a client fails to pay for services. By including the combination of the aforementioned clauses, both parties are protected.

## Contract Fulfillment

Firms often make the mistake of putting a lot of effort into finding an OSP, and then fail to continue preparing for an exit. This leaves the business vulnerable in the event that off-site resources are terminated or relocated. During the contract term, clients should prepare for termination by maintaining sufficient procedural knowledge internally. It is imperative that the business notify the vendor and document occurrences of contract breach or failed expectations. Always follow up verbal communications formally through either email or other written correspondence.

Before terminating an agreement, businesses should ensure they have sufficient business and process knowledge about the outsourced task available internally. When a task is outsourced, significant knowledge on how to perform the task can be lost. Maintaining ample understanding of what the task entails, how it is done, and what resources are required should be documented, especially in environments that rapidly change. Otherwise, executives can find internal knowledge is lacking or outdated and require time to redevelop.

Documenting occurrences of contract beach or failed expectations by the vendor can be useful in terminating a contract. This assists companies in avoiding expensive early termination fees. This can also be a strong defense, should any legal actions be taken. and that reduces the business flexibility needed control the OSP.

Clients should not have to keep a constant eye on vendors, but like any good business relationship a degree of oversight is necessary in order to protect your business interests.. Brad Peterson, a partner at Mayer, Brown, Rowe & Maw LLP, the nation's 10th largest law firm focused on outsourcing, advises "In outsourcing relationships, problems tend to fester and grow rather than diminish if you don't pay enough attention to them." Recognizing and documenting problems can help save company assets.

**Renegotiating**

In some cases, renegotiating with a vendor instead of terminating a contract can be more cost-effective and time-saving. Three common items to renegotiate are benchmarks, service levels and price.

Many contracts allow pricing and service levels to be adjusted based on benchmark results. Benchmarks allow a third party to compare the contracted services and prices in relation to typical relevant market standards. If the prices or services have fluctuated from the contract terms, either party may seek to revise the agreement.

Service is a big factor that can be renegotiated. Depending on how the market has changed, a business may find that it needs to increase or decrease its service levels. A client may also find that the OSP is performing well for one task, but not meeting standards in another. In this situation, the client may contemplate terminating services that are not meeting expectations and keeping those that are performing well.

Over the course of the contract, term prices can vary. This is especially true in technology markets where cost of a service, software or hardware decrease with age. In such situations a provision in the contract may be written so that should such technologies increase in capacity, but decrease in cost, both parties benefit from upgrading technology systems.

# Contract Termination

Terminating the contract is similar to starting the contract in reverse. Resources and knowledge and migration models must be planned for. When a client has determined that it will terminate the outsourcing contract, there are several key questions that should be answered first. These questions include, who will manage the exit, how will services be fulfilled post-termination, and how and where will resources be transferred.

### Exit Manager

To guide a company through contract termination, an exit manager should be designated. This exit manager should be an experienced and qualified senior manager. The manager acts as the liaison between the organization and the OSP, ensuring that exit terms are followed. If this individual already has a good relationship with the vendor, it will help ensure that both parties leave on good terms. The exit manager will have an even greater task should the client not have an exit strategy in place. The manager will guide the business through the final stages of exiting.

### Services Post-Exit

A client must know where it will turn for the tasks that were outsourced. Once the contract is terminated, will the tasks be transferred to another OSP, or handled internally? With those questions, a client must ask how long the transfer phase will be from off-site to in-house or from off-site to off-site. A transfer phase should be established so that the client does not receive an overload of back services. This also gives the new in-house or off-site resources time to set-up.

### Transfer

There may be a significant amount of resources that need to be transferred from the OSP. This may include hardware, software, people, assets, intellectual property and knowledge. Any hardware equipment that was lent to the OSP needs to be retrieved. If there was no hardware given, a client must find out what hardware was used to ensure that the proper tools are obtained for use in-house or by a future OSP. The same principle should be followed for software. Some contracts contain provisions that a client may hire the OSP's employees. This will allow the client to gain access to valuable employees. If such an option is not available, the client must determine what skills are needed in new employees. Ensuring that key resources will be available immediately is crucial to ensuring that there will be no delay in service.

The transfer of other assets, such as facilities, vehicles and other items must be planned. A checklist should be created to ensure that keys, insurances and utilities are all transferred. Intellectual property rights and licensing should be agreed upon in the initial contract. The exit manager should ensure that both parties adhere to agreement to avoid legal action.

The transfer of knowledge may be the most crucial aspect in terminating a contract. Without the right skills and knowledge, all of the hardware, software and other resources are useless. Planning for an exit from the beginning of a contract will include maintaining a knowledge base on task procedures. The length of the contract may mean that internal resources that were once knowledgeable on the task are no longer available. These resources may have been outsourced, or in worse case scenarios have left the clients staff. If there is no in-house or documented knowledge source, the client will be severely disadvantaged, and have to quickly develop internal resources to manage the returning process. Part of the transition phase may include the OSP training new employees to offset this lack of knowledge.

## Conclusion

By preparing for the end from the very beginning of an outsourcing contract, a client can expect a smoother and more efficient contract termination. An exit strategy will outline the steps necessary to comply with the termination clauses. This plan should start before a contract is agreed to, while the contracts terms and conditions are in the development stage and while both parties to the relationship are cordial. By planning for the worst and hoping for the best, businesses can be prepared to manage and lead an effective exit strategy.

# About Rosewood Partners, LLC

Headquartered in a rural East Texas town, Rosewood Partners, LLC is a unique management consulting group that builds on its small town roots of loyalty, partnership and commitment. Its team is comprised of industry specialists with centuries of combined practical hands on business experience in the areas of change management, operations management, off-site and staff augmentation services. Rosewood’s leadership philosophy is drawn from actually having led teams located all over the world through corporate downsizing, merger and acquisition activities and everyday business operations.

With its down-to-earth small town roots Rosewood believes in keeping things simple. Real-life experience has granted its team members the ability to employ simplicity to solve real world business problems. The straightforward tasks that simplicity demands deliver the reward of constant and consistent results. It is this simplicity that drives Rosewood’s OES methodology, Operational Excellence Simplified.

## Sources

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