Preventing Value Leakage in Outsourcing Contracts

Outsourcing provides client organizations access to a broad range of specialized technical skills, the ability to control and manage operating costs, and the realization of improved efficiency, speed and agility to deliver services. However, studies indicate that the ability to sustain high value realization over the complete life cycle of the outsourcing agreement is a major challenge.

For example, during the initial transition and transformation activities, the focus is on contractual terms, conditions, and pricing. As the relationship matures, the client and the provider must shift their focus to factors impacting operational effectiveness and relationship management if they expect to minimize value leakage and realize the full benefits of outsourcing.

There are a number of forms of value leakage in both government and private sector contracts. One form of value leakage is the inability to achieve efficiencies through key operating metrics and service level agreements. Another example is nonperformance in innovation deployment and in the use of emerging technologies. A third example is non-compliance to regulatory requirements or agency expectations resulting in the inability to support goals and objectives.

Additionally, value leakage may begin to occur when contractual terms become unworkable because of industry or regulatory changes or as a result of operational challenges caused if the client fails to fully leverage the provider's talent.

Providers may cause value leakage by transferring key resources to new opportunities outside of the client organization. Value leakage may also result from relationship challenges where unresolved cultural differences get in the way of effective communications and operational goals.

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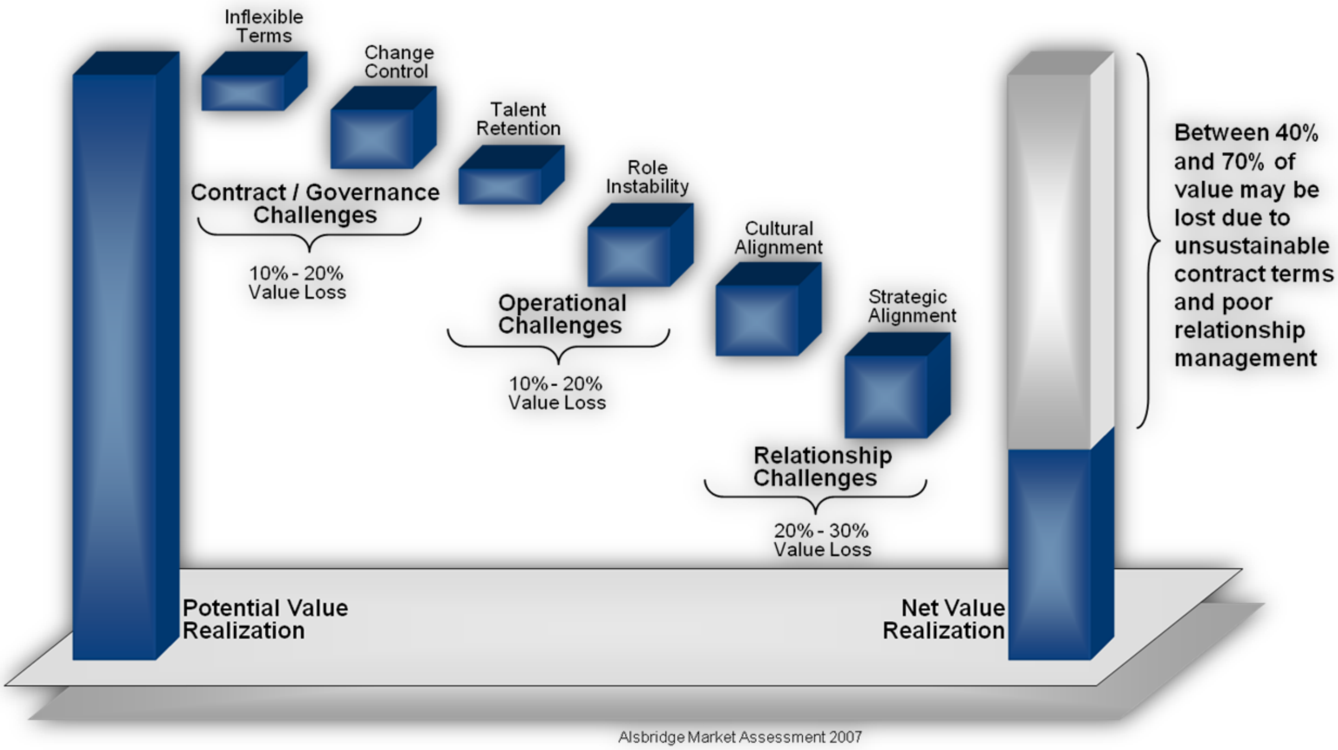
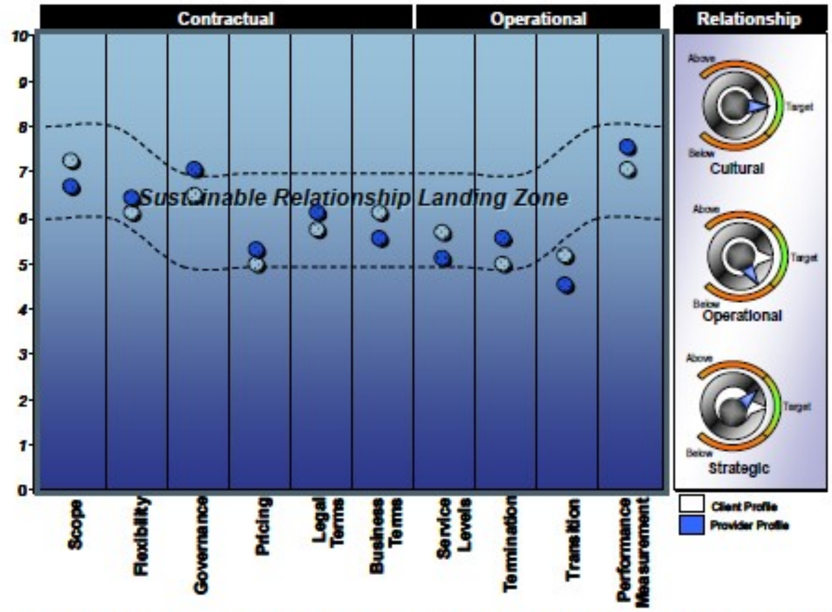


As represented in the graph above, many factors can cause value leakage. Alsbridge research shows the loss is typically in the range of 40 to 70 percent of the original business case.

Stopping value leakage carries with it a huge return. If issues surface early and regularly, and have an underlying fact-based diagnosis, then the agency and provider are able to address issues, remedy the situation and avoid costly and laborious interventions. There are several signs of value leakage that client organizations should assess:

- Lack of fact-based information for resolving issues between the agency and the provider
- Contractual terms and governance processes that don't fit current operating requirements
- Questions surfacing about the wisdom of the sourcing strategy or original rationale for the sourcing decision
- Provider or service center status reports showing green but the relationship still feels red

Much can be done to manage and minimize value leakage. As the graph on the following page demonstrates, the consistent application of assessment processes and tools can indicate to the client and provider where they are in agreement and where gaps are appearing that contribute to value leakage. The process demands discipline on both sides and willingness to benchmark contractual, operational, and relational factors over the life of the agreement.



- Contractual Best Practice
- Market Competitiveness
- Value Leakage Root Cause
- Realignment of Expectations
- Fact-Based Output
- Repeatable Process
- Actionable Plan
- Value Realization

The graph above is an output of Alsbridge's proprietary Market Reality Assessment (MRA)© tool for Value Leakage Assessment.

Clients and their providers should consider four key strategies to optimize outsourcing value realization:

1. Agree on a multi-dimensional approach and a set of tools to consistently assess the value exchange and relationship from its inception and at key milestones along the way.
2. Establish a fact-based, repeatable reporting mechanism that goes well beyond traditional service level agreement (SLA) dashboard reporting to underlying issues (e.g., contractual metrics).
3. Be consistent, open and conscientious in focusing on critical contractual, operational, and relational factors that are draining away potential value.
4. Apply tools and share results cross-functionally to drive out silo thinking at multiple levels of the organization and to eliminate points where pain is being created.

By monitoring and preventing value leakage throughout the duration of the contract, both the client and provider can better serve users of the services and keep costs to expected levels while continuing to improve service performance.

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