Sole–Source Outsourcing

Ensuring a Successful Outcome

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Introduction

As companies look for ways to streamline the outsourcing process, a range of reasons may make sole sourcing a viable, cost- and time-saving option – if applied wisely.

Sole sourcing is the practice of working with a single service provider to define, negotiate, and purchase services. Traditionally, buyers employed sole sourcing to deliver a simplified, faster service acquisition process, with fewer of the difficulties of staging and reviewing a multi-provider process. Today, the use of sole sourcing is most often a function of the trust that exists between a buyer and service provider. As buyers of outsourcing services look to limit the proliferation of service providers with whom they maintain relationships, the sole-source option is becoming increasingly relevant.

Sole sourcing can deliver significant potential efficiencies over multi-provider outsourcing efforts in terms of cost for completing the process and time required to make a decision. However, a sole-source approach is susceptible to stakeholder challenges that should be addressed early on to ensure a successful outcome. Doing so increases the chance that the initiative will suit the buyer's and service provider's objectives – today and in the future.

The key is for the buyer to take responsibility for making the sole-source approach disciplined and rigorous. The necessary components of this include:

- Defining carefully the buyer's objectives and the services required
- Establishing a framework (financial and other factors) that helps both parties know when the proposed solution is acceptable
- Laying the foundation for the two organizations to productively govern the implementation and ongoing execution of the solution

By establishing such a process, the buyer provides a level of tension that drives the process to produce increased performance from both the service provider's and buyer's organizations, while also forging a productive working relationship with the service provider.

Why Sole Source?

As described in **Exhibit 1**, buyers of outsourcing services may select either a sole-source or multi-provider approach for a wide range of reasons. In many cases, the buyer has a preexisting relationship with the service provider, either through consulting efforts or existing outsourcing relationships. Indeed, it is rare that a buyer elects to pursue a sole-source approach without having already entered into some form of dialogue or relationship with a potential service provider.

EXHIBIT 1

Reasons for buyers electing either sole-source or multi-provider approaches

Sole source	Multi-provider
• Speedy process is critical • Reputation of service provider is critical • Service provider has unique capabilities, in some cases offering unique business cases (e.g., drive top-line in addition to efficiencies) or helping transform processes in a manner that delivers business value • Complexity of the potential arrangement – typically driven by the size of the deal, interdependencies with other processes, or strategic importance • Existing "entangling" alliances (e.g., service provider owns critical software or exclusivity rights) • High degree of trust between buyer and service provider in the form of preexisting relationships, either institutional or personal, often based upon proven ability of service provider to deliver results • Corporate culture favors collaborative sole-source approach • Opportunity for a broader buyer-provider alliance (e.g., cross-selling of products, managing sales channels, or providing access to technology or research capabilities)	• Services in scope are well defined within the marketplace • Focus on achieving lowest price over broader measures of value • Multiple solutions based on differing service provider strengths need to be evaluated due to insufficient ability to perform rigorous internal analysis of options • No dominant preexisting relationship guides the selection • Corporate guidelines, governmental policies, or culture dictate multi-provider approach • Change management and implementation challenges are minor • Organization is highly skeptical of any sole-source approach, thereby slowing down decisions and undermining the credibility of the process

Our research reveals that existing relationships and a desire for a speedy process are the two largest factors influencing a company to consider a sole-source approach – in fact, together they account for almost half of the decisions to consider a sole-source approach. Other less common reasons cited by companies are the limited number of service providers with the required capabilities and previous successful experience with sole-source approaches.

Interestingly for outsourcing service providers, buyers state that a provider approaching them with an attractive proposal is the least likely reason to consider a sole-source approach. Given the high switching costs of outsourcing arrangements, building upon existing relationships can increase the success of a sole-source approach, but that alone does not ensure success.

Sole Source: A Brief History

In the early 1990s, buyers took sole-source approaches to outsourcing for many larger information technology outsourcing (ITO) transactions requiring either complicated or rare sets of capabilities. Since service providers with such capabilities and geographic presence were scarce, buyers were faced with a limited selection of those capable of delivering the required services. As business process outsourcing (BPO) and offshoring became common in the 2000s, buyers now choose sole-source approaches with service providers with which they currently have a relationship or service providers that have unique capabilities.

For purposes of this discussion, a relationship refers to any existing or pending engagement between a buyer and service provider. When a buyer and service provider worked together previously, that "relationship" often carries the weight of trust and confidence in the service provider's opinion and ability to deliver service – especially as needs and business conditions change.

The rationale to tap existing relationships for BPO was often pragmatic. First, in the early days of BPO, few service providers had proven capabilities for delivering the processes under consideration. Second, by entering into a sole-source relationship, the buyer taps existing, strong relationships, and simplifies the intermingling of current ITO services that often serve as the foundation of existing BPO processes. Third, existing relationships can shorten the procurement process at a time when economic pressures dictate a need for speed.

A fourth and final factor also contributes to the consideration of sole-source approaches: buyers experienced in multi-provider outsourcing arrangements recognized the less obvious limitations that multi-provider approaches face. The rapid growth of offshoring highlighted the complexities that can emerge if the buyer does not carefully control the portfolio of service providers. The "hidden costs" of multi-provider sourcing can dramatically influence the ability of the buyer to build a relationship with the right service provider. These hidden costs include:

- **Longer, more taxing procurement process.** In a multi-provider, multi-bid process, requests for proposals must be solicited, then delivered, reviewed, and weighed for individual merit. This lengthy process can slow the development of relationships between key executives at both the buyer and the service provider and can raise the resulting cost of the overall procurement process. Further, the burden of simply engaging with more than one service provider may strain existing resources within the organization, notably including the already limited time of the executives involved.

- **"Over-promising" by a service provider.** In an effort to win in a multi-provider situation, service providers occasionally commit to deals that they cannot deliver. Such commitments lead to poor solutions or solutions that the service providers cannot reasonably implement. In other cases, the parties will need to renegotiate the winning contract within a few years.

- **Lack of attention.** Small buyers to mid-size buyers in a multi-provider process may struggle to gain the full attention of service providers. The result is the service provider allocating fewer "pursuit dollars" to the sales efforts, thereby limiting the degree to which the service provider can tailor its solution to match the buyer's unique needs (or even pursue the opportunity at all). This "lack of attention" can also extend well beyond the sales cycle; if a small to mid-size buyer has many service providers, the buyer is not an important customer to any of the service providers.

How Sole-Source Approaches Can Derail

While it can help streamline the process, sole sourcing can also create unanticipated stumbling blocks. Deciding to undertake a sole sourcing arrangement is just the beginning of what can turn into a long and expensive process. Therefore, it is important to understand how a sole-source process can unravel if not carefully managed.

Consider the potentially divergent goals of the buyer and the service provider. The buyer wants a solution tailored to meet the company's specific needs, while the service provider wants to close quickly on a solution that leverages its capabilities and infrastructure. Although the buyer also values a quick close, the buyer wants assurances that a quick close in a non-competitive procurement will not compromise its ability to obtain a fair deal that achieves the business objectives at a fair price.

Progress may bog down as both buyer and service provider attempt to inject their goals and motives into the process. If negotiations do slow down significantly, two additional challenges are prone to emerge:

1. Any slowing of the negotiations can lead to a respective "wandering" of focus and attention by both buyer and service provider. The buyer's lost focus can result in reinterpreting the effort's desired objectives and scope. This leads to a "moving target," which changes the nature of the effort from both the service provider's point of view as well as the buyer's internal forces opposed to the initiative. Opposition then finds opportunity to build barriers to the arrangement. This results in undermining consensus regarding the project's scope and objectives.

2. Idle time can lead the service provider to introduce additional processes to broaden the scope of the initiative and include mechanisms to limit its risk. Risk shifts to the buyer when the scope is poorly defined or the customer expectations are unclear.

To avoid these types of issues in a sole-source situation, the process must be carefully designed – by the buyer, not the service provider. In order to present an option that is credible to internal managers and decision makers, the buyer must guide the sole-source selection process. This prevents any inappropriate influence by the service provider and ensures that the buyer makes the decision according to the buyer's specific needs.

A Design for a Successful Sole Sourcing Approach

Although a poorly managed sole-source approach can fail to meet the buyer's expectations, those organizations that take time to develop and lead a thoughtful approach can attain the desired benefits of a sole-source approach including an accelerated conclusion of the transaction. Seven factors come to bear in creating a successful sole-source approach to outsourcing. Several of these factors are important in multi-provider approaches but take additional importance and increased opportunity in a sole-source situation.

1. Develop the relationship

The significant costs associated with entering into an outsourcing relationship dictate that the buyer and service provider nurture and maintain a healthy relationship that will endure. A healthy relationship displays many attributes including mutual respect, desire to align interests as best as possible, commitment and ability to work out differences, and trust in the other party's intentions. In short, in an outsourcing context, service providers should be much more than mere vendors. Accordingly, one objective of a sole-source approach should be to advance the relationship as much as possible; this is an especially rich opportunity in a sole-source situation because the buyer and service provider can spend increased amounts of time together.

For example, a sole-source situation provides an opportunity to foster intensive collaboration between the buyer and service provider, with the buyer seeking a solution based upon real insight from the service provider – not an "off-the-shelf" solution. These interest-based solutions demand mutual transparency and information exchange between the buyer and service provider. Through these interactions, the relationship grows with the buyer gaining more trust in the single service provider and seeking that service provider's insights. In a sole-source situation, the parties can design the solution's available time and process to provide opportunities to strengthen the relationship beyond what is possible in a multi-provider approach.

Additionally, the approach to negotiations provides an opportunity to lay the foundation for an enduring relationship. The parties should adopt a solution development and negotiation philosophy that builds a relationship between service provider and buyer, versus a positional-based spec-and-bid process that tends to agitate differences. Buyers and service providers can use an "interest-based" approach[1] to negotiating to help focus the relationship on the most important principles and identify common interests, which increases the chance that the relationship will endure over time. The ability

1 The Harvard Negotiation Project is the most recognized group for developing "interest-based" negotiation strategies. This approach is described in *Getting to Yes:Negotiating Agreement Without Giving In,* by Roger Fisher, William L. Ury, and Bruce Patton.

of a buyer and service provider to work more closely together in a sole-source approach may better facilitate this process than a multi-provider outsourcing approach.

2. Engage senior leadership

Senior executives from both buyer and service provider must view the engagement as a broad problem-solving endeavor versus a mere review and service provider evaluation. Buyers and service providers build successful sole sourcing upon trust and goodwill. While rank-and-file employees might carry the day-to-day activities between buyer and service provider, sole sourcing relies more extensively on trust at the highest levels of the organizations.

This is important for several reasons. Service providers often highly tailor specific solutions to the individual buyer's needs, both in terms of the actual services delivered and commercial terms of the arrangement. As a result, these decisions require authority and buy-in from the highest levels of both the service provider and buyer – and also meaningful engagement in the details of the agreement. The natural tendency of senior management to delegate the accountability for the process to lower levels within the organization often spells trouble.

Also, without senior management setting a strong course and accepting accountability for the decisions, lower-level managers will tend to evolve sole sourcing processes into an unending benchmarking exercise (i.e., "to see if we are getting a fair deal"). This typically leads to murky conclusions that do not reflect the limits of benchmarking and a breakdown in the much-needed trust between the two organizations.

3. Involve the board

Companies have different internal governance guidelines for reporting programs of particular sizes, scope, or impact. Depending on the size and impact of the transaction, buyers might need to inform and educate the board of directors about the outsourcing project in order to understand, agree to, and, if necessary, sign off on the sole-source approach. Preferably, buyers should do this at the earliest stages of the process.

It is often not enough to have senior executive knowledge and buy-in for a sole-source arrangement to work. Such acceptance must permeate to the board level due to the significant economic impact under consideration.

By their very nature, sole-source approaches are easy to criticize for lacking options – ranging from service provider to scope, solutions, and pricing. These approaches may also be criticized internally for lack of objectivity, appearing that the organization not only eschewed an outside opinion but relied solely on preconceived needs and expectations in determining the outcome of the solution remedy. In short, a sole-source approach often appears to offer only *one* choice. However, this conclusion does not acknowledge the intense time and concerted effort that a buyer can spend with a single service provider designing a solution tailored to a buyer's specific needs. Such customization typically works through a range of alternative solutions to identify which creates the greatest mutual benefit.

Many boards of directors have limited experience with sole sourcing approaches. Therefore, the first time that a buyer presents to its board a sole-source situation for which it has little to no background, the typical reaction is to question the legitimacy of the approach. Concerns can range from whether the buyer considered all options to whether it is the most cost-effective solution for the buyer organization. This typically results in additional fact gathering and potential redesign of the process to attain proposals from additional service providers. The inevitable impact is that the buyer invests additional time, effort, and resources in the outsourcing procurement process. While the board might eventually come to the same conclusion it was originally presented (i.e., that sole sourcing is a viable approach for the given situation), quite frequently more time and money are ultimately expended than if the organization had pursued a multi-provider approach.

Buyers can avoid this outcome by taking any proposed sole-source approach to the board early in the process or before the process begins to attain buy-in and provide an opportunity for the board to influence – or at least feel integrally involved in – the design of the process.

4. Don't boil the ocean

Success in an accelerated time frame requires a focused initiative that accurately delineates the work that needs to be prioritized and done versus what should wait until later. A buyer needs only three things to confidently enter an outsourcing agreement:

1. Business case that is robust, accurate, and easily explained to the organization
2. Confidence that the service provider, scope, and pricing are reasonable
3. Master Services Agreement (MSA) that focuses negotiations on the terms most relevant to outsourcing

5. Develop a robust business case

To effectively obtain the buy-in from senior leadership, the board of directors, and the broader organization, it is critical that the buyer have a robust business case that is easily explained. An effective business case will include the following:

- **Baseline:** A robust baseline model helps identify the true costs for the current service delivery.

- **Base case:** The base case model will project the baseline for the desired number of years.
- **Real-time solutioning:** The base case model must be a tool that allows for dynamic modeling for real-time solutioning.
- **Comprehensive:** The business case must account for not only direct-cost impacts but also business and strategic impacts.
- **Integration:** The models must be integrated with the data collection tools and with the planned-for pricing mechanism and tools.
- **Risk:** The measures of direct cost, business impact, and strategic impact are necessary but insufficient; the business case must address both risk and return. Measures of risk must be multi-dimensional and include financial, operational, organization, legal, and strategic risks.
- **Clarity:** Although the business case needs to be robust, comprehensive, integrated, and inclusive of both risk and return, the output of the business case must strive for clarity and simplicity.

6. Compare to ensure value

The buyer must have confidence that the service provider, scope, and pricing are reasonable. The parties must adopt a sophisticated external comparative analysis process to ensure fairness of value sharing.[1] It is essential that the buyer be intimately involved in the development and ongoing refinement of the scope of the services to be delivered. To do so, the buyer must know what it seeks from the service provider's services and how such services will help the buyer achieve its goals. Working in tandem, both buyer and service provider must confer on and set specific targets for the service provider, which requires the buyer to complete analyses that would not be required if the buyer had alternative solutions for comparison. Furthermore, the buyer must have independent validation that the scope of outsourced services is a workable solution with acceptable risk and that the service provider capabilities are an appropriate match to the services in scope.

By comparing each component of the potential solution, the service provider effectively continues to "compete" for the deal. The possibility of pulling some or all of the services out of the scope of the agreement provides tension to ensure the service provider provides the best possible solution at a fair price. The buyer must set out unequivocally from the beginning that if goals are not achieved, the process may become multi-provider at any time.

1 Although external comparisons are almost always a part of the decision process, the limits of benchmarking and comparative analysis must be understood. Ideally, buyers could treat services as "commodities" and simply compared based upon price. However, services by their very nature have subtle differences (differences in responsiveness, quality of input, operational reporting, service provider flexibility) that cannot be captured by benchmarking; the final decision must consider a range of quantitative and non-quantitative measures.

7. Focus the contract and negotiations on truly important factors

The buyer must specify the process by which the problem solving, analysis, and solution evaluation are to take place. This requires the buyer to take ownership of the engagement process with the goal of setting specific milestones and end goals. This allows the buyer to maintain control of the decision and problem solving involved in reaching the deal, thereby avoiding having a deal on the table with significant questions surrounding the validity and competitiveness of the solution. Additionally, the buyer's objective in specifying the process is to build a framework by which both parties will be aware of prescribed milestones and goals and ultimately realize when a fair deal – and its defined tenets – has been achieved.

In addition to setting the timing and objectives for the process, buyers should set guidelines for the level of detail for the scope and metrics used to measure the success of the relationship. The scope targets must be set to define which processes are in scope. This should be the buyer's decision, although the service provider can offer alternatives through appropriate mechanisms.

The buyer must also dictate the level of precision the service provider must use to establish its roles and responsibilities in the outsourced process for the proposed pricing. For example, developing a responsibility matrix for the proposed solution can help quickly delineate the critical responsibilities of both the buyer and service provider, thereby allowing the buyer to understand which activities it would retain or lose and the financial impact of each.

Lastly, the buyer must control the level of detail for the metrics that would be used to measure the success of the proposed solution.

The time-to-value realization accelerates when the buyer uses independently validated tools for scope definition, service metrics, and the MSA framework. Everest Group has identified 31 contractual terms that are most relevant to an outsourcing agreement; negotiations need to be focused on these key relevant terms.

Summary

A sole-source approach will not be the best solution for every organization; however, it can be a viable approach in many situations. Buyers must weigh many factors including the service provider's ability to meet the buyer's specific needs – either with an off-the-shelf service or a custom-tailored solution. Other factors include existence and strength of current relationships, the scope of the required services, the ability of the service provider to adapt and provide new services over time, and executive acceptance of sole sourcing from all levels of the organization.

If a buyer selects a sole-source approach, the chance of success is increased by using the sole-source environment to begin building or deepening the buyer-provider relationship, meaningfully engaging senior leadership, involving the board early in the process, focusing the process on what is important, developing a robust business case, comparing the service provider's solution to external measures, and developing a contract and negotiations process with the appropriate level of detail. Carefully designing and executing a sole-source process can then capture the desired benefits: a more streamlined process to contract signing leading to quicker realization of benefits and a stronger relationship.

About Everest Group

Everest Group is an advisor to business leaders on next generation of global services with a worldwide reputation for helping Global 1000 firms dramatically improve their performance by optimizing their back- and middle-office business services. With a fact-based approach driving outcomes, Everest Group counsels organizations with complex challenges related to the use and delivery of global services in their pursuits to balance short-term needs with long-term goals. Through its practical consulting, original research and industry resource services, Everest Group helps clients maximize value from delivery strategies, talent and sourcing models, technologies and management approaches. Established in 1991, Everest Group serves users of global services, providers of services, country organizations, and private equity firms, in six continents across all industry categories. For more information, please visit www.everestgrp.com and research.everestgrp.com.

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