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The Outsourcing Handbook
A guide to outsourcing

Version 2.0

Contents

Foreword

Love it or loathe it, outsourcing is now a permanent feature of business life. As companies search for cheaper and more effective ways of working, handing over non-core functions to lower cost specialists can be an alluring prospect.

But before you bring in third parties to run parts of your business, it is worth pausing to consider the risks. Some outsourcing deals fail dramatically and publicly. Rather more are quietly set aside as one (or both) parties look for an exit and an even larger number limp on, failing to deliver quite the benefits that were expected. There are however many success stories – businesses that have used outsourcing to achieve dramatic savings, shed themselves of expensive assets or build the capacity to grow in a way that would not have been possible using in-house resources.

So how do you become one of these success stories and avoid the pain, cost and frustration of a failed deal?

Whilst there is no magic bullet, a combination of common sense, a structured approach and learning from others' experiences will go a long way. This handbook is intended to help you do just that. It is not an exhaustive guide to every aspect of outsourcing, but it does lay out the full lifecycle of an outsourcing deal and help you understand some of the key issues, challenges and decisions that you will be faced with at each stage. We've based it around our own outsourcing methodology, which acts as a checklist to make sure all aspects are considered at each stage in the process. One poison pill that will almost certainly guarantee failure is treating outsourcing as 'just another' procurement. You'll see that much of the content in this handbook encourages you to take a much broader view of outsourcing, considering everything from change management to tax optimisation and regulatory compliance.

Each chapter of the handbook focuses on one stage in the lifecycle, beginning with the all important initial 'Assess' phase, when you first consider the pros and cons of outsourcing and determine the right strategy for your business. As you look at this do please bear in mind that here at Deloitte we are not advocates for outsourcing, nor do we supply outsourced services. We're simply here to help our clients make the right decisions. The handbook reflects this, recognising that a structured decision not to outsource a function is as much a victory as a successful outsourcing deal.

Whilst you may want to look through all of the content, this isn't a book that you have to read cover to cover. Each section is designed so that you can dip in at the point that is most relevant to where you are with your outsourcing activities and extract some real value based on our experience. We've structured our approach so that it is relevant to both Business Process and IT outsourcing (BPO and ITO), using onshore and offshore resources. While the approaches and tool set work across all industry sectors, we have pulled out some features where there are industry-specific differences; one example is procurement, where public sector organisations are usually required to comply with EU Public Procurement Directives.

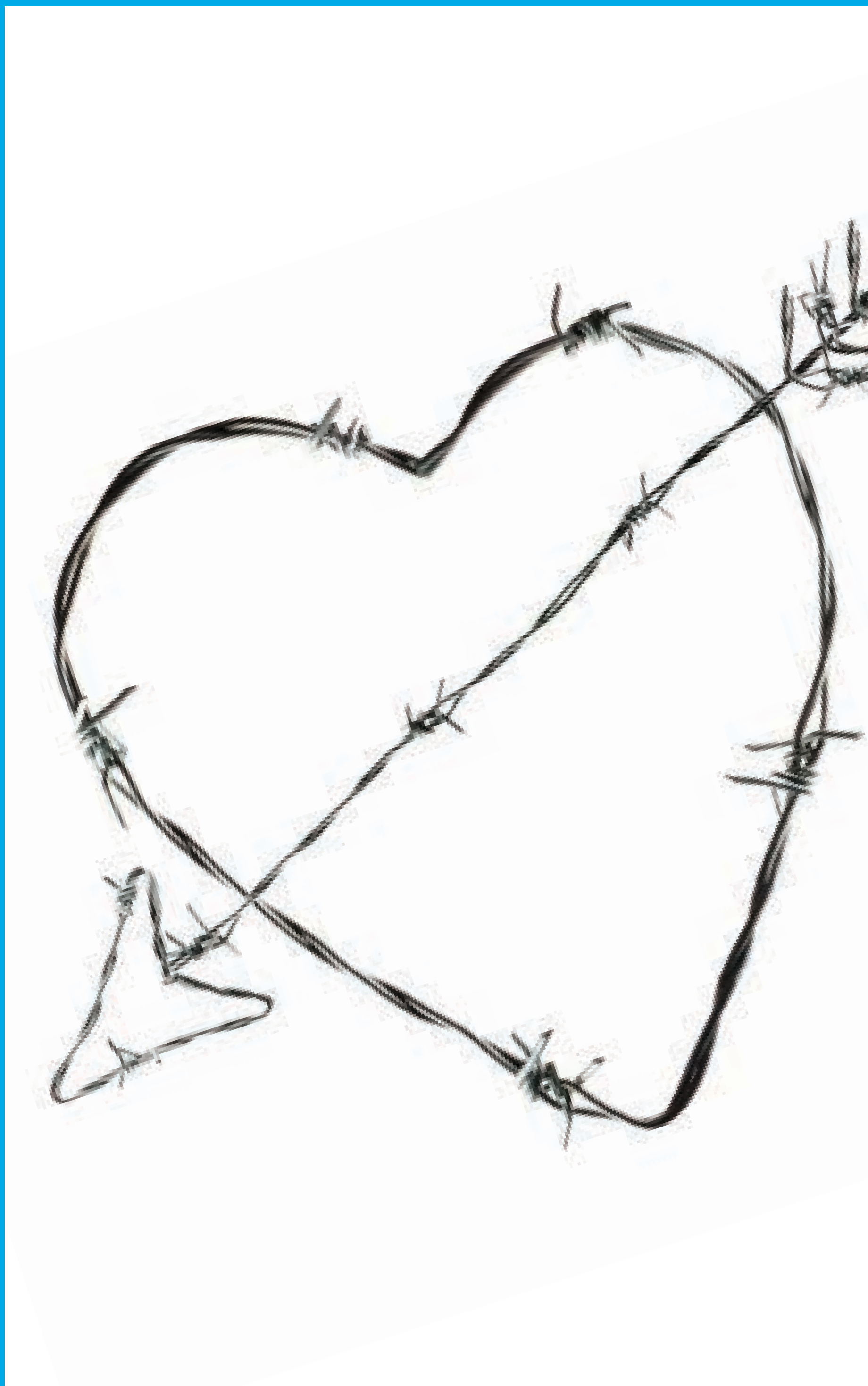
This handbook has been written by senior members of Deloitte's UK and European Outsourcing Advisory Services (OAS) team. No copywriters were involved and there are no sales pitches, although we would urge you to think hard about the help you may need as you progress your outsourcing activities. Embarking on an investment that may run into tens or hundreds of millions of Pounds is not for the faint-hearted and having an experienced adviser by your side will help your project join the ranks of the success stories.

So wherever you are in your own outsourcing journey, whatever the scope of your outsourcing deal, and whatever your industry background it is worth reading this handbook.

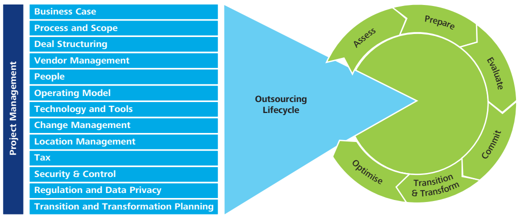
Introduction

This section provides an overview of outsourcing – what it is, why one would outsource a business function, and the gains to be experienced by undertaking it.

The individual sections of the handbook are set out in a consistent and structured manner for ease of navigation. Understanding the structure that has been used will enable the user to more quickly identify the relevant elements of a section.



Introduction



What is Outsourcing?

Outsourcing: Defining the term

In its simplest term, outsourcing is the contracting out of a business function to an external supplier, involving the transfer of people, processes and assets. This contracting out can be undertaken at either an on-shore or off-shore location, and to one (single-sourced) or more (multi-sourced) outsourcing partners.

Outsourcing is most mature in the Information Technology sector (Information Technology Outsourcing – ITO) although it is increasingly developing to include a wide range of business processes (Business Process Outsourcing – BPO) such as HR, Finance, Procurement, Customer Service, and the wider back office function.

IT Outsourcing

From small beginnings in the 1980s IT Outsourcing has evolved into a sophisticated global market and most companies, no matter how traditional their business model, have outsourced one or more layers of their IT function. Outsourcing IT has always been a complex exercise, in part due to the requirement to bundle IT into 'services' combining hardware, software, people and processes. These services ('towers') often contain data centre, end-user computing, service desk, application development and maintenance, and voice and data network packages.

For traditional IT outsourcing there are intricacies in transferring staff, novating contracts and assessing the financial impact of selling physical assets. These complications have been recently compounded by on-demand IT offerings, the evolution of offshore centres, and the advent of cloud-based offerings.

Business process outsourcing

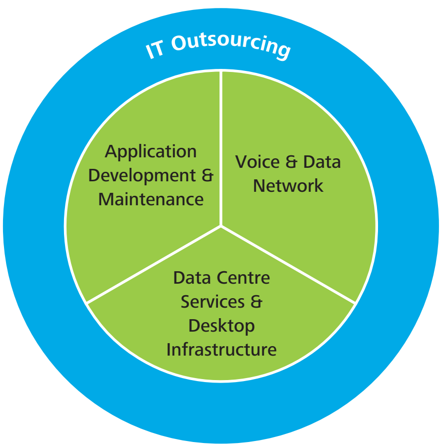
The outsourcing of business processes that were typically performed in-house began in the early 1990s, and has since grown dramatically with the drive for reducing costs and improving performance.

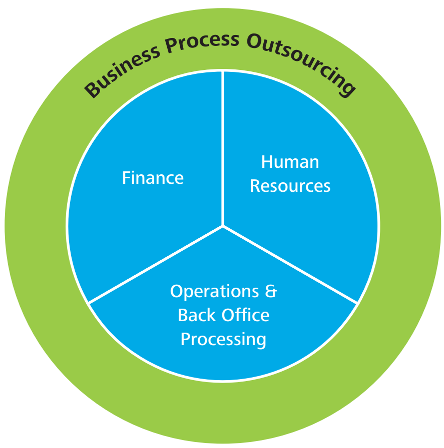
There are two broad sub categories of BPO:

- **Horizontal BPO:** Which focuses on the delivery of classic, back office business support functions such as Finance and Accounting (F&A) and Human Resources
- **Industry specific BPO:** A rapidly emerging sector which includes services such as claims processing in the insurance industry, and mortgage processing for banks

Sometimes perceived as a simpler proposition given its focus on transactional processes when compared to ITO, BPO faces its own unique challenges. These are primarily driven by the relative immaturity of BPO, particularly in the industry-specific arena, and the consequential risks of the first generation outsourcing for both the supplier and customer.

Whilst the offering mix is widening, deals are becoming shorter with five years now the prevailing contract term. This aligns to a more rapid technology refresh cycle and provides a client with further control over the deal.





Drivers and evolution

Traditionally, the key driver for outsourcing activity has been cost reduction. Cost is still key factor, and at Deloitte we have yet to see anyone adopt outsourcing when it is more expensive than in-house delivery. Nevertheless, there are other drivers that are important:

- **Speed of development:** Following a start up or carve out, a new business entity can use outsourcing to put in place key functions much more quickly and cheaply than developing an in-house capability from scratch

- **Flexibility:** Outsourcing can provide the flexible capacity that a rapidly growing – or declining – business may need to keep pace with changing demand

- **Specialist skills:** In specialist areas such as IT, attracting, developing and retaining skilled staff can be a real challenge: outsourced providers can often offer access to these scarce skills

- **Political manoeuvring:** Off-shoring can be a sensitive topic – outsourcing to a provider that can then draw on its own near-shore and off-shore capability can be politically acceptable way of achieving the same end

Outsourcing: A dynamic market

Outsourcing has become a major market activity, with Gartner forecasting the IT Outsourcing market alone to reach $287 billion in 2013. With an annual growth rate of 6.5% until 2017, average annual IT Outsourcing investment has reached almost 25% of total IT spend.

As this shows, the outsourcing market is growing in complexity as well as size – IT's impact on the business is growing and with continuing economic uncertainty, there is an ever stronger focus on innovation. In recent years, offshore providers have entered the global market, providing increasingly sophisticated alternatives to the established US and European providers. Outsourcing can also bring regulatory and financial complexity, with legislation around services frequently changing and the tax implications of shifting sourcing strategies providing considerable complexity. Throw in issues such as risk, and rapid, game-changing technological advances such as cloud computing, and you have a market increasing in both sophistication and significance.

A challenging relationship?

"Outsourcing Failure Stories" is its own Google keyword. The potential to achieve significant savings through outsourcing is well known. However, there are a number of examples where companies hit obstacles, get entangled in complexities and simply get it wrong. Without adequate advice, planning and management, outsourcing projects can and do fail. The consequences of a messy public divorce can be disastrous.

In our experience, organisations will almost certainly fail to realise the benefits of outsourcing unless they stick rigorously to the following steps:

1. Adequately plan, manage and retain the right level of control/direction in the outsourcing relationship

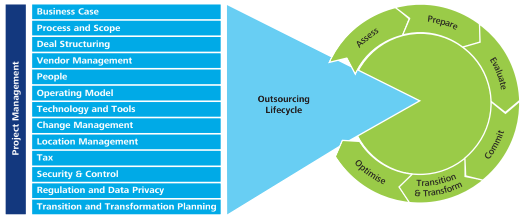
2. Establish and manage an effective governance process

3. Effectively manage the commercial, legal and financial risks of outsourcing

4. Effectively manage any transition and transformation phases (these being the highest risk, and most failed upon phases along the life-cycle)

With so many opportunities for failure, and to get the very best from suppliers, a **'tough love' approach** to outsourcing is required.

Navigating the Handbook

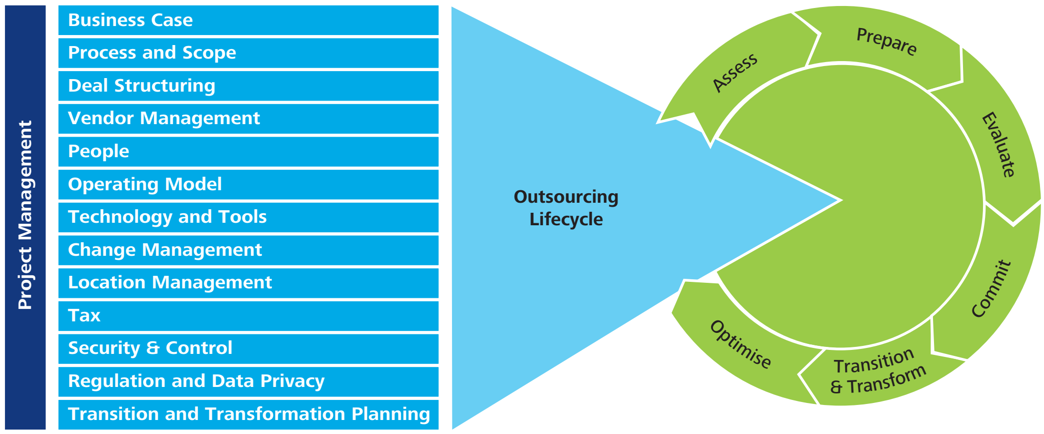


Deloitte's Outsourcing Methodology

Outsourcing Advisory from Deloitte

In order to provide a clear and structured approach to outsourcing, this hand book utilises Deloitte Outsourcing Advisory Services (OAS) Methodology, covering both information technology (IT) and business process (BP) outsourcing. Our comprehensive approach means we can support development, operating model design, business case negotiation, transition management and programme governance.

The OAS method is based around six phases of activity and 13 streams of work:



The six phases of activity can be defined as follows:	
Assess: Define objectives and assess capacity.	**Commit:** Contract development and finalisation.
Prepare: Service level definition and RFP creation.	**Transition and Transformation:** New service implementation.
Evaluate: Response evaluation and supplier selection.	**Optimise:** On-going supplier and vendor management.

The 13 streams of work can also be identified:	
Business Case: How will the business case for the deal be defined and managed?	**Change Management:** How will the impact of the change be managed?
Process and Scope: What are the processes and/or services affected?	**Location Management:** Which locations will be sourced to and how will real estate be managed?
Deal Structuring: How will the contract be structured to best suit the organisation's needs?	**Tax:** How will the tax structure be optimised to support the deal?
Vendor Management: How will third party vendors be effectively engaged and managed?	**Security & Control:** How will the organisation ensure policy and procedures are followed?
People: How will any negative impact on staff be minimised?	**Regulation and Data Privacy:** How will data be protected and regulations complied with?
Operating Model: How must the structure of the organisation change?	**Transition and Transformation Planning:** How will the project transition and transformation elements be planned and managed?
Technology and Tools: What change to the technology landscape must be made?	

In addition, **Project Management** is required across every stage and activity of the outsourcing lifecycle to manage and control the effort.

Section structure

Each section of the handbook begins with an overview of the key concepts, guiding principles and a summary of the main activities being undertaken. The exact structure of each section varies according to the exact detail being described, but a consistent format for these pages has been followed, as set out below.

Overview
This provides an overview of the phase and the activities being covered within the section

Body Text
The body text on each page describes the topic in more detail

Points To Remember
Key points relating to the specific phase

Diagrams
The diagrams provide a visual representation of key concepts

Key Principles
Key principles relating to the specific phase

Additional Information
Additional information describing a particular concept

Deloitte Accelerators and Tools
The relevant proprietary tools, templates and methods that Deloitte have developed

End of phase checklist
Each checklist identifies the key activities that must be completed prior to progressing to the next phase

Phase 1 – Assess

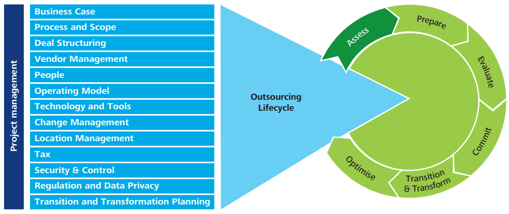
This section describes the Assess phase of the outsourcing lifecycle, the initial determination as to whether or not outsourcing should be pursued as an option. If so, an initial understanding of the likely size and shape of the deal should be developed.

It is in the Assess phase that the early high level unknowns must be flushed out and confronted. The activities in this phase are critical to establishing senior stakeholder expectations, both for the deal as a whole and for the amount of time and effort required to secure it.

By the end of the Assess phase there will be a commonly understood view of the likely benefits, costs and risks of the potential outsourcing deal and of the activities required to respectively maximise, minimise and mitigate these.

Determining the scope of outsourcing

Phase 1 – Assess



Aims and objectives

The overall objective of this phase is to determine whether or not outsourcing should be pursued as an option and, if so, the likely size and shape of the deal. This view must be complemented with a mature view of the strategies to be adopted when looking at critical issues such as overall deal scope, location and sourcing strategies.

A key element of this phase is to identify all key stakeholders and engage with them early in the outsourcing process. This is especially critical where those stakeholders have little or no experience of outsourcing. Expectations set in this initial phase will be difficult to change later in the process.

Overview

The Assess phase ensures that due consideration is given to all key aspects of the outsourcing lifecycle, particularly with regard to:

- The overall objectives for the deal, which should be more than simple, short term cost reduction
- The financial benefits which can be delivered by an appropriate outsourcing contract
- The costs which will need to be incurred in order to deliver these benefits
- The risks which must be mitigated in order to ensure a successful outcome
- The overall size and shape of the deal, ensuring that this is aligned with business requirements
- The degree of change required by both business and IT functions in order to ensure that the outsource is successful for the full lifetime of the contract

Once the initial business drivers are understood, a high-level business case has been agreed, and the decision to go forward with an outsourcing initiative has been made, it is tempting to rush straight into the creation of the Request For Proposal (RFP) and the design of the 'to be' structures (see the Prepare phase description in the next section).

However, conducted Assess phase ensures that this temptation is avoided by delivering high-value analysis early in the deal lifecycle.

The goals and strategies defined in the Assess phase should endure throughout subsequent phases, providing a clear statement of objectives and a clear scope and approach to team members, stakeholders and vendors alike.

The Assess phase requires appropriate resourcing to solicit input from a wide range of stakeholders, including senior business and IT leaders. Securing the right resources is often an initial stumbling block, testing the importance of the potential outsource relative to other priorities.

Whilst the Assess phase is typically completed without the involvement of outsource vendors, external input may be required to provide knowledge of:

- Outsourcing market trends
- Deal structures
- Successful sourcing strategies
- Likely costs and timescales for securing the best deal
- Vendor capabilities and preferences

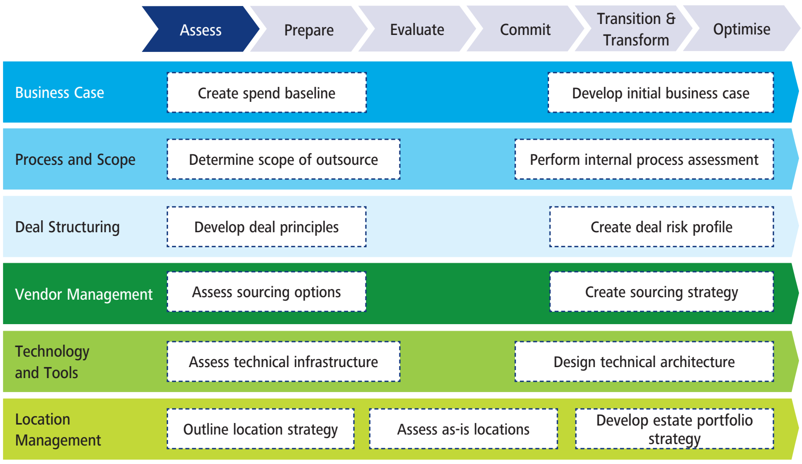
Where a degree of outsourcing is embedded or the use of external managed services already exists then it may also be necessary to undertake a formal legal review of existing contracts in order to ensure that there are no onerous, termination or novation costs.

Key principles

- **Be clear about objectives:** In order to achieve the best results from an outsourcing project, it is vital to be clear about your objectives and communicate these to stakeholders
- **Understand current costs:** Understanding current costs is vital to get a view of the likely benefits (and whether outsourcing should be pursued) and to be able to determine success at a later stage
- **Engage stakeholders early:** Strong and frequent senior stakeholder support will be required throughout the outsourcing project, so it is of critical importance to ensure that all stakeholders understand the scope and scale of the project and the support that they will be required to give. Any stakeholders who are known to be resistant to the project must be tackled head on, with the understanding that they might be right!
- **Build the right project team:** Do not underestimate the effort required to manage, drive and complete an outsourcing journey. A wide range of skills will be required, some of which may not exist in the organisation. Starting with a team which is too small or which does not have all of the skills required will lead to a drawn out or incomplete project initiation, where what is needed for success is a quick and thorough launch
- **Lift the rocks:** Tackle known or potential problem areas early and put pragmatic plans in place to tackle these in advance of contract negotiations. There may be a number of discrete projects required to 'get fit' for outsourcing, but it is cheaper and more effective to tackle these prior to contract signature rather than passing the risk and mediation cost on to the vendor. Even if the outsourcing deal falters or fails the internal standards will have been improved

Activities

The key activities of this phase are shown below:



Business case

This is the first and arguably most important step in the outsourcing journey. The initial business case will define:

- The scope and timescales of the outsourcing project
- The shape and size of the deal
- The pace of change necessary to deliver required benefits

All of these will impact the whole of the deal and the subsequent outsourcing contract, and the business case will evolve over the period.

Developing a realistic initial business case will require a thorough assessment of existing spend, which can be challenging if this is not currently under the control of a single department (i.e. for IT outsourcing deals it is often the case that business units retain responsibility for some IT provision alongside a central IT function).

Another critical dimension to the business case is the setting of challenging yet realistic value goals. Many first generation IT outsource deals were focused exclusively on cost reduction, with some considering only short term rather than full contract term reductions in IT cost. As more complex and sophisticated outsourcing models have emerged it has become easier to focus on the addition of value, typically through improved levels of service or an increased ability to deliver innovation whilst still ensuring that overall costs are reduced.

Any failure to set goals in line with the real business objective of the outsource runs the risk of setting the project off in the wrong direction, leading at best to a waste of elapsed time and cost and at worst to a deal which is designed to fail at meeting the real objectives.

> The first step in the outsourcing journey is to define the initial business case.

Process and scope

Whilst it is tempting to think of the scope of an outsource deal in terms of the impacted organisation – technology towers (mainframe, storage, desktop etc.) or business products (invoices, expense claims) – early consideration of the maturity and coverage of current processes will add clarity to the overall deal process and will help to eliminate any perceived ‘fuzzy boundaries’ between client and vendor as the deal progresses.

Once an outsource arrangement is operational it is the process handover points which will drive many of the day-to-day interactions between vendor and client, with the client-retained teams existing to execute those processes deemed to be out of scope for the outsource.

Whilst ‘as is’ and ‘to be’ processes do not need to be modelled in detail at this early stage, it is important that all key process areas are reviewed and understood. Particular emphasis should be given to the processes relating to the management of the outsource vendor or vendors. If there is no history of outsourcing within the organisation then a number of new processes will need to be created and for existing processes the focus will be on agreeing the division of responsibilities between the client and vendor.

Although the detailed scope and nature of the outsource agreement will not yet be known, consideration should also be given to the governance model under which the contract and the vendor relationship will be managed. Early communication of this will help to demonstrate a carefully thought through and professional approach to the outsource relationship from the outset, and will ensure that vendor expectations and behaviours are managed in a structured and efficient manner.

Deal structuring risks

Consideration of the major deal risks should cover both internal risks, with a view of mitigation actions, and external risks, which are inherently harder to mitigate but should still be assessed and understood.

Typical internal risk areas that would prevent an organisation entering a contract include:

Risk Area	Description	Mitigation
Stakeholder adoption	The outsourcing project needs active and visible support from senior business and IT leaders, which may not be forthcoming.	Senior stakeholders must be fully engaged during the Assess phase with a formal communication plan being followed to keep them on board.
Business case weak	The business case may be weak if the scope has been incorrectly set or the baseline costs are not well understood.	Prior to entering a contract the costs must be fully understood and external resources may need to be brought in to ensure that the scope is correct and the costs are realistic.
Change overload	There may be too much change going on within the organisation without adding a major outsource to the mix.	External resource may need to be brought in to backfill critical resources for the duration of the outsourcing project.
Incumbent supplier management	The incumbent supplier may pre-emptively extend the existing contract and offer a reduction in costs.	This needs to be factored in and a decision made by senior stakeholders regarding how to proceed in such an eventuality.

External risks, such as those arising from business acquisitions or mergers within the vendor base during the course of the outsourcing project should also be considered. Whilst these are difficult to mitigate, an impact analysis should be completed and a contingency plan established.

At this early stage it is also worth defining a clear set of 'deal breaker' risks which may cause the outsourcing project to be significantly re-scoped or even terminated ensuring that senior stakeholders are aware and supportive.

Vendor Management: developing sourcing options and strategy

The outsourcing market has become far more sophisticated in recent years, presenting clients with a wide and potentially confusing range of options to consider. In order to focus activities for the outsourcing project as a whole and to avoid the temptation to 'circle back' and constantly review options and choices, it is necessary to undertake a thorough, honest and transparent evaluation of all options. These will typically include:

- Outsourcing to a single vendor
- Adoption of a multi-vendor model, with individual technology towers or business products being tendered for by multiple vendors
- Adoption of a multi-vendor model where individual subsets of the above areas are tendered separately
- Use of a hybrid approach, with some functions remaining in-house whilst others are procured externally
- Retention of physical assets (especially buildings) vs. selling off assets as part of the outsource contract

One of the well marketed advantages of the use of outsourcing is the ability to benefit from the economies of scale which the outsource vendors enjoy. Delivery of this benefit is usually dependent on the completion of a transformation exercise which better aligns the in-scope outsource processes and technologies to those of the selected vendor.

It is imperative that the sourcing strategy gives careful consideration to the option of completing any transformational activities prior to outsourcing and that it takes into account the fact that the post-transformation organisation may deliver a level of quality and value for money which dilutes, or even negates, the value of outsourcing.

The key challenges to this approach are the availability of sufficient in-house resources to undertake the transformation whilst maintaining existing operations, and the feasibility of re-skilling a large workforce to operate efficiently in the post-transformation organisation.

Location management

A discrete location strategy is required where buildings are to be sold to the outsource vendor as part of the deal, where additional location-sensitive capacity is to be provided by the vendor or where offshoring of services is within the scope of the deal.

The location strategy will be shaped by a combination of logistical and technical factors. These typically relate to the physical limitations on where processing can be performed relative to the locations of users, and regulatory and legal factors, will determine who can handle what data in which locations.

Where offshoring of services is being considered, it is important to take a rounded view of capabilities and risks rather than focusing solely on short term cost savings. Many offshore locations have seen marked increases in labour costs in recent years, with increasing levels of geopolitical risk and instability of energy supplies increasing the risk associated with some regions.

Technology and tools

When outsourcing business processes the supporting IT systems also need to be considered. A full assessment should be undertaken to understand what the impact will be on both the IT systems and the IT organisation.

Architecture Considerations in IT Outsourcing Deals

In IT outsourcing deals an early decision needs to be made about the position to be taken on technical architecture. At one end of the scale it might be appropriate to have a very prescriptive technical architecture, with specific hardware and software being mandated to vendors. At the other end of the scale a more outcome-based approach can be followed, where technical architecture decisions are left to vendors, and IT is defined in terms of services rather than technologies.

The latter option is becoming more prevalent with the advent of cloud computing, where the technology is deliberately abstracted from the user, who is usually completely unaware of the technologies which are used to deliver the service.

Organisations often adopt a hybrid approach to technical architecture, with some areas being defined in technical detail (often the case when a specific set of technologies is required to deliver required performance levels, support key legacy applications, enable integration or meet regulatory or legal requirements) and others being defined in an outcome-based manner, in order to encourage vendors to provide innovative solutions.

It may be necessary to guard against additional technical projects being included in the scope, as the outsourcing project may be regarded as a vehicle to deliver technical transformation, regardless of whether or not this transformation is related to the outsource.

Points to remember

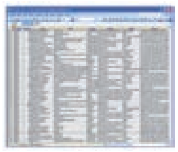
- **Be honest about current capabilities and performance.** Any significant issues with current provision will become obvious during the remainder of the deal process, so tackle them up front.
- **Set expectations appropriately**, both with senior business and IT leaders and, where appropriate, with staff who may be impacted by any outsource deal. Do not underestimate the effort which will need to be focused on internal stakeholder communications and management.
- **Manage resources carefully.** There will be key in-house team members who are the main, or even sole, experts within functions in critical areas. Consequently, it is unlikely that they will be free to work on the deal on a full-time basis, so their input will need to be optimised.

Deloitte Accelerators and Tools

- **Business Case Method**
  The Business Case Method provides rigorous analysis and quantification of expected project outcomes and benefits, so that these can be considered before the procurement project is commenced. The method provides guidance, tools and sample deliverables to support the Assess, Prepare and Evaluate phases of an IT Sourcing engagement.

- **Industry print and global process builder**
  Deloitte proprietary tools that include good practice process definitions and process diagrams. These can be used to define the process scope and assist with the definition of process splits and process maturity assessments.

- **Market intelligence databases**
  This provides a repository of IT outsourcing deals across industries and vendor capabilities. This can help with the initial supplier longlist.



End of phase checklist

✓ **Agreed business case:** The high level business case for outsourcing should clearly set out all the costs and benefits of the deal

✓ **Clearly defined scope:** The size and shape of the deal should be well understood and clearly communicated in terms of organisation and key processes

✓ **Managed risks:** Both internal and external risks associated with the outsourcing project should be understood by all stakeholders, with mitigation plans and actions established

✓ **Sourcing and location strategies:** The strategic approach to the sourcing activities of the project should be clearly defined, with clear linkage between the sourcing strategy and any assumptions in the business case

✓ **Technical architecture approach:** The extent to which the technical architecture is to be dictated to vendors rather than being left to their discretion should be clearly communicated, with a clear understanding of where vendors must conform and where they can innovate being shared across all stakeholders

Phase 2 – Prepare

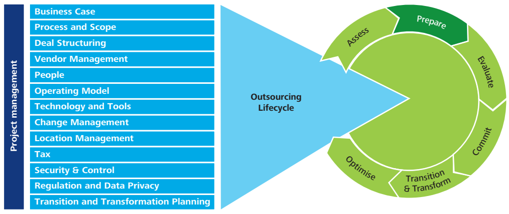
This section describes the Prepare phase of the outsourcing lifecycle, focusing on selecting the right vendor(s) to participate in the process and developing a Request for Proposal (RFP) document.

It encompasses the initial vendor selection process through an examination of the market and the preparation of detailed requirements to be included in the RFP document.

During this phase the fundamental elements of the remaining phases of the lifecycle are defined and agreed.

Identifying suitable partners

Phase 2 – Prepare



Aims and objectives

This phase takes us from the initial decision to proceed with an outsource to the point where we have selected potential vendors and have issued an RFP. A market assessment of vendor(s) is completed and a Request for Proposal (RFP) is developed and issued. Throughout the RFP creation process all services in-scope of the procurement become well defined, are signed off by key client stakeholders and are clearly articulated within the tender documentation.

Overview

The Prepare phase is an important step in the outsourcing lifecycle, as it initiates the first formal engagement with the vendor(s) and defines the client's detailed requirements from the process.

Starting with an initial long-list of vendors, a number of criteria are applied to narrow down to a short-list. This is based on the vendor's ability to meet the client's requirements, and could be informed by a Request for Information (RFI) process.

In parallel, the organisation develops the high level commercial and financial structure of the deal, highlighting key success factors and deal breakers.

Activities

The key activities of this phase are shown below:

	Assess	Prepare	Evaluate	Commit	Transition & Transform	Optimise
Process and Scope	Analyse benchmarks and leading practices	Design to-be process map				
Deal structuring	Define outsourcing deal	Structure outsourcing deal	Structure outsourcing deal for vendor selection			
Vendor Management	Conduct market assessment	Initiate vendor due diligence	Develop, issue and evaluate RFI/PQQ	Develop and issue RFP/ITT	Agree vendor engagement approach & assessment criteria	Engage relevant vendors
People	Prepare stakeholders and leaders for outsourcing	Prepare project teams for outsourcing	Develop capability transfer programme			
Operating Model	Define organisation operating model requirements	Design to-be organisation structure				
Tax	Develop alternate model tax structures	Identify vendor assessment tax criteria	Develop financial model tax input			

The future processes are developed and agreed internally and used to define the future organisation structure. These will form part of the formal RFP alongside the client's detailed requirements.

There is also a large amount of stakeholder management activity within the client's organisation. This is necessary to:

- Increase visibility within the business of the vendors targeted
- Communicate the scope of services to be procured
- Discuss key business Critical Success Factors (CSFs) and deal breakers

Process and scope

At this stage the objective in a BPO deal is to develop a detailed understanding of the processes that will be outsourced. Additionally, the point where an end-to-end process will pass from in-house to outsourced should be defined, i.e. the process split.

Close collaboration with the customer of the services (business users) is vital at this stage to ensure a smooth process transition without encountering significant hurdles and operational risks.

Throughout this activity, leading practices and benchmarks can be used as the blueprint for the process designs, although these need to be customised to meet the individual needs of the client.

In an ITO deal, the scope will have been set in the preceding Assess phase. At this stage all that will be required is refinement.

Deal structuring

The objective of this activity is to develop the deal structure which will set out the key principles and objectives of the outsource deal, define success factors and produce financial models which will be used as the basis for communicating to the vendors the key objectives of the outsource.

Key principles

- **Consideration of a variety of vendor(s):** A variety of vendors should be considered as part of the RFP process to enable a comparison based on skillset, which could lead to a 'best of breed' vendor selection. Upon assessment, between 3-8 vendor(s) should be qualified per service, to enable fair competition
- **Choice of RFP style:** Make the decision on the style (from highly prescriptive to descriptive) and structure (from one-size-fits-all to modularised) of the RFP based on the scope, timelines and vendor relationship approach
- **Development of a vendor liaison plan prior to issuing RFP:** Establish a vendor relationship plan for the entire procurement exercise, which will underpin the vendor communication plan and align the vendors' expectations from an early stage
- **Clear articulation of vendor proposal requirements:** These should be clearly articulated and be informed by the evaluation criteria used in the next phase to support a consistent evaluation across vendors. The pricing response requirements should also be well defined to enable like-for-like comparison and effective scenario modelling

Deal principles should cover a number of dimensions, ranging from business driven goals to service delivery goals and incorporate flexibility and agility targets.

Key deal breakers are also defined at this stage, which will assist in identifying potential show-stoppers throughout the process and assist with vendor selection.

Vendor management

This activity selects the vendors that are invited to participate in the RFP process and develops and issues the RFP document based on the overall sourcing strategy.

To select the long list of participating vendors, the following steps are required:

- Conduct the initial market assessment of outsourcing providers (based on the overall strategy)
- Agree the vendor engagement approach
- Issue an RFI (if required)
- Commence vendor due diligence which will be concluded by the end of the Commit phase

High level assessment criteria for vendor selection are required to assist in validating vendor capabilities in meeting the client's requirements. This is particularly important if the services being procured deviate from commodity-type standardised services.

In parallel, the detailed requirements of the in-scope services are gathered and populated within the RFP document. Requirements should cover all aspects of the services and include key volumetric data (to the extent available) to enable a more detailed and accurate pricing response from the participating vendors.

Example contents to be covered within an RFP include:

- Overview of opportunity, in scope and out of scope items, and relevant context
- Current state description in terms of Process, Technology, People, and Governance
- Future state requirements for the above dimensions
- Service transition
- Affected third party contracts
- Commercial considerations of the deal
- Outcome and performance standards
- High level opportunity timelines

During the creation of the RFP, sessions with the long-listed vendors are held to brief them of the high level service requirements and allow for vendor questions to be raised and addressed early on in the process.

Points to remember

- **Include any relevant industry specific regulatory requirements** within the RFP and ask the vendor(s) to demonstrate their experience is meeting these for other clients
- **Establish clear business CSF's to be met through the RFP process** and identify key deal breakers
- **Consider the degree of cultural fit between vendor(s) and client** as a criterion in the vendor selection process

Figure 2.1. Choosing the right type of RFP

Points to remember

- The type of services being procured, the overall evaluation model, the level of detail required in the responses and the amount of current state information available all impact the type of RFP that can be chosen. This ranges from highly prescriptive (detailed shopping list) to descriptive (conversational)
- The evaluation method and criteria should be defined at a high level during this process to inform the selection of the RFP style
- RFP documents can also be tailored to adhere to a multi-sourced or single-sourced services model

People

The output of this activity is to develop a capability transfer programme, based on a high level capability strategy, to transfer the key capabilities of the internal organisation to the vendor providing the future service.

It requires liaising with key stakeholders to identify the skills and capabilities to be transferred across to the vendor at the point of transition and the capabilities to be retained in-house which inform the internal organisation design.

It is important to ensure that there are clear lines of communication with all impacted parties and that a comprehensive communications and engagement plan is developed and implemented.

Organisation

This activity defines the operating model requirements for the internal (retained) organisation and designs the future structure of the organisation that will manage the service post transition.

The current as-is organisational structure is used as the starting point for this.

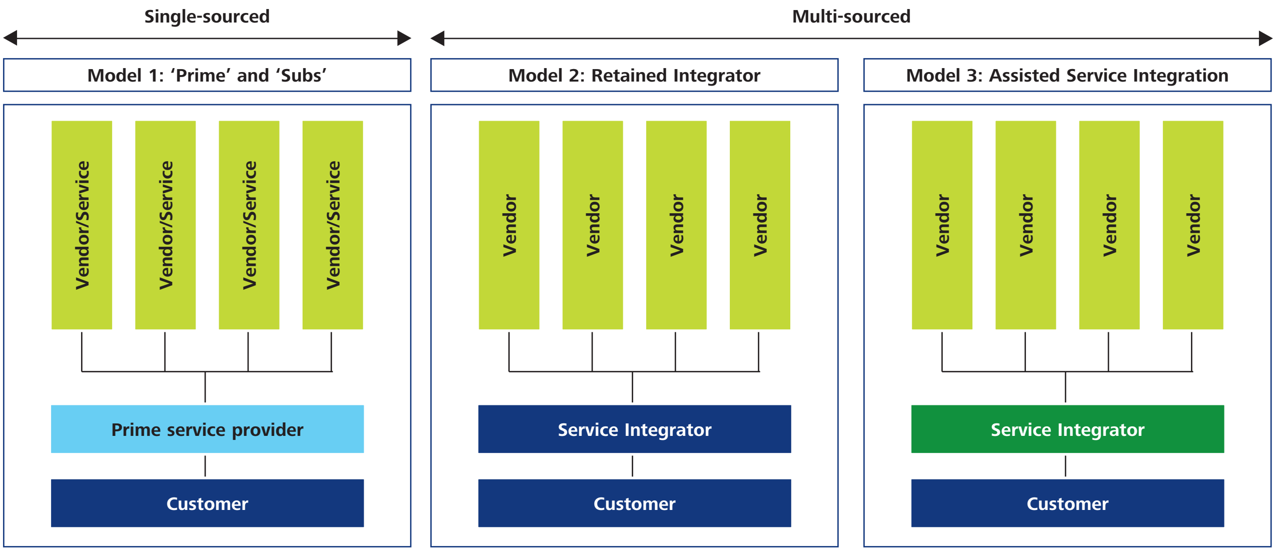
The guiding principles for process demarcation between the retained organisation and the service provider should be agreed in advance of vendor long-listing as it will determine the type of vendor required and help distinguish between service integrators, managed services providers and output-driven process vendors.

The detailed structure of the retained organisation should be included as part of the process requirements in the RFP and will be further refined during the detailed negotiations which occur in the Commit Phase.

The structure of the retained organisation should also be informed by the desired service management model. This is driven by the number of vendors involved in delivering the services (multi-sourced vs. single-sourced) and the level of end-to-end service management required to manage the delivered services which could be part of the vendor provided services if required.

Figure 2.2. Service Management models

- Different Service Management models can be chosen based on the desired retained operating model, the number of vendors involved with delivering the service and the contractual accountability model
- These include models where the responsibility for the end-to-end service delivery is retained with the client (Model 2), or passed on to a third party vendor who is contractually responsible for service delivery (Model 1)
- Alternatively, the Assisted Service Integration model (Model 3) could assist with service delivery management, however the contractual responsibility still lies with the client's retained organisation team



Contractual & Operational responsibility for Services/Vendors

Operational responsibility for Services/Vendors. (Contractual responsibility remains with the Customer)

Tax

The objective of this activity is to define suitable tax structures for the delivery of the required services and inform the proposal evaluation criteria and financial model with the appropriate tax treatment considerations for accurate cost analysis. This is based on the cost-benefit analysis on the tax profile of the deal.

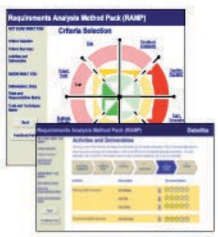
This activity is particularly important if various legal entities are considered for the delivery of the services (joint ventures, offshore shared service centres, etc). It also covers VAT treatment which is often a particularly sensitive issue with financial services organisations who can only recover a small portion of the tax.

Furthermore, tax issues involved with the sale of assets (e.g. hardware, property) are also considered and should be examined to understand the impact on balance sheets and profit and loss statements.

Deloitte Accelerators And Tools

- **Requirements Analysis Method Pack (RAMP)**
  This is a source of best practice content and support for requirements analysis, e.g. when developing technical and operational requirements for an RFP/ITT.

  The method pack includes an interactive software tool that enables identification of deliverables, tools and techniques that are appropriate for specific projects. It also contains a library of deliverable templates including, a roles and responsibilities matrix that links activities and deliverable responsibilities with defined project roles and detailed guidance.



- **RFP template**
  A structured template, including best-practice instructions, sample content, guidance and questions to help practitioners develop a comprehensive RFP document for this phase.

  This template captures technical, operational and commercial requirements, which will need to be developed and communicated to the vendors prior to the Evaluate phase. If dealing with a multi-stage tender process the RFP can be updated in the subsequent Evaluate and Commit phases to invite Best and Final Offers (BAFO) from the bidders.

Defining robust requirements is key to reducing the risk of services "falling within the cracks" of the final contract.

End of phase checklist

- ✓ **Signed off RFP document:** The documentation which will be distributed to all participating vendors describing the rules of engagement, detailed requirements and key timelines.
- ✓ **Long-list of vendor(s) to receive the RFP:** An auditable document showing the rationale for selecting or eliminating vendors from the process based on their experience, competence and organisational and financial stability.
- ✓ **Vendor engagement model:** The process by which to engage with participating vendor in a fair and consistent manner, including escalation procedures.
- ✓ **Service management model:** Clear definition of the end to end model by which delivery of the services will be managed.

Phase 3 – Evaluate

Choosing the right partner

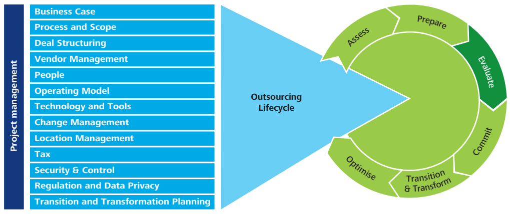
This section describes the Evaluate phase of the outsourcing lifecycle and is focused on a structured evaluation of the vendors' proposals followed by negotiations that result in a final shortlist of vendors for contract negotiations.

The activities within this phase are broadly aligned to three steps that cover:

- The management of the vendors whilst preparing their proposal responses
- Evaluation of the proposal responses and negotiation and
- Down-selection to one or more short-listed vendors

Following completion of the Evaluate phase the client will be ready to proceed to final negotiations and contract with the short-listed vendors in the Commit phase.

Phase 3 – Evaluate



Aims and objectives

The Evaluate phase focuses on managing the question and answer process with the vendors whilst they are preparing their responses, evaluating their responses and then negotiating with the vendors to down-select to one or more short-listed vendors.

The overall aim of the Evaluate phase is to identify and select the vendor(s) that represent the best value for the services being outsourced so that they can be taken through to final due diligence and contract negotiations.

The actual approach taken to completing the Evaluate phase will vary depending on the scope, value and complexity of the services being procured, and the number of supporting resources required may vary from a large dedicated evaluation and negotiation team to a small part-time team running a reverse auction.

Irrespective of the nature of the outsource deal, in completing the evaluation the focus should be on objective decision making that results in the short-listing of one or more vendors that are best able to supply the service that is being outsourced.

Overview

The Evaluate phase will take the client from having issued an RFP to the short-listing of one or more vendors for final contract negotiation and signature.

It is a key step in the process as this is the stage at which the client is able to accurately assess the vendor's offerings and validate the business case.

Effective management of the vendors and internal stakeholders are key components that must be focused on during the Evaluate phase, or else the procurement team risk losing control of the process which can result in a reduction in the value delivered.

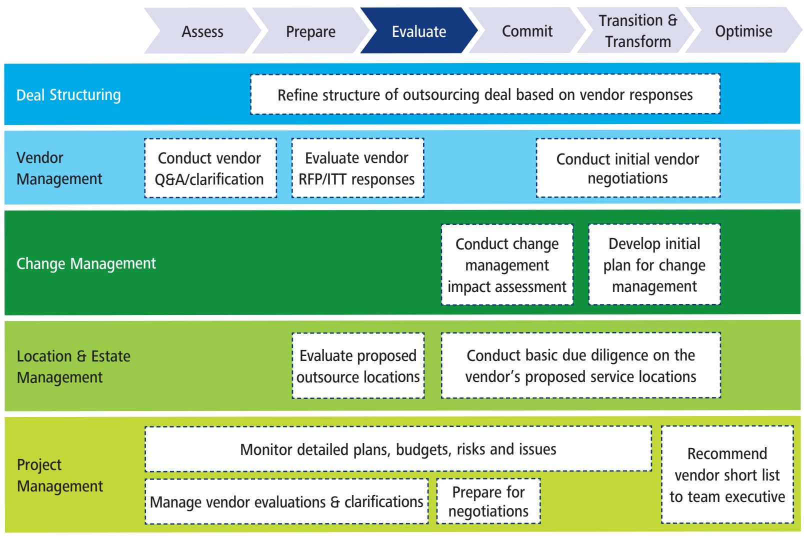
It is also important to recognise that the vendor's initial proposal responses may not effectively capture their respective competitive positions accurately and it is not unusual for subsequent negotiations to substantially alter the initial evaluation outcome. Therefore, to gain the best understanding of the relative value of the vendor's proposals the client should plan for early negotiations with the vendors to refine the proposal responses. Depending on the scope of the procurement this may be achieved through a series of face-to-face negotiations or if appropriate using a reverse auction.

Key principles

- **Creating a shortlist aligned to the contract negotiation strategy:** The shortlist of potential vendors should support the negotiation strategy. For small, low value services, shortlisting a single vendor may be appropriate, but for complex, high value projects, maintaining competition through to contract signature often drives greater value.
- **Make objective decisions that are auditable:** To ensure that the correct vendors are shortlisted, the evaluation process must focus on objective measures of the vendor's capabilities. Recording and evidencing that the decisions are supported by an auditable trail of supporting information will provide confidence to the key internal stakeholders that the right decision has been made.
- **Negotiate with the vendors before composing the shortlist:** Before making a decision on the shortlist, negotiating on the key points and seeking to gain additional understanding and concessions from the vendors will help validate the decision and provide greater transparency.

Activities

The main inputs, outputs and activities of this phase are shown below:



Vendor management

The Evaluate phase commences following release of the RFP document to the potential vendors at the end of the Prepare phase and the first task is managing the question and answer process with the vendors.

The vendor's clarifications should be handled through a single point of contact within the client. The contact may take the form of email, or it may be through a web portal, but in either case all requests for clarification and subsequent answers should be logged. Vendor clarifications which are not commercially sensitive to a vendor should be shared with all bidders.

Following receipt of the vendors' proposal responses, the client must conduct an evaluation to identify the relative value of the proposals and the key differentiators between the proposed services.

The size of the evaluation team may vary depending on the scope of the procurement and the degree of subject matter expertise required to complete a review of the responses, however more than one individual should be involved in reviewing each section/component of the proposal responses.

Following the scoring of the proposals, the client should seek to further clarify and improve the vendor's proposals through negotiating with the vendors (note for commodity services this may be through a reverse auction – see following page). The starting point for any negotiations should be any key deficiencies with the vendor's proposed service/solution and any cost 'outliers' that are identified through the commercial evaluation. The progress of negotiations should be tracked on an ongoing basis and where limited progress is being made the client should consider using escalations and negotiation levers to secure additional benefit from the process.

In parallel with the negotiations, the vendors should be given the opportunity to complete a basic level of due diligence on the client at this stage to allow them to increase their understanding and confidence in the solution and subsequently refine the solution and firm up their commercial offer. Where appropriate, this should be done through the use of a shared data room for client data, site visits to key client service locations and interviews with key client stakeholders.

Deal structuring

The commercial evaluation of the vendors' responses will be the first point at which the anticipated financial business case can be validated and a review against the proposed benefits completed. The financial analysis should also identify any financial 'outliers' that differentiate the vendor's proposal from the other competing responses and these should be captured and summarised for further review.

As the ongoing vendor negotiations progress, the projected financial and service benefits should be continually tracked and reported to ensure that the projected benefits continue to support a viable business case.

Change management

Following receipt and evaluation of the proposals, it should now be possible to complete an impact analysis of the outsource on the organisation and commence planning for the changes that will result from implementation.

The impact analysis should consider any personnel changes, and also what impact the outsource may have on the client's processes and ways of doing business, and consider the most effective way of managing change within the client's organisation.

A key aspect of change management is effective communication on the impact of the changes on the client's team. Staff who may be affected by the outsource are typically keen to gain clarity on how the change will affect them and uncertainty will likely cause disengagement from the process.

It may also be appropriate to begin formal engagement with unions and works councils during this phase to discuss the potential scope of changes.

The client should consider using escalations and negotiation levers to secure additional benefit from the process.

Location and estate management

The location of the outsourced staff or support functions may have a significant effect on the success of the client's outsource and this should be considered when evaluating the proposal responses. The analysis should consider the organisation and cultural fit with the client, including factors such as language skills, workforce availability, cost, stability and accessibility.

A basic level of due diligence should be undertaken on the vendors to gain confidence that the capabilities in their planned locations are sufficient to deliver the requirements. Typically, site visits and reference calls to review the vendor's capabilities should be conducted including ensuring that:

- The infrastructural and IT capabilities are sufficient to support the service effectively

- The proposed service locations and facilities management are suitable to deliver the service requirements

Project management

The success of the activities performed during the Evaluate phase is highly dependant on the rigour that is placed around the project management framework that supports the process. Whilst the details of the process may vary what stays consistent is the requirement to: be effective in managing the interactions with the vendors; ensure consistency and objectivity within the evaluation teams; structure any due diligence and negotiation activities effectively; and manage the senior stakeholders within the client.

Throughout the Evaluate phase the identification, reporting and management of risks and issues is key to delivering an effectively managed and co-ordinated procurement. For large deals the Project Management Office (PMO) should take a formalised approach to this, but for smaller deals, a regular informal review may be sufficient.

The evaluation of the vendor's responses should be co-ordinated by the project management team and they should take the lead in the following activities:

- Communication of the evaluation plan and framework to the evaluation team

- Receipt and distribution of the vendor's responses to the team (note that as all members of the team may not be evaluating a section, only relevant sections should be sent to reviewers)

- Co-ordinating the evaluation responses and any consensus meetings

- Reporting the results of evaluation to the leadership team

The final task that the project team often perform in this phase is to inform the shortlisted and rejected vendors and offer to debrief the losing vendors on the reasons for not being selected.

Scoping the project management effort

Although the core requirements for project management are equally important on all outsourcing deals, the structure and size of the project team will normally vary to take into account the complexity and importance of what is being procured.

Managing small outsource deals:
For smaller scope projects the challenge is typically reduced due to the scale of the teams and scope of the service being smaller and the project management resource may not be a dedicated role. However this does not reduce the importance of effective project management. Indeed in many cases the smaller team size may introduce challenges around ensuring that objectivity and audit trails are maintained with the stakeholders.

Managing large outsource deals:
With a large scale project the challenges are often much more complex and a dedicated project manager and supporting PMO function are often required to co-ordinate activities between different workstreams and to manage communications and formal reporting. A clear focus on the objectives and managing scope creep is critical in successfully delivering these large projects successfully.

The project management team also takes the lead in preparing the initial negotiation positions with the vendors. This will be a summary of the key areas within which the vendor's responses fail to meet the requirements or to deliver the financial benefits required. The list of negotiation items should be prioritised based on the importance of the shortfall.

Throughout the negotiations, the project management team should be monitoring and reporting progress and acting to update the evaluation and scoring to reflect the current positions. Following completion of the negotiations with the vendors, the project management team will prepare a summary pack that will capture the vendor's final positions and make a recommendation to the deal sponsor/board on a suggested shortlist of vendors for the Commit phase.

If at any point during the evaluation it becomes evident that the business case may not be delivered and/or the anticipated benefits are significantly less than estimated, the project management team should immediately escalate this to the deal sponsor/board and consider putting the deal on hold.

Throughout the negotiations, the project management team should be monitoring and reporting progress and acting to update the evaluation and scoring to reflect the current positions.

Alternate approach – The reverse auction

Where the service being procured is a commodity then it may be more cost effective to run reverse auctions rather than a complex evaluation and negotiation.

The reverse auction is a mechanism whereby several potential vendors are given access to an online portal within which a time-boxed auction is executed. The vendors are then encouraged to submit bids for the service being auctioned, with the lowest bid typically winning the work. Although the client usually retains the right to choose to award the contract to a bidder who did not submit the lowest bid, choosing to do this may have consequences for future reverse auctions so this should only be done by exception.

The reverse auction approach is only appropriate for commoditised services or products where the outputs of the service are well understood and the only significant difference is the cost of the service. Where the client is not confident in the nature of the commodity services, then a reverse auction is typically not appropriate. Therefore, it is not appropriate to reverse auction highly customised, high value or complex services that are dependent on many other factors other than price.

Table 4.1 Good practice guidelines for conducting vendor evaluation

Task description	Good practice	Explanation
Managing vendor questions and answers	Share the questions and answers of non-commercially sensitive questions with all bidders.	It is key to create (as much as possible) an 'apples-for-apples' comparison of the vendors' proposal responses and therefore questions which add clarity to the process and are not commercially sensitive to the vendor should be shared with all vendors.
Define evaluation criteria and weightings	The evaluation criteria and scoring weightings are defined prior to release of the proposal document to the vendors.	Early definition of the evaluation criteria demonstrates greater objectivity in evaluating the proposals and helps to ensure that the proposal document is focused on asking the right questions to support the evaluation.
Scoring the vendor's tender responses	The scoring is done with reference to an objective scoring chart with reasons given for all scores.	To ensure the evaluation identifies the strengths and deficiencies of the vendor's proposals, the schema for scoring the responses should identify the degree to which the requirement is delivered by the vendor's proposal and the evaluation should capture the reasons for the score given to provide an audit trail of the scoring.
Selecting the evaluation team	More than one evaluator should score every section. For large proposals consider dividing the evaluation up amongst subject matter experts (SMEs).	For smaller proposals a small number of evaluators scoring the entire proposal may be appropriate. For large proposals, dividing the evaluation up amongst the SME community is likely to provide a more robust evaluation of each section and ensure that the evaluation is carried out by appropriately skilled individuals. Generally all sections should be evaluated by more than one individual to maintain objectivity.
Managing communications with the deal sponsor/board	Maintaining regular updates and briefings to the sponsor/board during the Evaluate phase activities.	The team should regularly brief the sponsor/board on all activities during the Evaluate phase to ensure that they are fully informed of progress on the project. Failing to keep the decision makers appropriately briefed risks losing control of the process and creating a perception that an ineffective or biased process has been followed during the evaluation of the proposals.
Vendor short-listing	Selection of two or more vendors for final contract negotiations.	Selecting a single vendor to take forward to final contract negotiations can be risky. Typically maintaining competition in the process through to contract signature drives greater value.

Deloitte accelerators and tools

- **Evaluation Framework**
  The evaluation framework template sets out our good practice approach to structuring and scoring the evaluation of vendor's proposal responses.

- **eValuate RFI/RFP Evaluation Tool**
  eValuate is a proprietary Deloitte tool that supports vendor proposal evaluations. It enables our clients to set up, administer and participate in evaluations, whilst offering them a method of centralising and managing evaluation data in a controlled environment.

- **IT Sourcing Health Check Diagnostic Tool**
  The sourcing diagnostic tool reviews the readiness and robustness of the client's procurement process and has a section tailored to reviewing the evaluation process.

- **Clarification Log Template/ Tracking Tool**
  This template is used to log and track questions and answers relating to an RFI/PQQ or RFP/ITT document, and can be used in conjunction with electronic tendering tools for communicating with bidders.

Points to remember

- There are **three key activities performed during Evaluate:**

  1. Managing vendor clarifications

  2. Valuation of the vendors' proposals

  3. Negotiating and identifying a shortlist

- The output of the Evaluation phase **is a shortlist of vendors for final due diligence and contract negotiations** during the Commit phase
- It is often appropriate to complete some **initial due diligence** during the Evaluate phase and where applicable this should be **both inbound and outbound due diligence**
- During vendor clarifications, unless commercially sensitive to the vendors' response, **clarifications should be shared with all the bidders**
- Evaluation of the vendors' proposals should be performed using an **evaluation framework determined before issuing the RFP** and be based on an **objective scoring system**
- Sections of the proposal responses should be evaluated by **a minimum of two reviewers**
- The evaluation scores and supporting rationale should be **captured for audit purposes**
- Following evaluation there should be subsequent **clarifications and negotiation on key service/solution and commercial points** to refine the vendors' proposals prior to **making a shortlist recommendation to the deal sponsor/board**
- For **commodity services a reverse auction** may be appropriate

End of phase checklist

✓ **Approved shortlisted vendor(s):** Following completion of the Evaluate phase, a shortlist of one or more potential vendors for final due diligence and contract negotiations should be approved by the deal sponsor/board.

✓ **List of key negotiation points for each shortlisted vendor:** For each of the shortlisted vendors, a summary of the prioritised key areas for further negotiation should be generated to accelerate negotiations during the Commit phase.

✓ **Evaluation audit trail:** The scoring from the initial evaluation and any subsequent updates to the evaluation is collated in a single location to provide a record of the evaluation and support any audit activities required.

✓ **Due-diligence activity summary and priority activities for each vendor:** To support agreement of the final shortlist of vendors, each of the potential vendors should submit a summary of their activities, including their findings and key risks from due diligence conducted to date. In addition, a list of prioritised due diligence activities for the Commit phase should be created.

Phase 4 – Commit

Negotiating the contract

This section describes the Commit phase of the outsourcing lifecycle, focusing on achieving the best value out of the negotiations and getting the deal 'across the line'.

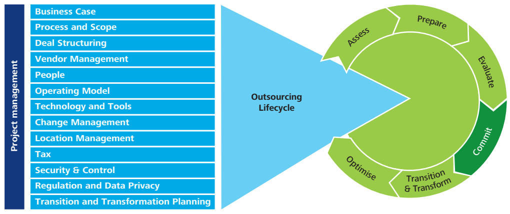
The Commit phase includes the final pre-contract stages of both internal and external activities across the deal, vendor management, people and organisation workstreams.

The outsourcing agreement itself is developed and negotiated with significant internal stakeholder management activities required to secure the buy-in and sign-off necessary to complete the deal.

In parallel, the organisation design will be finalised and transition plans developed.

This is often the most resource intensive and commercially significant phase of the outsourcing lifecycle.

Phase 4 – Commit



Aims and objectives

The primary objective of this phase is to get the deal ‘across the line’. Many of the activities that were initiated in the previous phases are completed during the Commit phase, culminating in the signing of the outsourcing agreement.

Whilst the deal team is focusing on securing the best deal value, significant internal effort is required to manage stakeholders and achieve the executive buy-in that is necessary for contract signature.

During this phase the vendors will increase the pressure on due diligence and try to use this process to gain an advantage.

Throughout all of this activity the client should remember that the objective is usually not a deal with the smallest initial price but a deal which provides optimal long term benefit to both parties.

Overview

The development and negotiation of the outsource agreement is at the centre of the Commit phase activities, from drafting the terms and conditions to contract signature.

The exact process that is followed can vary greatly from deal to deal with a balance needing to be struck between internal preparation and vendor engagement. Typically, a degree of internal preparation will take place which can include drafting of the first version of the terms and conditions, development of the negotiation strategy and further definition of the services being procured.

While the deal team are negotiating, vendor due diligence activities will increase in volume, with additional requests being driven from the negotiations and additional detail being sought across all areas.

In parallel to the deal activities, a series of critical internal activities are taking place:

- Effective stakeholder management is crucial in order to gain direction for the negotiations and ultimately approval for contract signature
- The design of the retained organisation needs to be finalised and the plan for the transition of staff developed (if applicable) with any necessary consultations taking place
- Security and control also need to be taken into account with security (and where appropriate risk and regulatory) approval being a pre-requisite for contract signature

Throughout this phase it is common for external support to be sought from law firms, specialist consultants, bench-markers and other professional advisors.

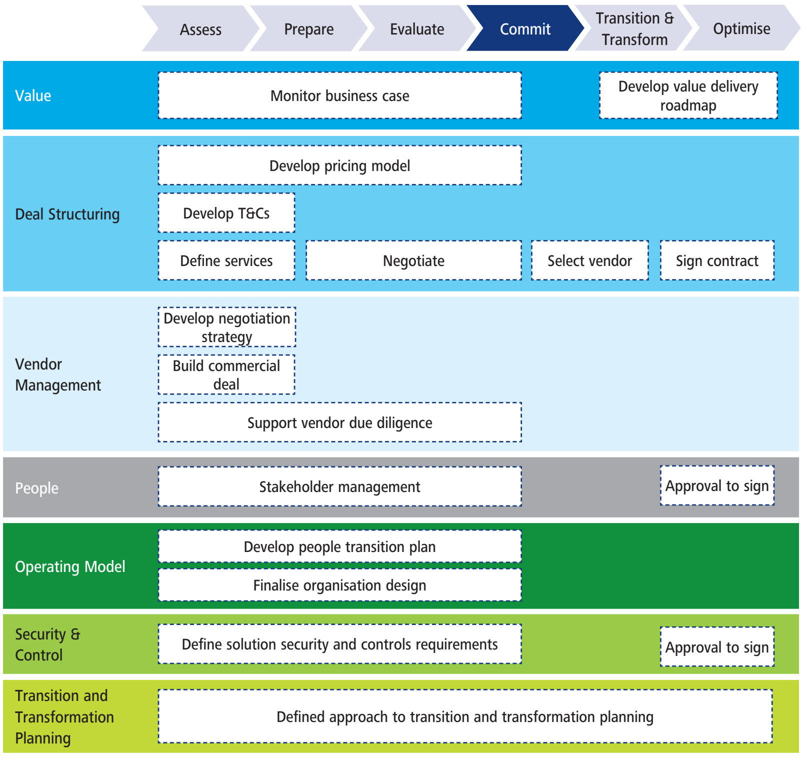
The primary objective of this phase is to get the deal ‘across the line’.

Key principles

- **One team:** Effective communication between the deal teams from the outset has a significant impact on the timelines, effort and overall success of the deal. This includes involvement of the legal team from the early stages of the process, constant alignment of the commercial, legal, financial and services aspects of the negotiations and open communication channels between the negotiating and supporting teams.
- **The services are the deal:** It is often tempting for the focus of negotiations to be entirely on the terms and conditions and commercials of a deal. However, the most common reasons why outsource agreements struggle operationally are related to transition, transformation and service. As such, the focus of the deal team should be aligned to the areas which will ultimately determine the success of the agreement.
- **Be well informed and realistic:** Unreasonable requirements, often originating from lack of information or expertise, will detract focus from what is truly important and prolong the negotiation process. Well informed and realistic requirements can be defended much more effectively.
- **Contract for outputs:** All aspects of the contract, from service descriptions and transformation deals to service levels should be described in terms of the end outputs that the client requires (unless there are specific reasons not to). This focuses the contract on what is important to the client and allows the vendors to develop the most appropriate solution.
- **Consider future change:** Often outsource agreements become out of date before they expire, ceasing to meet business requirements in the new market conditions. All aspects of the contract should be considered with potential future change in mind, from the definition of pricing units to the flexibility of service levels.

Activities

The main inputs, outputs and activities of this phase are shown below:



Deal structuring

The extent to which the development of terms and conditions (T&Cs) takes place internally and how much is completed as part of the negotiations can vary. It is often best for a full set of T&Cs to be developed internally, building on the legal and commercial requirements set out in the previous phases. This is then sent to the shortlisted bidders as the starting point for the negotiations.

The T&Cs should be developed with the broader deal in mind and the emphasis should be representative of the client's objectives and risk appetite.

It is recommended that legal advisors are chosen who have experience in the specific type of outsourcing and template contracts are used to accelerate the process.

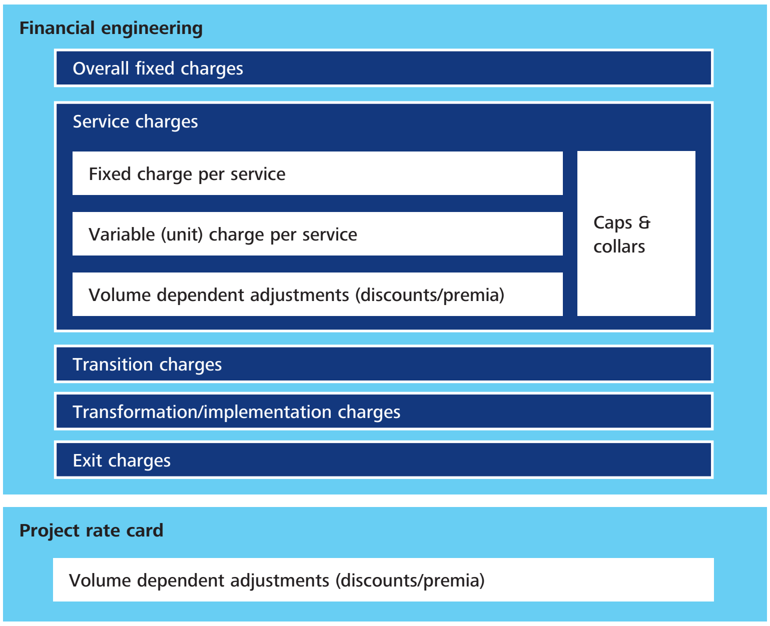
The process for defining the services is driven by the level of understanding that the client has of their requirements. In some cases (for example, a second generation outsource), it may be possible to use existing service definitions as the basis. In other cases the negotiation process is used to jointly create the solution with the bidders.

In all cases it is important to differentiate between the service definition (i.e. the requirements) and the solution (i.e. how each bidder is proposing to meet the requirements). The service definition is typically drafted by the client while the solution is provided by the vendors.

In addition to the ongoing services (e.g. business processes), the service definition will also describe any transition, transformation and exit requirements.

At its core, the pricing model will answer the question 'how much will the charges be at any given time and under any given scenario'. Although ultimately it will be included in the contract, the pricing model usually begins as a spreadsheet which is either developed by the client and distributed as a template to the vendors or developed independently by the vendors.

Figure 4.1. Typical pricing model elements



The pricing model should include all foreseeable charges and cater for all likely scenarios in order to provide predictability to the contract (and good long term value to the client). Figure 4.1 demonstrates some typical components of a pricing model.

In addition to the charges, it is not uncommon for a pricing model to include some information on the composition of the charges. For example, breakdown of charges into people, property, hardware and software. This can aid the client in understanding cost drivers, comparing solutions and facilitating the negotiation.

There is often a temptation to create a very complex pricing model which is ultimately difficult to manage. The aim should be for the model to align with the client's business objectives whilst incentivising good behaviours for both parties.

A key component of the service definition is the Service Level Agreements (SLAs). The SLAs describe the performance level at which the services should be provided and can include the vendor's performance in delivering projects (e.g. a transformation programme).

The call-out box below provides some guidance on building a service level and credits regime. Service credits are additional days of service or monetary credit given to the customer at no charge for performance below the SLA.

Tips for building an SLA scheme

1. The sole purpose of a regime should be to align the vendor's objectives to the client's (i.e. to incentivise the correct behaviours).
2. It should not be intended as punishment or as a method of reducing the charges.
3. The regime should be aligned to the client's business priorities, prioritising services appropriately.
4. Any credits should be proportional to the level of 'pain' felt by the client. As such, disproportionately punitive credits (e.g. hairline triggers) should be avoided while the level of credit should increase as service performance continues to deteriorate.
5. The regime should be flexible and be able to react to changes in business priorities or technological improvements.
6. Simplicity should be pursued at all times to control the effort required to manage the regime.
7. Scenario modeling of good, average and bad performance is the recommended method for testing a regime against these key tips and to help draw out any unintended consequences.

Key principles

- **The only constant is change:** Review the pricing model with the perspective of how the marketplace and your business may change during the course of the contract. For example, contracts which charged computing power 'per CPU' struggled with the advent of multi-core CPUs.
- **The contract is not the deal:** There is often a temptation for the negotiations to focus disproportionately on the contract terms and conditions to the detriment of the actual services.
- **Common areas of post-signature contention are services, service levels and charges:** As such, these areas should be given as much legal attention as the terms and conditions to ensure clarity.
- **Make careful use of standards:** Making reference to standards (such as ISO) provide a way of quickly defining a significant volume of requirements in a commonly acceptable way. However, requiring certification to these standards can often have a significant price impact.

Vendor management

Building the commercial deal includes both the definition of the commercial parameters of the deal and the drafting of the contract schedules that represent them.

The specific commercial parameters vary but typically include the term of the contract, any phasing of the contract (e.g. transition, transform, operate, exit), the service credits regime, exit conditions, key transformation milestones, people and assets transfer, the pricing model (as described previously), financial engineering and benchmarking.

Most of these commercial parameters influence each other and must be considered together in order to create an effective commercial deal. It is recommended that the dependencies between the parameters and the desired outcomes are decided in advance of the negotiations and included in the negotiation strategy.

A negotiation strategy is a powerful tool that enables the deal team to drive effective negotiation. In its simplest form it documents and prioritises the desired outcomes. In a sophisticated form the negotiation strategy will not only define the priority outcomes but also set out how these will be achieved.

It is common for the negotiation strategy to be tiered, with the highest tiers setting the overall direction of the negotiations (e.g. long term cost reduction) and the lowest tiers describing the specific and measurable objectives and levers (e.g. a minimum cost reduction of 20% is required in year 2).

It is critical for the negotiation strategy to be developed in advance of the negotiations and to be signed off by the appropriate sponsors. This will force discussions and decision making to take place outside of the pressure of the negotiations and will equip the deal team with the authority to negotiate.

The negotiation strategy also provides direction for the creation of the terms and conditions, the services and the commercial deal.

The vendor due diligence activities which began in the Evaluate phase will complete during the Commit phase. As the vendors' solutions are developed and the negotiations commence the vendors will carry out broader and deeper due diligence

It should be noted that the vendors' propositions are dependent on the findings of their due diligence and as such failure to support it sufficiently can result in exclusions being included in the contract (e.g. if additional third parties are identified post signature then the client is liable for additional charges) as well as the vendors including a risk premium in their charges.

It is recommended that a dedicated due diligence team is mobilised to support the vendors' due diligence and should perform three functions:

- Proactive gathering of due diligence data that the vendors are expected to require. This is especially important for data that requires long lead times (e.g. typically 3rd party contracts information)
- Responding to vendor requests for due diligence information and activities
- Logging and managing responses to vendor questions

An electronic data room can be used as an effective way of disseminating large amounts of data.

The negotiation period is usually time constrained, expensive and results in many significant decisions.

As such it is critical that all preceding steps have been completed thoroughly. A signed-off negotiation plan, services and T&Cs and a robust commercial deal are instrumental to success.

A negotiation strategy is a powerful tool that enables the deal team to drive effective negotiation.

Key principles

- **Successful negotiations are driven to a large extent by preparation**. Ensure that the negotiating team has the required authority, information, tools and plan for negotiating
- The **logistical aspects of negotiations can be complex.** It is often **useful to have a dedicated resource managing** this
- **Third party contracts are very frequently the most time consuming and commercially significant aspect of due diligence.** This includes understanding the contracts that are impacted by the outsource, accounting for their value and securing any consents or novations
- The list of information required by vendors during due diligence can be mostly determined before negotiations begin. **Gathering it in advance will remove due diligence from the critical path**

During the negotiations, effective project management and efficient communication between the negotiating teams are the key drivers for a successful client driven negotiation.

The close of the negotiations is often signified by the vendors submitting their best and final offers (BAFO) on the basis of the contract that has been negotiated. At this point the client will evaluate the deals holistically and decide which vendor to proceed with.

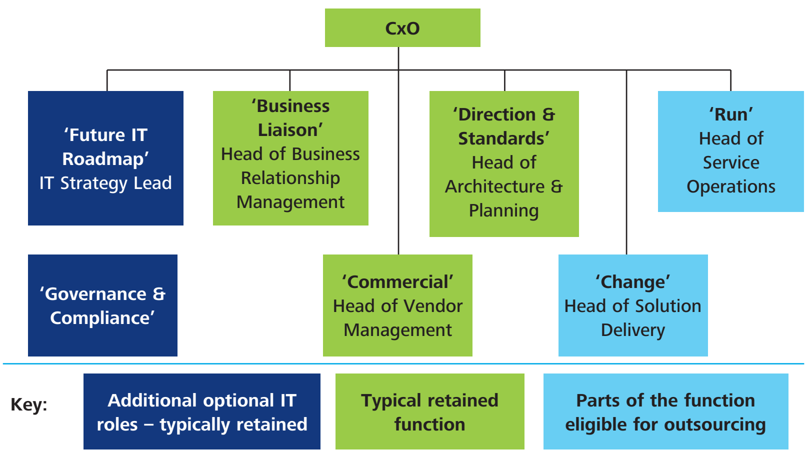
The evaluation criteria used during the Evaluate phase can be used if still appropriate or can be revised to reflect the final priorities. The evaluation should take into account all aspects of the contract including legal, commercial, price, service and vendors' solution, the client's due diligence, as well as softer aspects such as the confidence of the deal team in the capability and solution of the vendor. Typically a detailed evaluation will take place by the broader team and the results provided to the deal sponsor/board for the final decision.

Business case

Throughout the negotiation process, the business case should be used to understand the overall impact of commercial and solution decisions.

As the negotiation progresses, the hypotheses in the business case will be replaced by the vendors' solutions and offers and the overall value of each deal can be weighted against the original criteria.

Figure 4.2. Typical retained organisation structure



Often the business case will be incorporated into the tool used to facilitate the financial negotiations and ultimately the financial evaluation of the proposals.

The business case represents the value that the outsource deal will bring to the client over the duration of the term. Typically the value profile will vary throughout the term and will be dependent on vendor and client actions as well as external influences.

A value delivery roadmap will document how and when value will be delivered and demonstrate how the total value of the business case will be achieved. It should be used to guide operations and ensure that the value is extracted.

Lack of focus on value delivery very often results in deals which do not deliver the benefits that the parties envisaged at the time of negotiations.

People

The final step prior to contract signature is the executive approval of the contract. In order to achieve this approval the project team should be managing its stakeholders throughout the course of the Commit phase.

This includes regular updates, deal review sessions, evaluation outcomes presentations and decision making workshops.

The objective of this activity is to ensure that the key stakeholders are fully informed throughout the process, that the deal receives timely guidance and that approval to sign is granted.

Depending on the organisational circumstances, this activity can be significant and can require a dedicated team.

Operating model

The design of the retained organisation should be finalised during the Commit phase (see Figure 4.2 for a typical high level retained organisation structure). It should reflect any changes to the solutions and overall deal that transpire during the negotiations and should include the timeline for implementing the design.

In many cases elements of the retained organisation should be in place shortly after contract signature and as such it is common for members of the retained organisation to be part of the deal team.

Once the design is finalised, communications to any in-scope and out-of-scope staff should be managed and any engagements with the unions and works councils completed. Note that in many countries there are clear legal guidelines and limitations placed on the ability of any outsourcing deal to be completed without a statutory period of consultation being completed so this may well be on the critical path to contract signature. It is important that these activities begin early during the process in order for the client to manage any impacts.

Security and control

The outcome of the deal is likely to involve some degree of transfer of security and/or controls between the client and the vendor or between the incumbent vendor and their replacement. Obviously this transfer can create a risk of loss of control or reductions in the effectiveness of the security functions (either permanently or temporarily). In addition, the location and storage of data may need to meet regulatory or legal requirements and this must be fully understood prior to the completion of any deal.

Therefore negotiation of a clear commitment that the vendor's solution for security, control and data management meets the necessary requirements is key to de-risking the deal. In addition, a clear understanding of the transition and transformation plan relating to these security aspects is equally important.

The scope of this activity can cover controls across personnel, policies, standards, physical security and technical security.

Transition and transformation planning

A critical element of the commit phase is to agree a well structured approach to transition and transformation planning that is acceptable to both parties.

The vendor's transition and transformation plans must be closely scrutinised during this phase. This scrutiny must look at the achievability of the plans alongside the dependencies with the client's plans and constraints. However, the detailed plans must also be analysed from a commercial perspective to ensure that milestones are aligned to proposed payments and related terms of the deal.

These areas will often form a major part of negotiations as the client and the vendor seek to define an approach and plan that is acceptable for both.

Deloitte Accelerators and Tools

- **3rd Party Contracts Methodology and Templates**

  The process of identifying the impacted 3rd party contracts and gaining the necessary consents and novations is often on the critical path and carries commercial risk. Deloitte's repeatable methodology reduces the timelines, effort and risk of this exercise.

- **Negotiation Plan Templates**

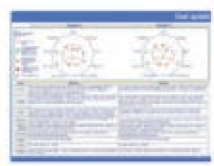
  Deloitte's negotiation plan templates will facilitate the process of defining a negotiation plan and provide the long list of potential negotiation levers.

- **Negotiation Tracker**

  The negotiation tracker enables the deal team to keep a detailed account of the negotiations both for use during the process and as part of the deal audit trail.

- **Stakeholder Management Templates**

  Deloitte's templates provide proven formats for presenting deal characteristics to senior stakeholders and facilitating the decision making process.



End of phase checklist

✓ **Signed contract:** The core outcome of the Commit Phase is the signed contract with the chosen vendor.

✓ **Signed-off people transition plan:** The people transition plan should be aligned with the outsourcing agreement's transition plan and comply with applicable legal requirements.

✓ **Signed-off retained organisation design:** The retained organisation will often need to be established immediately after (or even before) contract signature.

✓ **Signed-off value delivery roadmap:** The roadmap will be used throughout the life of the contract to monitor progress against the delivery of anticipated value and support the initiation of any necessary corrective action.

✓ **Completed consultations:** In many cases consultations with unions and/or works councils must be complete before a deal can be signed.

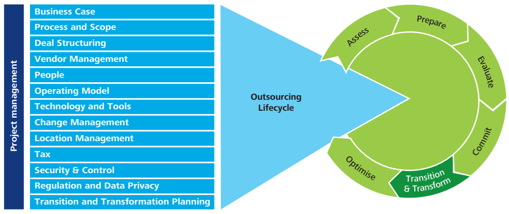
Phase 5 – Transition and Transform

This section describes the Transition and Transform phase of the Outsourcing Lifecycle, focussing on transitioning the work and resources (infrastructure and responsibility) to the selected vendor(s) and effective stakeholder management to ensure optimised value.

The phase includes implementing a robust transition plan with the vendor(s) and implementing a reporting mechanism to track value.

Moving to the new contract

Phase 5 – Transiton and Transform



Phase 5 > Transition and Transform

Aims and objectives

The objective of this phase is to transition the work and resources (infrastructure and responsibility) to the selected vendor(s).

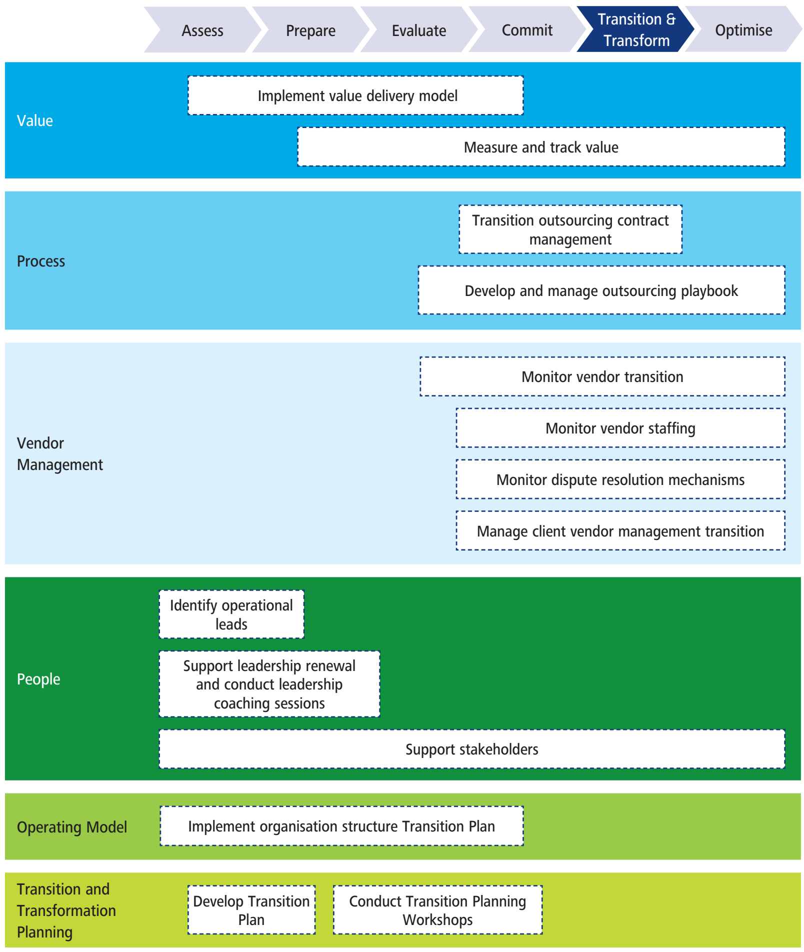
This is the phase where the ‘rubber hits the road’. The value realisation of the program is initiated during this phase and emphasis is put on process implementation, project/programme management and knowledge transfer.

Teething problems are expected to be resolved during this phase. The programme should have a strong, streamlined escalation mechanism to resolve them quickly and keep the ball rolling. Another key pre-requisite is stakeholder commitment to the programme.

Overview

This phase has key tasks around transition and transformation in every work-stream:

- Implementing a robust transition plan in collaboration with the vendor
- Planning and implementing a retained organisation re-design so that the key staff are retained and they know their future role in the organisation
- Developing and implementing an integrated playbook/standard operating procedures that clearly identify the operating model, governance framework, service levels, decision rights matrix, and roles and responsibilities
- Practical and open communications and change management to ensure that the organisation understands the plan and the impact
- Implementing the measurement and reporting mechanism to track value consistently to understand variations from the business case and take necessary action
- Overall project/program management that ensures stakeholder and organisation wide commitment, risk management, and status reporting



The objective of this phase is to transition the work and resources (infrastructure and responsibility) to the selected vendor(s).

Activities

Business case

A value delivery roadmap will document how and when value will be delivered and demonstrate how the total value of the business case will be achieved. This plan will clearly identify the initial investments required and the value that will be delivered over the term of the contract. Based on the deal the value model will be updated to input year-on-year improvements that the vendor(s) have agreed to.

Implementation of the value delivery model essentially includes getting approval of the value roadmap with the senior management, vendor management team and finance, creating a reporting mechanism to measure and track the value being generated and identifying roles and responsibilities of the various teams going forward.

Once the delivery model is implemented, key performance measures as identified in the model would need to be tracked and reported in a consistent manner. This will include creating reports in a timely manner. During the transform phase issues and exceptions are expected in this process and it is important to resolve them to stabilise the data gathering, reporting and exception handling process. Any customisations to the process or the reports should be identified in this phase. At the end of the transform phase, it is expected that the process of measuring, reporting and tracking of value is stabilised.

Process

The leadership teams on the client and vendor side jointly develop the transition plan to provide a guide through the different steps involved in the transition. The plan will typically identify the following steps:

- Pre transition activities such as ensuring any IT, HR, Logistics issues are resolved
- Knowledge transfer activities such as conducting meetings with all SMEs to understand the operational details in delivering in-scope services to the business
- Ramping up and training activities for onshore and offshore resources
- Stabilisation activities of running test scenarios
- Parallel run to ensure that transition is complete and successful

The contract, approved and signed in the Commit phase now enters the operational phase. The outsourcing contract management is transitioned to the Vendor Management Office (VMO) for operational management. A steering committee consisting of business leadership is formed to oversee the VMO activities. The VMO is responsible for ongoing monitoring and reporting of risks/issues and status and governance reports on a regular basis to the steering committee. Various roles are identified within the VMO to effectively manage the contract. These roles include a transition manager, work stream leads and work stream SMEs.

Transition of knowledge and work is very important to the project's success.

People:
In this phase the interaction between the client operational team and the vendor(s)' team is initialised. This interaction will be the basis of a long term successful partnership. It is important that leads from the client and vendors' are clearly identified to create a strong framework of collaboration. The vendors typically tend to deploy transition experts to manage this phase and then replace them with operational leads at the end of transition.

Transition of knowledge and work is very important to the project's success. It is important to plan for the transition process to ensure the transfer of knowledge is exhaustive. The transition plan is created jointly between the client and the vendor leads. The workshop provides a collaborative mechanism to discuss specific needs, identify areas that need additional focus and risks that need to be mitigated.

As part of this transformation of the organisation, the leaders of the client organisation need to renew their support to the cause and communicate the change to the organisation. Along with regular communication and change management, it is also important to conduct leadership coaching sessions to educate the leaders about the new structure, dynamics of vendor management, governance of the new model and provide tips on extracting the maximum benefit from the model.

Vendor management:
This step begins once the transition of contract management to the Vendor Management Office (VMO) has started and continues throughout the transition phase. The VMO monitors the knowledge transfer processes, documentation during the knowledge transfer, training and shadowing sessions.

The vendor reports the transition performance through regular transition performance reports to the VMO.

The VMO monitors vendor staffing plans and implementation to ensure the level and experience of the resources being staffed are as agreed upon.
In addition, the VMO will monitor to ensure that the staffing ramp up is able to meet the service delivery goals. The VMO will continue to monitor the vendor staffing throughout the service delivery.

Additionally the VMO provides an escalation mechanism for dispute resolution. The issue resolution governance will typically span from the project managers, on both client and vendor side, to the steering committee.

The areas of vendor management are defined during this stage and can consist of various departments including Demand Management, IT, Service Management and Supply Management. Each of these departments work with the vendor in their respective areas to ensure the service delivery is smooth. For example in a typical IT service delivery organisation these departments would perform the following roles:

- Demand Management manages all interactions with business (corporate and regional); owns requirement analysis, budget approvals and user acceptance;

- Service Management manages day-to-day vendor interactions for both steady state operations and projects and is accountable for service delivery

- Supply Management leads sourcing and procurement to create new/change vendor contracts; manages contractual disputes; interfaces with legal

- IT manages vendor relationships; provides vendor governance; operationalises vendor contracts; tracks vendor financials; manages vendor performance, adherence to agreed service levels; and facilitates resolution of vendor related issues

During the Transition phase service management and IT will be the most active in order to reach a steady state.

Operating model

As part of any outsourcing deal, it is expected that a large portion of the responsibilities will be shifted to the vendor's organisation. The client organisation will reduce to a smaller team who are responsible for management, leadership and governance. To accommodate the new set of responsibilities in the client organisation, a revised team structure will need to be implemented. This new structure will include client team members in critical leadership and management roles and could include vendor personnel in more operational roles. It is important to structure the team that facilitates collaboration and innovation while ensuring commitment to performance measures.

Project management

Depending on the size and complexity of the outsourcing agreement, managing the transition could be extremely challenging. In addition to standard project management tasks the Project Management Office has the critical role of facilitating communication and aligning the work streams. A dedicated team is required to manage multiple vendors, multiple client teams, client leadership, stakeholders and functional leads so that they work in a cohesive and collaborative way.

End of phase checklist

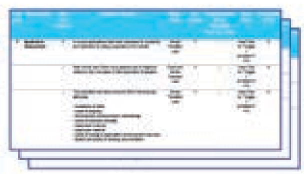
- ✓ **Outsourcing play book is complete.**
- ✓ **VMO team is in place.**

Deloitte Accelerators and Tools

The Transition Assurance Toolkit
This provides a framework and checklist for undertaking Quality Assurance (QA) on the transition phase of an outsourcing engagement together with an automated reporting dashboard.

Support is provided for the different modes of transition (e.g. vendor – vendor, client – vendor and vendor – client) and the full scope of transition activity (including both application and infrastructure outsourcing).

It has been designed to help provide programme assurance on the work being performed by a vendor rather than act as a replacement for a vendor's methodology or plans. The focus is on key outcomes and providing insight based upon good practice and experience in each area of a transition.



Lifecycle stage	Potential pitfalls	Lessons learned
Transition and Implementation	• High staff turn-over rates leading to loss of continuity, experience and knowledge • Vendor staff are poorly trained and of insufficient quality • Little control over vendor human resource management processes and approach • Poor communication mechanisms between on and offshore elements hampers successful delivery	Create and monitor onshore Vendor Management Offices and functions with key stakeholders.
Vendor Management	• Poor governance structure for managing outsourcing relationships • Poor management of the ongoing relationship with key Service Provider(s) to ensure satisfaction after e.g. loss of major bid • Service levels not measurable, do not provide means for action, and are not monitored on an ongoing basis • Intellectual property issues and loss of institutional knowledge • Loss of flexibility to react to changes in the market (e.g. competitive, regulatory) as a result of being locked into multi-year deals	Manage and document knowledge transfer as transition continues. Contract clauses for periodic SLA review and contract renegotiation based on service levels.

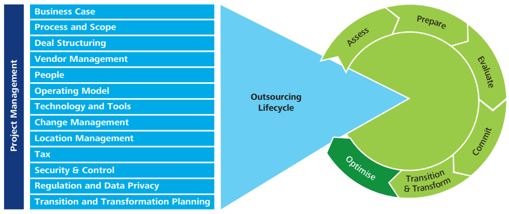
Phase 6 – Optimise

This section describes the Optimise phase of the outsourcing lifecycle which focuses on the steady-state operation of the outsourcing arrangement after the Transition and Transform phase has been completed. Within this phase clients need to focus on managing the vendor relationship, monitoring contractual obligations as well as tracking the vendor charges against the original business case.

By its very nature, Optimise is very much an operational responsibility which continues throughout the duration of the contract until the contract renewal, renegotiation or exit.

Managing the new contract

Phase 6 – Optimise



Aims and objectives

The Optimise phase focuses on those activities that ensure the outsourcing arrangement is managed and continuously improved beyond transition and transformation. The focus is not only on management of the vendor but also includes looking inward into the client's organisation to ensure that contractual obligations are fulfilled in a timely and effective way and that service demand is properly managed and satisfied.

The phase also includes the preparation for the renewal (or in some cases exit) of the contractual relationship.

Key principles

- Continue to **measure benefits realisation** against the original business case
- Ensure continuing review of pricing to ensure that the right behaviour is being demonstrated
- Review and **manage service performance** and ensure all contractual obligations (client and vendor) are effectively managed
- **Conduct service audit and benchmarking** and assess and implement IT improvements in accordance with the innovation process
- Monitor and **review security arrangements** and ensure that any changes in the legal and regulatory framework are tracked
- **Manage service provider risk** whilst effectively governing and evolving the vendor relationship
- **Ensure documentation is maintained**
- **Rapidly address and resolve disputes and issues**

Overview

Following the transition and transformation of services, it is important to focus on the conditions under which the arrangement can flourish and services and costs can be optimised.

Realisation of a projected outsourcing business case requires sustained commitment and effort to manage the vendor, rigorously track and manage projected benefits and build strong internal understanding of the service scope, pricing and obligations. Key activities to support this include:

- Operationalising the agreed governance model and setting conditions for a strong, mutually rewarding relationship
- Internally agreeing a strong, appropriately empowered function to manage business demand and vendor supply
- Providing the focus and resource for dedicated, sustained 'benefits realisation' activities
- Building an experienced, commercially-focused team to contract-manage the client and associated vendor rights and obligations
- Investing time, effort and sponsorship in innovation management to ensure improvement and transformation objectives are pursued after signature

Frequently once the 'ink is dry', commitment to these activities falls away and expectation gaps begin to open – leading to self-feeding cycles of client criticism and vendor defensiveness. Such behaviours can needlessly undermine the deal's objectives.

The Optimise phase focuses on those activities that ensure the outsourcing arrangement is managed and continuously improved beyond transition and transformation.

Looking further along the contractual term, regardless of current performance, clients need to plan and prepare for next steps, ranging from tactical remediation work to mid-term renegotiation or even to a full re-tender process at the end of the term.

During the Optimisation phase, it is important to keep a focus on the demand of IT services from the business. The contract is responsible for ensuring the correct price is sought in the P*Q model however robust demand management is required to manage that quantity utilised.

This is done through the retained organisation using such processes and levers as:

- Linking IT consumption to IT cost so the business has a transparent view of the implications of their consumption decisions
- Managing business expectations
- Project manager challenge process during the receipt of quotations from the vendor during service request management
- A clear forecasting processes

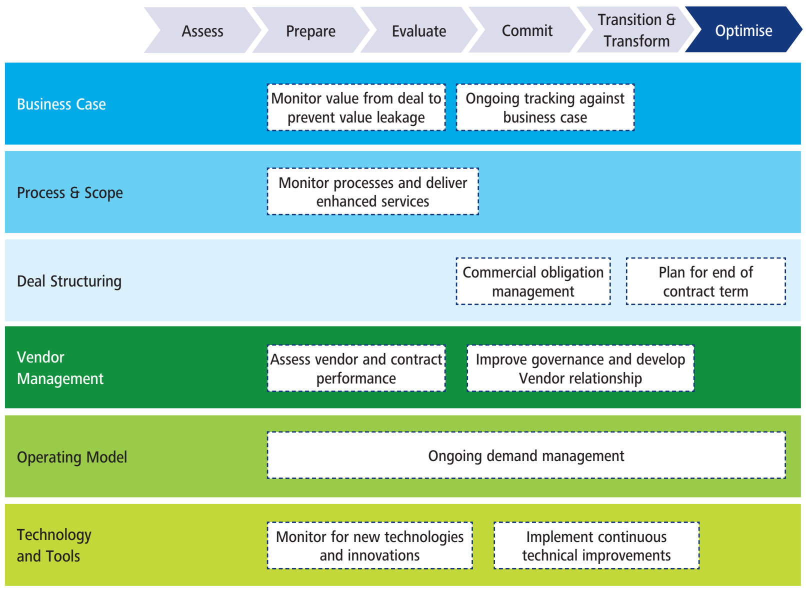
Vendor Management

Key to ensuring the contract performs against objectives is a functioning, efficient governance model and strong senior relationships. Achieving this can be challenging but critical success factors include:

- Ensuring senior interactions and meetings take place regularly and at least as per contractual commitments
- Ensuring interactions focus on the right things, through good preparation and appropriate inputs and facilitation to ensure clear, fair and informed decisions are made

Key activities

The diagram below summarises the key activities of this phase.



During the Optimisation phase, it is important to keep a focus on the demand of IT services from the business.

Well-designed performance monitoring is an important part of this phase and the implementation of a balanced scorecard approach which monitors a broad range of performance indicators is good practice. This may include:

- Customer satisfaction (formal and informal, e.g. via a survey)
- Service delivery performance (i.e. via traditional SLAs)
- Relationship alignment (e.g. via annual senior interviews)
- Transformation progress and other client strategic and operational objectives

Operating Model

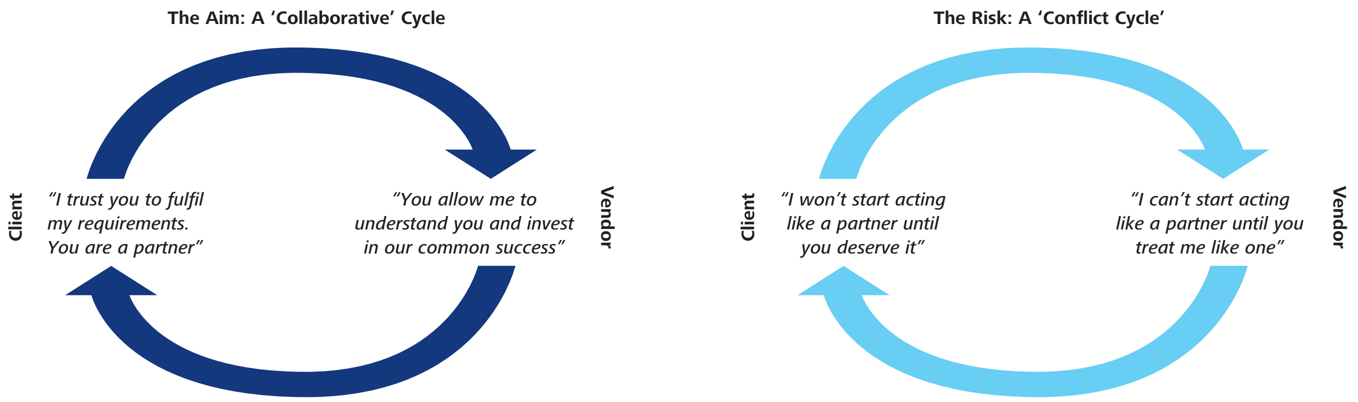
Although cost reduction is not always an explicit primary objective most outsourcing deals nonetheless seek to reduce costs for particular services. Whilst well-constructed deals can help address the supply side of such service provisioning, our experience is that neglecting the quantity and nature of underlying demand risks compromising business cases and can erode savings.

A specific example of this from an outsourced IT contract could be when a projected business case assumes a shift from physical to virtual servers as part of a transformed service but in practice internal clients continue consuming physical servers. In such a scenario a demand management process would include review gates to check the validity of client requests and a sensitively designed challenge step to push-back on such requests, suggest different approaches and articulate the benefits to the business of alternatives.

Additionally, although direct contact between the vendor and the internal clients may appear beneficial, vendors consistently attempt to create a privileged position directly with business clients. More often than not these privileged positions lead to an excessive supply of services beyond the projected business case.

As in any type of relationship both client and vendor have a responsibility to work together to achieve the deal's objectives.

Figure 6.1. Establishing the right 'feedback loop'



What happens when optimisation is ignored?

Underinvesting in the Optimise phase risks the gradual deterioration of the arrangement over the term, for example because value is not realised or commercial obligations are missed. Alternatively, even where financial performance is good, unaddressed negative perceptions within business customers can cause issues. in our experience, many clients expect that once the contract is signed the vendor will get on to deliver the benefits with limited client oversight.

Example situation
A large insurer outsourced their Application Management Services to a global vendor. During the first 2 years of transition and transformation, the client organisation robustly managed the vendor to ensure obligations were upheld, benefits were tracked and value driven from the arrangement.

Over time however, the business' focus shifted toward working with new providers to develop new applications to support new processes. This shift in management focus reduced the quality of oversight on the existing contract and less robust commercial management subsequently allowed the vendor to sell a license for a major Life Insurance platform to the client at what seemed like a 'bargain' price. Once development work commenced, it was quickly realised that the Total Cost of Ownership (TCO) was significantly higher than was expected based on the low 'sticker price'.

Business case

A key management tool of any deal is a mature benefits tracking approach. In a multi-year contract, achieved benefits are likely to differ from projections for any number of reasons but active benefit tracking will enable the source of such differences to be understood and articulated and should enable 'value leakage' to be identified and remediation plans against deviations to be developed.

Along with retention and maintenance of the original business case, it is fundamental to:

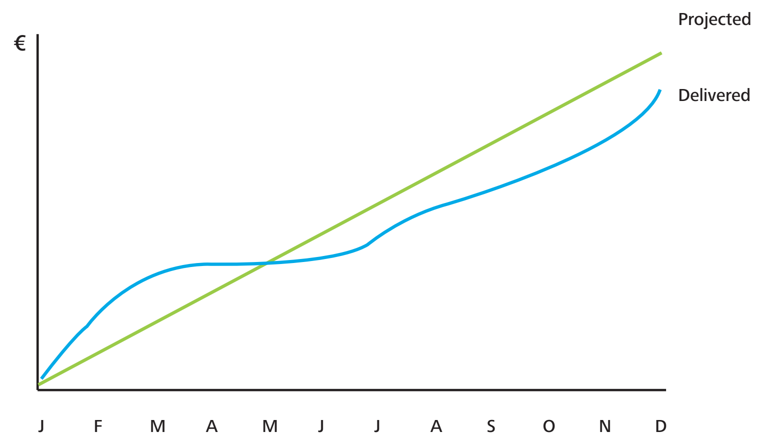
- Implement a robust invoice verification process and seek to manage by exception non-verified spend
- Regularly audit and update inventory records and compliance to inventory obligations
- Properly verify foreign exchange and cost of living adjustments

Other financial processes that must be considered include:

- Forecasting and budgeting (along with demand and supply management)
- Internal allocation and chargeback processes based on actual consumption rather than historic or other types of algorithms

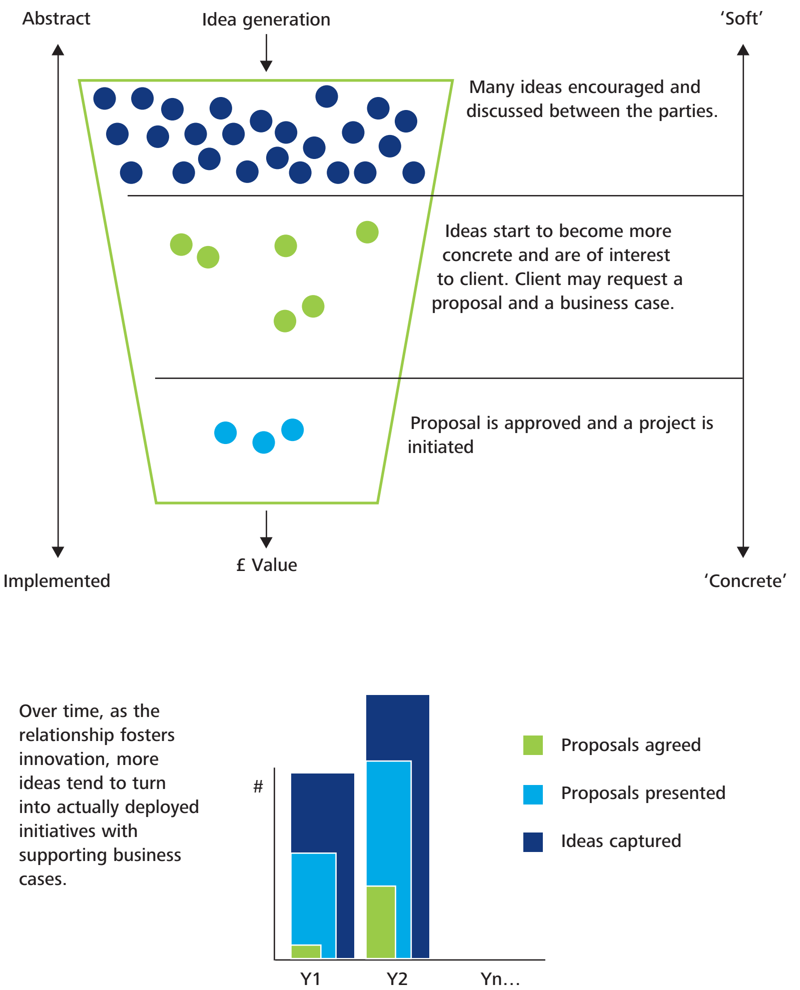
Figure 6.2. Benefits tracking report

Benefits should be tracked on an ongoing basis to determine the success of the arrangement and status should be reported to senior management



Underinvesting in the Optimise phase risks the gradual deterioration of the arrangement over the term, for example because value is not realised or commercial obligations are missed.

Figure 6.3. Innovation management process



To encourage ideas any administrative overhead around submission and review needs to be minimised to enable good but immature ideas to be investigated.

Process and Scope

Innovation is often a victim in outsourcing arrangements. Once an arrangement is ongoing and the focus is on meeting contractual transformation objectives or steady state delivery, any initial impetus around ongoing innovation may subside.

However a lack of internal innovation is often an underlying driver for outsourcing in the first place as clients are looking to benefit from the scale and research and development capabilities of a new service vendor. De-prioritising innovation therefore undermines the long-term value of a deal.

To avoid missing out on innovation opportunities, clients should recognise its importance by instituting processes to incentivise, capture and sensitively review innovative thinking, for example through facilitated forums where ideas can be presented.

To encourage ideas any administrative overhead around submission and review needs to be minimised to enable good but immature ideas to be investigated. That said, innovation can still be encouraged within a four phased structured framework:

1. Idea generation: Large numbers of ideas generated for discussion

2. Formulation: Ideas are formed into more concrete potential solutions and may even be presented at forums

3. Proposal submission: Well-formulated ideas are documented in a structured way that enables comparison and financial evaluation

4. Realisation: Approved proposals are translated into projects and actions, accompanied by tracking of the benefits

Ideally this process should be made explicit and enshrined in the process. Management of this process should be assigned to a specific governance body, linked to the commercial and contract management function.

Deal Structuring

As an outsourcing deal moves through its term, operational and contractual requirements evolve and changes to the arrangement are likely. Such evolution needs careful commercial management to ensure the true, long-term implications of changes are understood.

Strong, experienced and sophisticated contract management is a must. Good contract management recognises that benefits must accrue to both the vendor and client and that negotiation is not always 'zero-sum'.

Contract management scope must include the following:

- Managing and tracking client and vendor obligations
- Managing contract compliance
- Maintaining a contract library for contractual documentation
- Providing contract interpretation and advice
- Signing off of all key decisions and formal correspondence
- Identifying change requirements and managing the contract change process

Ideally all commercial discussions should be reserved for the commercial team and all agreements should be documented, signed-off and logged in a contract library. In our experience, a relaxed approach to commercial management governance has resulted in major issues for clients ranging from simple disagreements to complex disputes for delayed or non-delivery and disrupted services.

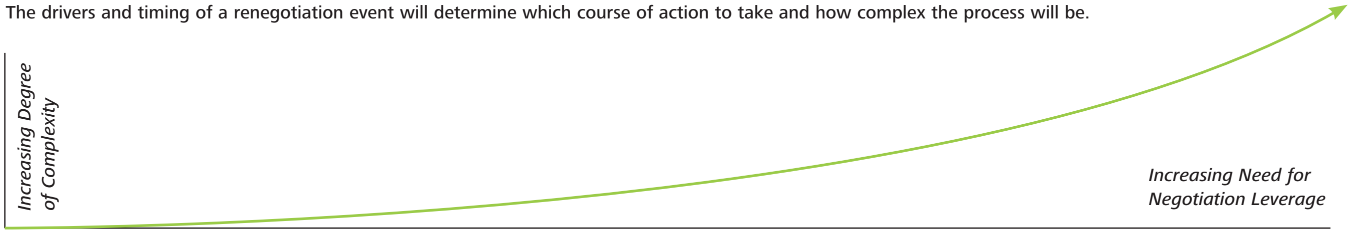
Long-term planning and preparation for the next steps is a critical activity. As the contract progresses towards its natural expiry date. However well a vendor has delivered the projected benefits of a contract, a new contract will almost always make sense because of:

- Opportunities to improve pricing
- Desire to increase service performance
- Change of requirements/demands from the end customer

End of term contract renegotiation and/or re-tendering of contract scope are now becoming more the norm rather than the exception. However most such activities still end with the incumbent vendor retaining key elements of the evolved contract in some shape or form.

Figure 6.4: Next step alternatives

The drivers and timing of a renegotiation event will determine which course of action to take and how complex the process will be.



Remediation	Restructuring	Renewal/Re-tendering
• Aimed at resolving specific issues that may exist in a relationship or the provision of services • Focused engagement with incumbent provider • Work between the parties involved • Should be mutually beneficial • May or may not entail a change to contract terms	• Wider scope engagement that is typically mid term • Client needs to fundamentally change the shape of the deal to support a change in business strategy or eliminate major issues • Aimed at changing the scope, level and/or price of the services	• Driven by expiration of existing contract or breach • May or may not be competitive but likely to involve a completely refreshed contract • Incumbent provider typically expected to retain some or all of the existing scope... • ...*however,* clients are increasingly using this as an opportunity to introduce additional providers into the mix

Renegotiation, as distinct from re-tendering, can be perceived as applying less pressure to an incumbent vendor. However thorough, long-term preparation can reveal significant client leverage, such as internal profit and loss pressures within a vendor. Therefore, in some circumstances, an effective renegotiation can deliver a similar return as formal re-tendering.

Figure 6.5. Preparing for a renegotiation

Develop clear understanding of 'As Is'

Change business case and negotiation approach

1 Relationship drivers
- Strengths and weaknesses of incumbent supplier
- Quality of delivery: Perception and reality
- Governance shortcomings
- Assess future of the relationship

2 Financial Review
- Review original business case and updated projections
- Assess changes in volumetrics
- Pricing – level and degree of variability
- Benchmark prices

3 Contractual Check Up
- Determine contractual rights and obligations and supporting information
- MSA, statement of work, service level agreements, pricing
- Compare existing contract to current market
- (Forensic) review of performance over the term
- Audit service provider

4 Assess Risks
- Willingness to continue with incumbent supplier
- Willingness to change service providers
- Transition risks and preparedness
- Leverage or lack thereof:
  – Feasibility of changing service providers
  – Feasibility of re-directing work away from incumbent supplier

The importance of optimisation

Implementing and effectively managing the optimisation activities outlined in this section will increase the likelihood that the projected benefits of the arrangement are realised, resulting in greater satisfaction amongst the internal customers and a greater likelihood that financial benefits and expectations are realised.

Figure 6.6. Qualitative benefits of good optimisation

Intangible measures of added value

- Customer satisfaction
- Delivery of value-add projects on time and on budget
- Quick response time
- Innovation and thought leadership
- Resources freed internally to do other work

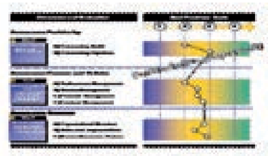
Annual contract value

Poor relationships destroy value

- Resource waste due to inability to trust/ delegate
- Greater need to monitor/audit
- Frequent conflict escalation
- Low internal customer satisfaction
- Ineffective execution and follow-through
- Decisions made based on limited information

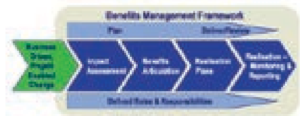
Deloitte Accelerators and Tools

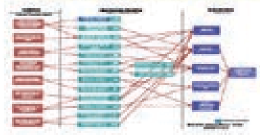
- **Outsourcing Maturity Diagnostic**
  The tool conducts a 'health check' of the contract management organisation to determine gaps, assess maturity and recommend improvements



- **Benefits Tracking Realisation**
  Our approach to benefits management is based on five key stages:

  1. Identification of a requirement for change
  2. Impact assessment
  3. Benefits identification
  4. Benefits realisation planning
  5. Continued monitoring and reporting





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Outsourcing advisory services methodology

Project Management

Manage and monitor project plans, quality, budget, issues and risks, project communications and resourcing

	Assess	Prepare	
Business Case	Understand client's business strategy and issues and begin to define business case and value targets	Build financial model, and define value opportunities and scenarios	Review suppl them; refine b
Process and Scope	Determine process and/or services, assess customer need and perform internal assessment	Define the target processes or services, build service descriptions	Evaluate supp defined servic
Deal Structuring	Develop and market-test deal pricing and contract principles, and assess deal risks	Define and structure components of deal	Refine deal pr
Vendor Management	Identify business objectives, assess market and sourcing options and define sourcing strategy	Prepare RFI/PQQ, refine vendor shortlist and develop RFP/ITT; set up vendor management function	Conduct vend responses and
People	Identify stakeholder groups, assess leadership and develop capability transfer strategy	Prepare stakeholders and leadership and develop capability transfer programme	Initiate stakel design HR pro capabilities
Operating Model	Assess as-is organisation and governance structures	Define target operating model and to-be organisation structure	Develop orga and design go
Technology and Tools	Assess existing IT systems, infrastructure and support organisation and define conceptual technical architecture	Confirm in-scope systems and infrastructure, develop requirements and design support organisation	Evaluate tech and analyse g solutions and
Change Management	Develop change management strategy and plan	Develop communications plan and end-user learning strategy	Implement ch plan and desi plans and per processes
Location	Assess locations and define location strategy	Define location specification requirements and develop property decommission plan	Evaluate loca management
Tax	Perform cost benefit analysis for tax profile	Develop alternate tax structures and identify tax assessment criteria	Develop optin identify addit
Security & Control	Review and assess security architecture	Define security requirements	Evaluate secu systems and c
Regulation & Data Privacy	Review and assess regulations and data privacy constraints	Define regulatory and data privacy requirements	Evaluate regu specifications
Transition & Transformation Planning	Assess organisational planning standards and constraints	Define **high-level** transition and transformation plan and related requirements	Evaluate venc transformatio

Evaluate	Commit	Transition & Transform	Optimise
iers bids and evaluate business case	Analyse "BAFO", build benefit tracking model and begin measurement	Track financials along "T&T" milestones	Manage business case and cost models
pliers' submissions against ce descriptions	Contractualise and agree end to end process and/or services	Deploy and manage process and/or service transition and transformation	Monitor process and/or services delivery and enhance
ricing and commercials	Complete deal commercial negotiation	Transition contract management and prepare for deal operations	Assess service delivery against commercials and optimise deal
dor Q&A, evaluate vendor d select preferred vendor	Negotiate and execute contract	Manage transition and outsourcing deal and establish the vendor management function	Assess vendor and contract performance
holder communication, ogrammes and transfer	Support stakeholders and leadership, transfer capabilities and develop HR systems	Plan and deliver communications to support transition activities and transfer capabilities	Assess stakeholder communications and finalise HR enrolment
nisation transition strategy overnance structure	Finalise organisation design and develop migration strategy	Manage transition to and transformation of new organisation	Perform organisation effectiveness reviews
nical solutions proposed gap between vendor client specification	Agree target architecture and implement support organisation	Transition and transform in scope systems and monitor support strategy	Assess and implement IT improvements
ange management gn workforce transition rformance management	Deliver end-user learning and implement performance management system	Implement workforce transition blueprint and transition related HR policies and processes	Monitor end-user learning and update communications plan
tions and facilities	Finalise location preference, operating environment and prepare logistics	Transition to and transform locations and manage property decommission plan	Monitor locations
mal tax structure and ional tax implications	Confirm optimal tax structure	Assess tax cost migration and design intra-group transfer pricing policies	Monitor tax law changes impacts
rity specifications, plans, organisations	Confirm security architecture, systems and organisations	Monitor security key performance indicators and testing	Monitor security continuous improvement plan and automation opportunities
latory and data privacy , plans and systems	Confirm regulatory and data privacy architecture and systems	Monitor adherence to regulations and data privacy specifications	Monitor regulatory changes and data privacy continuous improvement plans
dor transition and on plans	Validate and agree detailed transition and transformation plans and align to deal structures	Implement and monitor transition and transformation plans	Monitor continuous improvement plans of vendor

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