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Key Outsourcing Trends 2015

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21/01/2015
9.05 – 9.30: Trends in pricing, benchmarking and greater flexibility in outsourcing deals
Paul O'Hare (Head of Outsourcing, Kemp Little LLP)

9.30 – 9.50: Multi-sourcing and SIAM: trends, benefits and challenges
Andy Nelson (Associate, Kemp Little Consulting LLP)

9.50 – 10.00: Coffee and networking break

10.00 – 10.15: Captives and other structures
Andrew Joint (Commercial Partner, Kemp Little LLP)

10.15 – 10.25: How is UK employment law shaping up to deal with the global outsourcing challenge
David Williams (Head of Employment, Kemp Little LLP)

Q&A
Pricing trends, benchmarking and contracting flexibility
Outline

Pricing model trends
- Input, output and outcome-based pricing structures

Building flexibility in outsourcing contracts
- Flexible pricing models
- Dealing with change, renegotiation and re-baselining
- Exit flexibility

Price protection
- Current market trends on benchmarking
Evolution of pricing models
Greater inbuilt flexibility on volume fluctuations (30%+)

Greater focus on capacity/demand management

Limit to where customer controls unit consumption
Dealing with change, renegotiation and re-baselining

Leveraging supplier goodwill/relationship

Multi-sourcing models – can provide post-signature supplier competition

Benchmarking – provides some protection (but unlikely to be immediate)

Increased reliance on ‘pricing principles’ to govern change

Increased exit flexibility
Pricing principles to govern change and renegotiation

**Common customer ‘asks’:**
- No increase in charges where no net material increase in supplier cost base
- Commitment to pass on benefit of any cost savings/cost reductions
- Information provision to demonstrate/justify cost increases
- Any price increase proportionate to increase in supplier cost base
- Spreading cost increases across affected customer base

**Challenges:**
- Starts to resemble open book pricing for contract change/renegotiation
- Monitoring and ensuring compliance
Increased exit flexibility: term and termination

Shorter term deals: typically 3-5 years
- Commoditised vs transformational outsourcings

Greater customer focus on termination for convenience/T for C charges

Termination by service tower - esp for sole source arrangements

Greater focus on exit provisions
Exit provisions

Exit costs:

- Customers rarely expect exit to be provided at no additional cost – even for cause (but may seek to apply different rate card)
- But require greater certainty on overall exit price – pre-contract signature

Inclusion of ‘incentives’ to ensure BAU exit activities occur

- Production and updating of exit plan
- Process manuals
- Asset database
- CMDB
Benchmark trends

More mature and settled approach to benchmarking:

- More mature benchmark industry
- Better quality benchmark data
- More supplier involvement in benchmark process/benchmark results
- More reasonable/pragmatic customer approach
Benchmark trends

Binding benchmarking provisions now becoming the norm

In return for:

- Supplier input on: appointment of benchmark advisor, selection of peer group and finalisation of benchmark report
- Reduction in frequency of benchmarking
- Overall cap on level of price reduction
- Tolerance threshold within which no price adjustment
- More realistic benchmark targets
Output-based pricing models now standard
- Greater focus on demand and capacity management
- And limited to deals where customer controls unit volumes
- Outcome-based pricing models – limited use in ITOs (beyond traditional gainshare mechanisms), but increasingly common in BPOs as a component of overall pricing

Contracting flexibility achieved via:
- Pricing terms, use of (balanced) pricing principles to deal with change, shorter term deals, and increased focus on exit, both pre-signature and during deal term

Benchmarking
- Aggressive customer approach to benchmarking leads to non-binding/unworkable benchmark terms
- Balanced approach – with inbuilt supplier protections – more likely to lead to effective benchmark provisions
Multi-sourcing and SIAM – trends, benefits and challenges
Multi-sourcing and SIAM – trends, benefits and challenges

Kemp Little and Kemp Little Consulting perspectives on the trends in Multi-Sourcing and the benefits and challenges of implementing a multi-sourcing model.

We will also the address the role of Service Integration and Management (SIAM) in these models and the ‘keys to success’ in implementation.
Multi-sourcing – what do we mean?

- Infrastructure and application services provided by many suppliers rather than just one or a few
- Services provided as a set of service ‘towers’ such as data centre, networks and desktop support
- A service tower could be provided by more than one supplier such as in networks separating out the provision of the physical network from telephony and other services (e.g. video-conferencing)
- Customer owns the contractual relationship with all service tower providers
- Need for Service Integration and Management (SIAM) to ensure effective end-to-end service is delivered to end users
Multi-sourcing trends

- Multi-sourcing not new but more customers moving to this model
- Big single source deals still being done
- Other market trends prompting this move
  - Commoditisation of infrastructure services such as networks and data centre services
  - Availability of on demand software services such as Office 365
  - Cloud computing
  - Competition driving buyers to look to a broader range of IT suppliers to drive innovation
- UK Government leading the way on large multi-sourcing deals
- Factors influencing degree of multi-sourcing for customers
  - Business strategy – e.g. are you an acquirer of businesses
  - Overall sourcing strategy
  - Capability of the internal IT organisation

You should be actively considering multi-sourcing
Multi-sourcing benefits

- Better service quality
- Post-signature competition
- Greater flexibility
- Avoiding ‘margin-on-margin’ payments

Multi-sourcing is a route to greater savings and better service BUT
Multi-sourcing challenges

- No single point of responsibility
- Increased management overhead
- Risk of service gaps
- Supplier collaboration and interdependencies
- Ensuring alignment to the wider business and IT strategies
- The degree to which the services are disaggregated
- The difficulty of transitioning to a multi-sourcing model
- Managing business risk and stakeholders
- Building or buying in the capability to manage both the transition to and manage multi-sourced models – the place where SIAM plays

These challenges can be addressed with the right external support and internal capability.
Service integration and management (SIAM)

- SIAM function can be fulfilled in different ways
  - By the internal IT function
  - By an independent provider
  - By one of the underlying service tower providers

- Role of the SIAM provider
  - End-to-end service management
  - Provider of some services such as the IT Help Desk
  - Take on some risk and liability for the end-to-end service
  - Dispute resolution support

- SIAM must be empowered to manage service tower providers

An effective SIAM is key to delivering effective and high quality end user service
Multi-sourcing – the keys to success

- **Target Operating Model** - for all IT services internal and outsourced
- **Service Model** – who does what between corporate IT, SIAM and the tower providers
- **Commercial model** – the right mechanisms to ensure collaboration
- **Contractual model** – the right balance between an overarching Master Services Agreement, collaboration agreements, and the individual service tower contracts
- **Technical Architecture model** – the architecture and technical standards you expect to comply with
- **Programme Delivery model** – transition is complex and should be treated as a business transformation programme

**ALL these elements need to be addressed**
Optimising the multi-sourcing model

- Reflecting your multi-sourcing requirements in the tender process
- The use of collaboration agreements with and between suppliers
- Inclusion of an appropriate balance of incentives and disincentives in their contracts to ensure supplier co-operation and collaboration
- Strong governance structures, including cross-supplier governance boards with attendance by senior management of the customer and each supplier

Your contracts need to address ALL these aspects
Conclusions

- You should actively consider multi-sourcing models
- These models can lead to greater savings and better levels of service BUT
- Lots of challenges to be addressed to be successful
- Challenges can be addressed with the right external support and internal capability
- The multi-sourcing model must be defined from a number of perspectives – operating, service, commercial, contractual and technology
- Implementing a multi-sourcing model is a significant change programme
- The right contractual arrangements and SIAM provision need to be in place to underpin the model and ensure its effectiveness
Captives and other structures
Outsourcing structures in 2015

- Standard outsourcing model is mature
  - Not necessarily a bad thing…
  - It means the level of customer experience is deep

- Ongoing challenges to “traditional” models include:
  - Labour arbitrage benefits quickly eroded
  - Control
  - Governance/audit/openness
  - Regulation/Legislation
  - Exit experiences

- Growth in appetite for different models continues
## Option comparisons

<table>
<thead>
<tr>
<th>Options</th>
<th>Set-up costs</th>
<th>Governance/Audit/Openess</th>
<th>Level of customer control</th>
<th>Flexibility</th>
<th>Exit costs</th>
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<tr>
<td>3rd party (offshore)</td>
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<td>3rd party (onshore)</td>
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<td>Medium/High</td>
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<td>Captive (BOT)</td>
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<td>Medium/High</td>
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<td>Medium/High</td>
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Key difference in models

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<th>Degree of ownership</th>
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<th>JV</th>
<th>3rd Party (onshore)</th>
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<table>
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<tr>
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<th>3rd Party (offshore)</th>
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<tr>
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Offshore – 2014

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<th>Rank 2014</th>
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<td>South Asia</td>
<td>India</td>
<td>Bangalore</td>
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<tr>
<td>2</td>
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<td>+1</td>
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<td>Manila (NCR)</td>
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<tr>
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<td>South Asia</td>
<td>India</td>
<td>Mumbai</td>
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<tr>
<td>4</td>
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<td>-</td>
<td>South Asia</td>
<td>India</td>
<td>Delhi (NCR)</td>
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<td>South Asia</td>
<td>India</td>
<td>Chennai</td>
</tr>
<tr>
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<td>-</td>
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<td>India</td>
<td>Hyderabad</td>
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<td>10</td>
<td>9</td>
<td>-1</td>
<td>Western Europe</td>
<td>Ireland</td>
<td>Dublin</td>
</tr>
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6850 miles
Captives

- Captive
  - Use of wholly owned offshore subsidiaries to provide services - not 3rd party vendor

- Advantages:
  - direct control over the offshored services
  - captive can leverage existing arrangements more easily
  - particularly attractive to regulated businesses

- Issues:
  - £ up-front
  - implementation timescales
  - direct control also = no risk transfer
Captive - practicalities

- Options:
  - **DIY** - Do It Yourself
    - customer builds from scratch
    - high "on the ground" commitment from the customer
    - if abandoned the wind-down costs are likely high due to sunk costs
    - **Documents**: will depend on tax/risk/compliance dept
  - **BOT** - Build Operate Transfer
    - customer engages a 3rd P to set up
    - option to acquire
    - implementation risk transferred
    - often a lower implementation lead time
    - **Documents**: As per DIY above but with an agreement with 3rd P as well to deal with set-up and transfer of the captive entity.
Outsourcing regulated activities
Regulated activities

- Certain sectors have a regulator which dictates how they outsource:
  - e.g. FS (SYSC Rule 8), Solicitors (Chapter 7 of Code of Conduct)
  - Services (and agreements) will need to be mindful of such obligations

- Within BPO, aspects of processes/services which are being outsourced may be subject to regulation/authorisation/licence e.g.:
  - legal advice

<table>
<thead>
<tr>
<th>Part 2: Rights of practice</th>
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</thead>
<tbody>
<tr>
<td>Rule 8: Reserved work and immigration work</td>
</tr>
<tr>
<td>Solicitors</td>
</tr>
<tr>
<td>8.1 As a solicitor, provided that you comply with Rule 9.1, you are authorised by the SRA:</td>
</tr>
<tr>
<td>(a) to undertake the following reserved work:</td>
</tr>
<tr>
<td>(i) the exercise of any right of audience which solicitors had immediately before 7 December 1999;</td>
</tr>
<tr>
<td>(ii) the exercise of any additional right of audience if you have a relevant higher courts advocacy qualification awarded by the SRA or another approved regulator;</td>
</tr>
<tr>
<td>(iii) the conduct of, and the preparation of documents in, court and immigration tribunal proceedings;</td>
</tr>
<tr>
<td>(iv) the preparation of instruments and the lodging of documents relating to the transfer or charge of land;</td>
</tr>
<tr>
<td>(v) the preparation of trust deeds disposing of capital;</td>
</tr>
<tr>
<td>(vi) the preparation of papers on which to found or oppose a grant of probate or a grant of letters of administration;</td>
</tr>
<tr>
<td>(vii) the administration of oaths and statutory declarations; and</td>
</tr>
<tr>
<td>(b) to undertake immigration work not included under (a) above.</td>
</tr>
</tbody>
</table>
Types of regulated activities

- E.g. debt collection services

Debt administration

36G.—(1) Subject to paragraph (3), taking steps—
(a) to perform duties under a credit agreement or relevant article 36H agreement on behalf of the lender, or
(b) to exercise or enforce rights under such an agreement on behalf of the lender,
is a specified kind of activity

(2) Subject to paragraph (3), taking steps—
(a) to perform duties under a consumer hire agreement on behalf of the owner, or
(b) to exercise or enforce rights under such an agreement on behalf of the owner,
is a specified kind of activity

Similar issues for:
- tax or accountancy advice or services
- Aspects of HR
Outsourcing these regulated services

- How can these services be outsourced?
  - With difficulty…
  - With acceptance that you cannot outsource the ultimate compliance responsibility

- Ideal scenarios:
  - For Customer: “Supplier shall comply with and be responsible for every law which applies to these services whatever happens…”
  - For Supplier: “Supplier shall only do what instructed, and Customer shall comply with and be responsible for…”
  - Neither overly simplistic approach is likely to work in any form of sophisticated scenario

- Where should responsibility lie, what is a middle-ground?
A middle ground… (Pt 1)

<table>
<thead>
<tr>
<th>Phase</th>
<th>Activity</th>
<th>Responsibility</th>
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<tbody>
<tr>
<td>1</td>
<td>Establishing controls for documents</td>
<td>Supplier</td>
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<tr>
<td>2</td>
<td>Testing controls and reviewing designs</td>
<td>Customer/Supplier</td>
</tr>
<tr>
<td>3</td>
<td>Designing testing program</td>
<td>Customer/Supplier</td>
</tr>
<tr>
<td>4</td>
<td>Sign-off on testing results</td>
<td>Customer</td>
</tr>
<tr>
<td>5</td>
<td>Suggest process improvements to improve compliance</td>
<td>Supplier</td>
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</table>
A middle ground… (Pt 2)

<table>
<thead>
<tr>
<th>Phase</th>
<th>Activity</th>
<th>Responsibility</th>
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<tbody>
<tr>
<td>6</td>
<td>Approve process improvements</td>
<td>Customer</td>
</tr>
<tr>
<td>7</td>
<td>Define compliance, policies and procedures</td>
<td>Customer</td>
</tr>
<tr>
<td>8</td>
<td>Define and be responsible for risk assessment processes</td>
<td>Customer</td>
</tr>
<tr>
<td>9</td>
<td>Review/interpret new or amendments to compliance/legal responsibilities</td>
<td>Customer</td>
</tr>
<tr>
<td>10</td>
<td>Input and suggest in relation to new or amendments to compliance/legal responsibilities</td>
<td>Supplier</td>
</tr>
</tbody>
</table>
How is UK employment law shaping up to deal with the global outsourcing challenge
Trio of trends

- The World with less application of TUPE
- The rise of the blanket indemnity
- The onward march of globalisation and multi-sourcing
Rights, duties, powers and liabilities transfer

Information and consultation

Notification of employee liability information

Dismissals automatically unfair in certain circumstances

Changes to terms and conditions at risk of being void

No contracting out-right of objection

Staff transfer on same terms

“relevant transfer”
Trend one – the world with less application of TUPE
Standard “multi-factorial” test

A transfer of a stable economic undertaking which retains its identity
Service provision changes

- Exceptions:
  - Doesn’t apply to:
    - a specific single event or task of short-term duration
    - procurement or supply of goods
Reasons service provision change test is unlikely to apply

These include (but are not limited to):

**Fundamentally or essentially the same activities**

- *OCS Group UK Ltd v Jones* (EAT) 2009 – activities “wholly different”
- *Enterprise Management Services Ltd v Connect-Up Ltd* (EAT) 2012 – 85% threshold
- *Nottinghamshire Healthcare NHS Trust v Hamshaw* (EAT) 2011 – change of ethos

**Organised grouping of employees**

- *Eddie Stobart Ltd v Moreman and others* (EAT) 2012 – “principle purpose of the organised grouping”
A world with less application of TUPE - implications

- **Outgoing service provider**
  - Potential for redundancy costs and collective redundancy consultation obligations
  - More inclined to ask client to:
    - help mitigate implications of TUPE not applying – novation
    - bear the cost if TUPE does not apply – eg share redundancy costs/increase outsourcing fee

- **Incoming service provider/client**
  - Potential to change services to prevent TUPE applying
  - Potential that knowhow will be lost

*NB – many historic agreements have been negotiated on the basis that TUPE is more likely to apply than it actually is*
The rise of the blanket indemnity
The rise of the blanket indemnity

The outgoing service provider will simply ensure that staff do not transfer on exit, and if they do will bear all costs and liabilities associated with this

Particularly prevalent in small outsourcing scenarios

- **Advantages** – simple clean break approach, often used on reciprocal basis
- **Disadvantages**
  - Outgoing service provider will have to assign staff to other activities – contractual right?
  - Potential for redundancy costs and to trigger collective redundancy obligations (next slide)
  - Potential for automatic unfair dismissal claims – particularly if no alternative roles are available
  - Potential for TUPE information and consultation penalties
Mitigating implications of blanket indemnity – collective redundancies

- Dismissals by reason of the transfer are automatically unfair unless ETO reason
- ETO = economic, technical or organised reason “entailing changes to the workforce”
  (includes change of location)
- New(ish) ability to conduct collective redundancy consultation before the transfer
The march of globalisation and multi-sourcing
The onward march of globalisation and multi-sourcing

_Holis Metal Industries Limited v GMB (EAT) 2008_

Implications:

- Staff will transfer to incoming service provider
- Incoming service provider will need to make them redundant – potential to mitigate costs/liabilities if the parties work together
Multi-sourcing (fragmentation)

**Principles**

- A service provision change can occur where the activities are distributed among a number of contractors, provided that it is possible to identify with which contractor they end up.
- TUPE may be avoided where services are randomly distributed.

**Examples**

- *Kimberley Group Housing Limited v Hambley* (EAT) 2008 – TUPE applied to a transfer of a contract for the provision of asylum seekers from one service provider to two service providers.
- *Clearsprings Management Limited v. Ankers* (EAT) 2009 – activities previously undertaken by one contractor awarded to several contractors with “no discernible pattern of reallocation.”
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