Update

Enterprise Risk Management & Governance
Advisory Service, Executive Update Vol. 6, No. 4

Special Considerations When Retendering an Outsourcing Contract

by Dr. Sara Cullen, Senior Consultant,
Cutter Consortium

Many client organizations nearing the end of an outsourcing contract start to consider whether they should retender the deal. Yet for most, these deliberations are mostly about whether to do so or not; very few go beyond the simple yes/no proposition to consider the "how." This is important because the odds are stacked against new entrants (bidders other than the incumbent provider) unless your organization does something about it, and your organization risks expending time and resources on what ends up being a pointless exercise.

Let's look at a common situation. It's a year before the end of a 5 + 2 + 2 contract; the client has used up both two-year extensions after the initial five-year term. The client's policies state that it now has to retender. The client's project team grabs the old contract and does a fairly superficial update — primarily dates and deletions of obvious things that are no longer relevant (e.g., Y2K assurances). This is what will be provided with the request for tender (RFT) for the bidders to state their compliance or otherwise. The team then grabs the old RFT document and updates it with a few things such as what some of the client's stakeholders were unhappy with. And in no time at all, everything is ready to go. All that the team needs to do now is advertise the RFT or invite two other bidders besides the incumbent, depending on whether policy states open tenders must be conducted or whether only three quotes are needed. Just like the original RFT, all the tendering processes are the same: a briefing to all bidders shortly after release of the RFT and all questions and answers during the process will be in writing and will be released to all bidders. Sounds straightforward, doesn't it? Now let's explore why it isn't — assuming you want genuine competition for your tender. If you don't, stop reading.

BASIC CONSIDERATIONS

First, understand the position of the new entrants. Here are three basic things that all clients need to understand about the bidder's side:

1. **Bidding resources are finite.** Providers don't keep resources hanging around idle while they wait with baited breath for RFTs to fall from the sky. While a lot of providers have some form of dedicated business development resource, most bids are prepared by taking people off chargeable work and putting them on a nonchargeable bid for your tender. This costs money and often lots of it.
2. **There is no magic button that pumps out a response.** Many clients believe bidders have all they need for a tender response already prewritten; it's just a matter of "massaging" it in the way the client wants to see it. This is not the case. While there will be some "codified objects" used for bids (e.g., company background), most is handcrafted to the particular opportunity. Giving a couple of weeks for a response would indicate to the new entrants that you are not serious and, accordingly, you will get nonserious responses.
3. **Yours is not the only opportunity, particularly during the December holiday season.** Nearly all clients think that the market will always respond to any tender request, whenever it occurs. However, say a potential bidder gets seven RFTs around 23 December (the peak of the RFT season, as clients rush to get theirs out by Christmas so the bidders can work over the holidays). First, that is when the resources are really scarce — oddly enough, the provider's staff want their holidays, too. Second, the bidder will decide which has the greatest probability of winning and the greatest return. The rest will be politely declined or responded to in a cursory manner. If yours doesn't top the list, you will not get worthwhile bids.

SPECIAL CONSIDERATIONS

Now that you understand that your retender will take time and money and will not be the only opportunity for the bidders, you have to convince the new entrants to take away resources from other work to put them on yours. This is absolutely critical in a retender situation. Remember, when this deal first went to market all those years ago, everyone thought they had a good chance to be your partner. Now they don't, because you're still "married" to the incumbent.

Irrespective of what you have told the market in the RFT document, potential bidders will do their own investigation and will know that the incumbent has been there for many years. So what have you done to show a genuine interest in switching providers, besides merely updating the old documents?

Have You Identified the Switching Costs and How You Intend to Treat that in the Business Case?

The new bidders know that the switching costs can be massive, so inherently the incumbent can have a 10%-30% cost advantage comprising your costs to disengage the incumbent, transition to the new provider, and the new provider's startup costs. The only way a new entrant might possibly win is to bid at cost or at a loss. Such a bidder would only bother responding if its financial situation is such that survival is at stake — a fragile way to start a new relationship, indeed.

Recognizing the inherent financial advantage of the incumbent, some organizations that wanted a completely level playing field excluded the switching costs from the business case altogether. While honorable, this is not usually economically viable. Ignoring the switching costs does not mean that they do not exist. They are real and they add up. Given that the cost of switching providers can be massive, there should be a very good reason to approach the market to try to get a new provider to replace the incumbent. That, then, provokes the next question.

Have You Identified Why You Are Retendering?

If you merely state that you are going back out to the market because a contract is ending, do not expect much in return. The common perception of the new entrants is likely to be that you are using a retendering process to get a better deal with the incumbent and are not seeking genuine alternatives. Sure, if a fantastic deal comes about, you will consider it. But other than being opportunistic, there is no underlying reason as to why you are doing it. Given that there is no strategic driver for change, why should new entrants invest their scarce resources in helping you get a better deal with the incumbent? New entrants will invest time and resources commensurate to their estimation of the value of the deal and the probability of winning. In this case, the possibility of success is remote, thus the investment in the bid reflects that remote probability — not much chance of winning, not much invested in trying. The result will be poorly written bids from new entrants and an adequate one from the incumbent. Any guesses as to who will win?

So you need some good reasons to switch — ones that will warrant the investment the client will need to make in the switching costs. A common strategic reason for retendering is that you want to break up a big sole source deal into multiple deals. Clients can do this to:

- Break up the incumbent's monopoly and reduce the power of the incumbent over the client by having many providers on board
- Reduce their dependency on the incumbent by having access to more providers and their collective resources
- Replace a one-stop shop that might only be adequate across the scope with a multiple-stop shop with superior collective resources because they didn't get the results and performance that they believed the incumbent had promised them and want to move to a best-of-breed approach

If this reflects your organization's position, you must consider in what order to release the broken-up deal. If your first release to the market is likely to result in retaining the incumbent, don't do it. Giving the first lot of work to the incumbent establishes a dangerous precedent, giving new entrants a negative perception of your intent to switch in future deals. Go to market in the first instance with the scope likely to be given to an alternative. This will establish your credibility in terms

The *Executive Update* is a publication of the Enterprise Risk Management & Governance Advisory Service. ©2009 by Cutter Consortium. All rights reserved. Unauthorized reproduction in any form, including photocopying, faxing, image scanning, and downloading electronic copies, is against the law. Reprints make an excellent training tool. For information about reprints and/or back issues of Cutter Consortium publications, call +1 781 648 8700 or e-mail service@cutter.com.

of your intent to switch and will help you obtain better bids from your later releases.

Then there is the reverse situation. You might be looking to rationalize several providers into a sole source deal. If that is the case, do not allow bidders to bid for all or part of a deal. That looks like you don't know what you want — maybe the same situation, maybe not. It is obvious that you do not intend to pick a winner(s) out of this exercise; rather, you are using this to decide what you might want to do. Yet the RFT is likely to be cumbersome and time-consuming to respond to. Given that you haven't decided your strategic sourcing direction, the probability of winning for anyone will be assessed as low and most will know there is a second exercise coming. This is because the "all or part approach" is extraordinarily difficult to evaluate. Some providers will bid for one thing, some for a few, and some for all. To line up the optimum solution could be impossible given the overlaps, as well as gaps, in the bids. Inevitably, clients that do this do make up their mind after receiving the bids to go one way or the other (sole source or multisource), and invite those that fit to bid again, typically as a "best and final offer" (BAFO). So until the second stage increases the probability of winning, new bidders will not invest heavily into the RFT, and the responses you receive are likely to be disappointing except for the incumbent, who knows your organization almost as well as you do.

What Are You Going to Do to Help New Entrants?

The incumbent has an extraordinarily detailed knowledge of your organization, and you cannot convey this to a competitor by just giving them access to copies of procedures and technical specifications. Knowing this, some organizations try to limit the incumbent accessing information by putting the retender project team in lockdown (typically this is a secure offsite area with no access by the incumbent to the worksite or data). The rationale is to reduce the information to the incumbent to try to create information parity with the new entrants. Unfortunately, the effort that goes into this approach is usually in vain, because the incumbents cannot be made to forget what they already know, and have known for years.

Instead, consider trying to get the new entrants up to scratch. Ask them want they need to know and how they want to see it. Show them anything they want to see (provided your incumbent contract was well written and doesn't preclude this). Have briefings for each new entrant. Holding a single briefing session with the incumbent present simply gives them a fantastic opportunity to quietly tell the other bidders that "this retender is a done deal, and they're all wasting their time."

Have workshops where they can freely ask questions that you won't share with others. When you share questions and answers, you are in fact inferring you don't want any questions. This is because you will reward a bidder that asks a good question by giving the answer to its competitors that do not; no one wants to help their competitors. Better not to ask than help the competition and disclose to the competition where the bid is at. By all means, correct errors in factual statements as they become known. Give everyone the opportunity to ask good questions and give good answers to those that do so. By the way, if you do state that you won't be disclosing questions and answers, be prepared for an unprecedented onslaught of difficult and important questions that wouldn't have been asked under the full-disclosure approach. You will need a dedicated team for this. But it will show that you understand that the new entrants are starved for information, that you are willing to help them prepare their best possible response, and that you are investing in this retender — all indications that this is not just an administrative process and that your organization is dead serious.

CONCLUSION

If yours is a situation that has a long-standing incumbent, with no convincing reason to switch, without proven investment in working with the new entrants, and without substantial evidence that you have made necessary switching preparations, you will be investing far too much in an exercise that will end up retaining the incumbent for many more years. In this case, renegotiate and save yourself the expense. However, if you are serious about switching providers, prove it and reap the benefits of renewed genuine competition.

ABOUT THE AUTHOR

Sara Cullen is a Senior Consultant with Cutter Consortium's Sourcing & Vendor Relationships and Enterprise Risk Management & Governance practices. She is the Managing Director of The Cullen Group, a specialist organization offering consulting, training, and methodologies regarding commercial agreements, and a former national partner at Deloitte in Australia. Dr. Cullen specializes in the design and management of commercial agreements. She has consulted to more than 110 private- and public-sector organizations, spanning 51 countries, in more than 140 outsourcing projects with contract values up to US $1.5 billion per year.

Her services include audits of providers, contracts, and arrangements; contract and SLA drafting, negotiation; design and implementation of contract management functions; due diligence; feasibility studies and business cases; design of scorecards and incentive/recourse schemes; market and provider assessments; sourcing strategies and approaches; pricing; relationship design, formation, and management; renegotiation and remediation; risk assessment, mitigation, and management; tender strategy, preparation, criteria, and evaluation; and transition (mobilization and/or disengagement) planning.

Dr. Cullen has facilitated contracts in a large variety of organizational areas, including call centers, claims management, construction, facilities management, finance, food services, HR, logistics, IT, maintenance, recreational services, sales, and security. She has designed partnering arrangements, franchise-type agreements, shared risk/reward structures, and incentive programs as well as traditional arrangements.

Dr. Cullen is a widely published author. Her publications include the *Contract Scorecard*, *Intelligent IT Outsourcing*, *Outsourcing: Exploding the Myths*, *Contract Management Better Practice Guide*, *Best Practices in ITO*, *Lessons Learnt in Outsourcing*, *Service Provider Management*, *Outsourcing Guidelines*, and *Outsourcing: What Auditors Need to Know*, in addition to research with various universities since 1994, including the London School of Economics, Melbourne, Oxford, and Warwick.

She has been featured in such publications as the *Australian Financial Review*, *Business Review Weekly*, *Computerworld*, *Directions in Government*, *European Journal of Information Systems*, *Information Economics Journal*, *Journal of Strategic Information Systems*, *Information Technology Report*, *Insurance Directions*, *Oxford Handbook*, *MIS*, and *MISQ Executive*. Her expertise is globally recognized, and she performs peer reviews regarding outsourcing research for *Harvard Business Review*, *California Management Review*, and *European Conference on Information Systems*. Dr. Cullen has lectured at many universities, including Seoul, Melbourne, Monash, Swinburne, Queensland University of Technology, and the Royal Melbourne University of Technology.

Dr. Cullen earned a BS in accounting from St. Cloud State University (US); she was awarded a master's of management (Technology) from Melbourne Business School, and earned her PhD from the University of Melbourne. She is also a Chartered Accountant in the US. She can be reached at scullen@cutter.com.

©2009 Cutter Consortium