Extend, divide or terminate

The three options when an outsourcing contract ends
The three options when an outsourcing contract ends—extend, divide, or terminate

When an outsourcing contract is nearing its end, the buyer must make a strategic decision based on its own unique situation: extend the contract in its current form, divide it between the incumbent and another or more parties, or terminate it with the existing provider. The decision should not be hastily made, as possible opportunities may be missed, or the solution may be worse than the problem. Conducting a critical review of the current outsourcing arrangement, and weighing the alternatives in terms of the desired future state, will help decision makers come to the right conclusion.

<table>
<thead>
<tr>
<th>The three options</th>
<th>1. Extend and renegotiate the contract with the current service provider</th>
<th>2. Divide the contract</th>
<th>3. Terminate the contract</th>
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<tr>
<td>If criteria such as end user satisfaction and service level agreements are being met, the existing agreement with the service provider may be extended. A contract extension can take two forms. If the buyer is fully content with the provider’s performance, or if it is looking to buy time, extending the contract under the current terms and conditions is a reasonable choice. If amendments are called for to help ensure that the new agreement is fit for purpose going forward and will deliver optimum results, the changes should be renegotiated and a new contract drawn up.</td>
<td>A buyer may also make the decision to transfer part of the responsibilities to one or more alternative service providers. This may be because the current service provider has failed to deliver particular services to the client’s satisfaction, the provider has decided to remove certain services from its portfolio, or the client’s requirements have changed to such an extent that a provider with a different area of specialization is required. When a contract is divided, it is quite possible that the client will bring elements of the outsourced services back in-house.</td>
<td>There are instances in which one or both parties will decide to end the relationship and terminate the contract. In such a situation, the services are transferred to a new service provider or back to the buyer organization itself. To help ensure a smooth transition, a complete exit strategy should be developed and the transition guided by experienced internal staff or an external advisor.</td>
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The cost, effort required and the risk factor for each option is different and depends primarily on the magnitude of change. Typically the “Extend and renegotiate” option is on the lower end of the spectrum as opposed to the “Terminate” option which involves a major transition.
**A road map for contract renegotiation**

Ideally, a suitable renegotiation strategy should be established at least nine to twelve months prior to the end of the contract term. Figure 1 below presents a broad outline of the timing and activities involved. Time frames may be reduced when the contract is being renegotiated with the existing service provider.

**Map for the change period**

- **Eighteen to twelve months prior to the contract ending**
  - **Sourcing review**
    - Final annual review of the strategy and exit plan and check on the contractual conditions
  
- **Twelve to nine months prior to the contract ending**
  - **Extend**
    - The scope of the service delivery, provided by the current service provider, either doesn’t change or not significantly
    - Renegotiations will only take place with the current service provider
  
- **Contract ends**
  
- **Through nine months after the contract ending**
  - **Change and improve**
    - Implement a change program based on new agreements with the current service provider
  
- **Twelve to nine months after the contract ending**
  
- **Contract ends**
  
**Looking ahead**

- What does the business require from us, and what technological changes do we see?

**Looking back**

- What has the contract provided over the last years?

**Change need and gap**

- What needs to be changed in the current relationship, which deficiencies exist between the current agreement(s) and the new necessary agreement(s), and how are we going to close that gap? Are expectations of both parties aligned?

**Sourcing decision point**

**Implement the chosen strategy**

**Divide**

- The scope of the service delivery, provided by the current service provider, changes in a structural way, and operations are (sub-) divided
- Negotiations will take place with the current service provider and parts of the services will either be transferred to the organization itself, or there will be a new tender to select (a) new service provider(s)

**Terminate**

- The service delivery, provided by the current service provider, ends. Based on the exit plan, the contract with the current service provider will be terminated, and the services will either be transferred to the organization itself, or there will be a new tender to select (a) new service provider(s)

**Transition**

- Transfer of (parts of the) service delivery from the current to the new service provider(s) or to the organization itself

**Exit**

- Formally end the relationship with the current service provider

Figure 1
Basis for making the decision: The services review
Most organizations make the mistake of drawing up new contracts based on negative past experiences. However, by conducting a comprehensive review of the sourcing strategy, looking ahead at future needs, and looking back at what has been provided throughout the life of the contract, buyers can make objective decisions on the most appropriate and advantageous course of action.

A thorough and rigorous fact based approach, such as KPMG’s 6P Value Assurance methodology, should be used to review the current provider services in order to get a holistic view of current state. It is important to include both internal business management and the service provider in the review process, and to carry out parts of the analysis together, as the provider frequently possesses information that the buyer organization lacks. It is also beneficial to know how the service provider views the current relationship, and what it has learned from it.

A key to outsourcing success is governance. This doesn’t just mean rules and procedures, but also the desire to improve service delivery and mature the relationship. A service provider that isn’t challenged to make improvements may often be satisfied with only average achievements. In such a situation, it is important to formally review the relationship at least once a year.

A look ahead: What do you need?
Being able to recognize potential areas of change is vital. Only then is it possible to pinpoint disparity between current services and those necessary in the future, and realize the full benefits of a renegotiated contract. During this phase, it’s important to think strategically about the current and future needs of the business, rather than simply delivering existing services as efficiently as possible.

The analysis steps in Figure 2 clearly show that the services strategy is not driven in the beginning by the current issues and the service provider, but by the company’s strategic needs, which impact its sourcing strategy, making it important to be aware of how the expiring relationship compares to other outsourcing relationships within the organization. Thinking purely from within the current framework of the existing relationship and contract very often leads to a less than ideal approach.

6P Assessment – Summary results

![6P Assessment Diagram](image-url)
Three critical questions when looking ahead

1. Does the current service provider fit into the company strategy?
   The capabilities of the service provider should be able to accommodate future company strategy. For example, can it be relied upon in unexpected circumstances? As developments frequently follow one another in quick succession, the service provider should be able to adapt quickly.

2. Is there sufficient connection between the current services and the latest developments in the market?
   It is important to assess the extent to which the service provider is able to implement both the technical advances and leading practices of the market into the current services. Does the contract provide sufficient possibilities to be able to realize the additional benefits? It is also important to review the contract for global risk, compliance with laws and regulations, and the provider’s financial viability. The review should take into account service delivery location risks, changing compliance needs, related contractual commitments, and the supplier’s perspectives.

3. Is there a well thought out long-term plan for the organization?
   Without a long-term business plan in place, there may be a disparity between the services bought and the actual services required. This can result in a weak negotiation position for the client.

Three critical questions when looking back

1. Is the organization happy with the current service provider?
   While this appears to be a simple, straightforward question, the answer is usually based on a gut feeling. To achieve a balanced view of the degree of satisfaction, sufficient data from the various user groups over the period of the contract should be collected and analyzed. It could be that the client-side manager of the relationship wasn’t satisfied with the service provider, but the end users were happy with the level of service delivered. Alternatively, there are also scenarios where all the service levels have been “Green” but the customer satisfaction is “Red”, commonly known as the watermelon effect.
2. Did the client organization have the right competencies and skills to manage the contract and service provider?

The success or failure of outsourcing contracts is, to a large degree, dependent on robust management and the governance structures. Lack of investment in these competencies and skills make it difficult to create a good renegotiation strategy and it is most definitely a mistake to think that simply changing the service provider will lead to better results.

3. Did the organization receive the value it was expecting from the service provider?

The end of the contract is a good time to once again look at the original business case. In retrospect, how realistic was it, and what areas of improvement should be included in the new agreement/s? For example, there may be issues relating to the and type of extra work that falls outside of the contract.

The importance of a renegotiation strategy

Organizations should take the time to prepare for the end of a contract, as their success or failure depends on essential functions such as information technology (IT) support. Even if the current contract allows for carrying out changes, it still makes sense to look at the ways in which the next contract can be improved. The chosen sourcing strategy also plays an important role in how companies can differentiate themselves in the market, via a lower cost base or exceptional service, and has an impact on business continuity and security.

Another consideration is that the necessary IT competencies change rapidly. When a contract comes to an end, this creates the opportunity to include the latest developments in sourcing strategy into the contract, so an understanding of what the market is currently offering is vital during negotiations.

While it is important to have a sourcing strategy, it is equally vital to allocate enough time and resources to implement it. Even the simplest renegotiation may have service elements that are transitioning to a new support model. And when a decision has been made to terminate service delivery, alternatives must be found. A well-organized transition, either to a new provider or back in-house, takes time.

Organizations that outsource will face end-of-contract term decisions. As this a time when many important issues must be considered, good preparation is essential to avoid the risks and enjoy the benefits that this period of change can create.
Key Things to Keep in Mind:

1. Don’t wait until it is too late – Waiting until the final year of the contract not only limits the options but also results in extended transition duration and additional cost.
2. Get your facts straight – Always use a fact based approach to decide which option to choose at the end of the contract term.
3. Changing the provider may not solve everything – Governance is extremely important and investing in right governance competencies is integral to realize the value of the relationship.
4. Transition is never seamless – although new service providers may make it sound easy, it never is and the risk associated with the change is typically high.
5. Change Management is not optional – The value of change management is often under estimated and/or ignored. It is important to effectively navigate through the change as an organization.
6. Engage the Business Stakeholders – It is crucial to effectively communicate to the business teams and make them feel like they are engaged in the overall decision making process.

About the authors

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