The Art of Contract Renegotiation

What happens when the contract winds down? A lot will depend on how you set up the terms the first time around.

By Paul Davies

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The last thing a buyer wants to think about when closing his long agonized-over HRO deal is what happens when the contract runs its course and round two begins.

The length of most big transformation contracts virtually guarantees that the folks in charge of renewal are not the same ones who negotiated it to begin with. So, after 5 to 10 years, the original crew are usually dug in at a safe distance watching the new lot fight with a pile of issues that didn't have to be there.

It takes broad shoulders to take on someone else's battles at the precise time when no credit will be accorded for doing so. But, that's just the kind of responsible, far-sighted team players found lighting up the HRO space: directors with long-term, strategic insight who know what the business will require a decade ahead of time. And in case not, one has to hope that the purchasing professionals dig in their heels sufficiently to insist that the first deal guarantees a competitive rebid.

The problem is, of course, that once the work has been outsourced, the related systems, technology support, people, knowledge, and skills tend to disappear from the buyer organization. At the same time, service delivery becomes dependent on the people, technology, and processes of the provider, and it's important to make sure that the dependency isn't provider-specific.

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For example, even with the best will in the world, few actually achieve "vanilla" HR systems. Many go with "best of breed" and would more than like to admit that their systems are plum for extensive "bespoke" modifications. The question is, what happens with those modifications if the contract is awarded to a new provider? We might not be talking just about a pensions calculator but rather the whole gambit of HR services for a multinational company.

Who owns the modifications? How is the migration to be managed in case of a change of application? And while we're stirring up the pot, how about the question of who owns the systems documentation? And on that note, who owns the process documentation, especially when providers are running "black box" services based largely on their own administrative processes, case management, and quality controls?

Dependency considerations affect people as well as systems and processes. Buyers who outsource in Europe are relatively familiar with the need to transfer their own staff as part of the deal. However, where a contract changes hands, there may be a requirement for the current provider's staff to transfer to the new provider. Or, of course, where the buyers wish to in-source the work, they are faced with the prospect of their ex-employees returning to the company.

As in a regular outsourcing deal, the buyer re-negotiating is interested in a full due-diligence investigation. However, the current provider does not have the same incentive to cooperate.

Similarly, a first-time buyer might have an interest in some of his own skilled and knowledgeable people joining the provider to help ensure the success of the outsourcing. A provider about to lose 10 years' worth of business has an incentive to move as many talented people as possible onto other accounts. This kind of issue is more of a concern in European jurisdictions, where transfer of people is legally mandated but not exclusively so. The transfer of key human resources is always a material issue.

Agreement and clarity around these kinds of areas can be as essential to a successful renegotiation round as to an actual change of a provider. Inertia exists whenever an outsourcing contract comes up for renegotiation, and this benefits the incumbent. However, if the inertia is of such intensity that it virtually precludes a change of provider, the negotiation itself is compromised.

The advantages of a competitive sourcing process can only be realized if there is a realistic chance that a new provider can successfully take on the business. For this reason alone, it is essential to pay attention the first time around to how the renegotiation issues should be handled. And if it ever came down to actually changing the provider, these issues could quite genuinely be the difference between success, survival, or disaster. HRO