

## Sourcing & Delivery Strategies<sup>SM</sup>

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### Insights to empower you to transform enterprise performance

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# Effectively Governing Your Outsourcing Arrangements

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#### Context:

One of the biggest reasons outsourcing relationships fail to meet expectations has to do with weak post-contract governance. Once the excitement of ~~doing the deal~~wears off and all the heroes and casualties have departed the arena, those that are charged with managing the aftermath for the term of the contract often find themselves with inadequate governance-mechanisms to manage the relationship and the agreement effectively. In such cases, at about the end of the second year if not sooner, the alignment between business needs, outsourcer deliverables and contract stipulations begins to break down.

A comprehensive outsourcing-governance framework, structured and integrated properly into an outsourcing arrangement, can ensure that the resultant agreement offers appropriate governance-mechanisms, and is more likely to yield win-win outcomes for the enterprise and outsourcer(s).

#### Analysis:

First Kernel recommends an outsourcing governance-framework encompassing the following six (6) outsourcing governance processes:

1. Performance Governance
2. Contract Governance
3. Financial Governance
4. Compliance Governance
5. Relationship Governance
6. Knowledge Governance

**Performance Governance** process addresses the tactical, day-to-day deliverables by the outsourcer, organized into a collection of Service Level Agreements (SLA), coupled with an ARC/RRC (Additional Resource Charge / Reduced Resource Charge) mechanism to account for fluctuations in the levels of service consumed. The SLA structure should allow for modifications to accommodate evolving needs of the enterprise.

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**Contract Governance** process addresses both the broader contract parameters of the relationship as well as the routine changes that are to be expected in a typical outsourcing agreement. About 15 to 18 months into an outsourcing arrangement, be prepared to make some major changes to the contract. A well constructed contract document is modular and can accommodate ongoing changes without structurally breaking apart.

**Financial Governance** process addresses the mutual obligations of the outsourcer and the enterprise regarding standardized unit pricing, pricing for out of band levels of service use, penalties and credits /earn-backs, cross currency adjustments, COLA and other indexes. Generally speaking, the simpler, common-sense mechanisms work better than complex ones.

**Compliance Governance** process addresses the increasingly elaborate requirements pertaining to data security, SOX and the like. While the enterprise may outsource its SG&A functions, it may NOT outsource its compliance obligations. Compliance-governance responsibilities usually come with a price-tag from the outsourcer, as can be expected.

**Relationship Governance** process addresses the people-to-people aspects. It covers such issues as the relationship governance board, escalation mechanisms within the enterprise and the outsourcer organization, and people-interfaces at multiple levels within both organizations, to keep communications flowing bi-directionally. In instances involving off-shore resources, additional considerations are warranted.

**Knowledge Governance** process addresses the nature and level of flow of knowledge regarding the outsourced function. Over time, it is natural for the enterprise to lose a certain amount of hands on knowledge regarding the outsourced SG&A function. Reciprocally, it is difficult for the outsourcer to keep abreast of the evolving business changes in the enterprise, despite the fact that some people from the enterprise may have transitioned to the outsourcer as part of the outsourcing arrangement. This issue takes on added significance during the disengagement phase following termination of the agreement. A process to safeguard knowledge is critical, especially to the enterprise.

*Each of these six processes should be developed in detail during the period leading to the outsourcing agreement by a dedicated cross-disciplinary team, and integrated into the body of the outsourcing contract. Between 5% and 10% of the total financial-value of contract should then be budgeted, over the term of the outsourcing arrangement, to fund the operation and fine-tuning the governance journey.*

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**Take Away:**

Outsourcing as an Enterprise Performance Transformation mechanism is here to stay. Using a comprehensive outsourcing-governance framework maximizes the likelihood of mutual success while minimizing avoidable risks.

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**Mentioned in this Research Update:**

Individuals:	None
Organizations:	None
Websites:	None
Publications:	None

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Our Clients leverage the integration of our expertise, intellectual property, tools and guidance to achieve or surpass their SG&A performance targets. First Kernel has developed the industry's first *Enterprise Performance Transformation System*<sup>TM</sup>, currently pending a United States patent.

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