

Sole Source Outsourcing

Ensuring A Successful Outcome

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Executive Summary

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, sole sourcing was employed to deliver a simplified, faster service acquisition process, with fewer of the difficulties of staging and reviewing a multi-vendor process. Today, the use of sole sourcing is most often a function of the trust that exists between a buyer and supplier.

Sole sourcing can deliver significant potential efficiencies over multi-vendor 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 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 supplier'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:

- Carefully defining 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 supplier's and buyer's organizations, while also forging a productive working relationship with the supplier.

Why Sole Source?

As described in **Exhibit 1**, buyers of outsourcing services may select either a sole source or multi-supplier approach for a wide range of reasons. In many cases, the buyer has a preexisting relationship with the supplier, 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 supplier.

EXHIBIT 1

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

Sole source

- Speedy process is critical
- Reputation of supplier is critical
- Supplier 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., supplier owns critical software or exclusivity rights)
- High degree of trust between buyer and supplier in the form of preexisting relationships, either institutional or personal; often based upon proven ability of supplier to deliver results
- Corporate culture favors collaborative sole source approach
- Opportunity for a broader buyer-supplier alliance (e.g., cross-selling of products, managing sales channels, or providing access to technology or research capabilities)

Multi-vendor

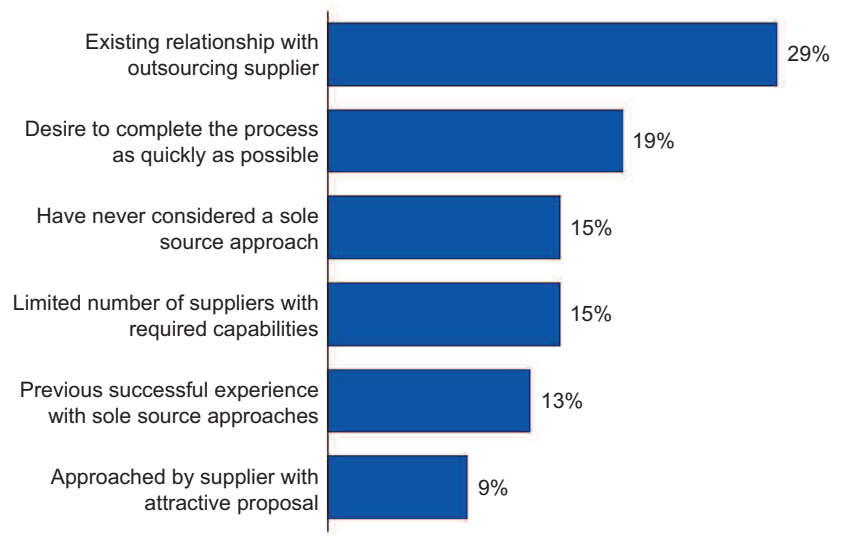
- Services in scope are well-defined within the marketplace
- Focus on achieving lowest price over broader measures of value
- Multiple solutions based on differing supplier strengths need to be evaluated due to insufficient ability to perform rigorous internal analysis of options
- No dominant preexisting relationship guides the selection
- Corporate guidelines, governmental policies, or culture dictate multi-vendor approach
- Change management and implementation challenges are minor
- Organization is highly skeptical of any sole source approach, thereby slowing up decisions and undermining the credibility of the process

An Outsourcing Center poll revealed that existing relationships and a desire for a speedy process are the two largest factors influencing a company to consider a sole source approach – together accounting for almost half of the decisions to consider a sole source approach (**Exhibit 2**).

EXHIBIT 2

Primary reason for considering a sole source approach

Source: May 2003 poll on www.outsourcing-center.com



Interestingly for outsourcing suppliers, buyers disclosed that a supplier approaching them with an attractive proposal was 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, sole source approaches to outsourcing were taken for many larger information technology outsourcing (ITO) transactions requiring either complicated or rare sets of capabilities. Since suppliers with such capabilities and geographic presence were scarce, buyers were faced with a limited selection of those capable of delivering the required services. More recently, as business process outsourcing (BPO) has become an accepted alternative, buyers are choosing sole source approaches with suppliers with whom they currently have a relationship or suppliers who have unique capabilities.

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

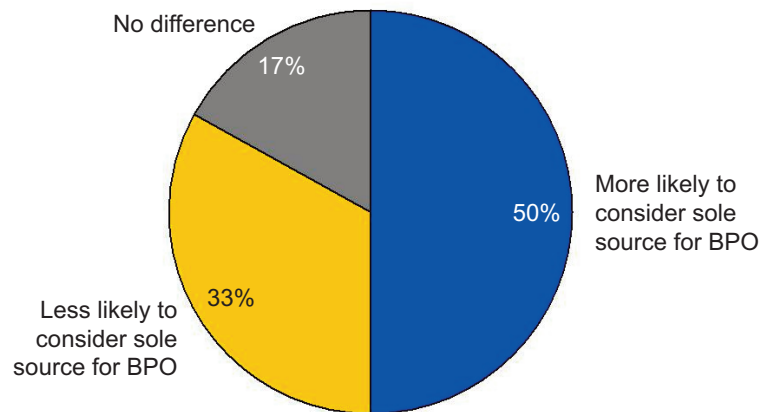
The rationale to tap existing relationships for BPO was often pragmatic. First, in the early days of BPO, few suppliers had proven capabilities for delivering the processes under consideration. Second, by entering into a sole source relationship, the buyer taps existing, strong relationships, as well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

Indeed, another poll indicated that 50% of organizations are more likely to consider a sole sourcing approach for BPO than ITO (**Exhibit 3**). Conversely, 33% are less likely to consider sole source approaches for BPO. Surprisingly, only 17% of respondents indicated that the difference between BPO and ITO has no impact on their sourcing approach. Clearly, BPO is driving a change in how organizations think about their sourcing approaches – both towards and away from sole source approaches.

EXHIBIT 3

Selection of sole source approaches for BPO

Source: April 2003 poll on www.outsourcing-center.com



A final factor has also contributed to the consideration of sole source approaches: buyers experienced in multi-vendor outsourcing arrangements have recognized the less obvious limitations that multi-vendor approaches face. The “hidden costs” of multi-vendor sourcing can dramatically influence the ability of the buyer to build a relationship with the right supplier. These hidden costs include:

Longer, more taxing procurement process

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

“Over-promising” by a supplier

In an effort to win in a multi-vendor situation, suppliers occasionally commit to deals that they cannot deliver. Such commitments lead to poor solutions or solutions that cannot be reasonably implemented. In other cases, the winning contract will need to be renegotiated within a few years.

Lack of attention

Small to mid-size buyers in a multi-vendor process may struggle to gain the full attention of suppliers. The result is fewer “pursuit dollars” being allocated to the supplier’s sales efforts, thereby limiting the degree to which the supplier can tailor its solution to match the buyer’s unique needs (or even pursue the opportunity at all).

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 supplier. The buyer wants a solution tailored to meet the company's specific needs, while the supplier wants to develop a solution that leverages its capabilities and infrastructure. Further, the supplier often makes service and delivery promises in order to quickly obtain a letter of intent (LOI). Why quickly? Because the supplier wants to create an emotional commitment, and the trust at the core of the relationship will usually prevent the buyer from declining to contract. The supplier's efforts to move quickly through the initial stages in order to expedite the signing of a loosely defined LOI can result in an engagement that better serves the supplier's needs than those of the buyer. This "Commitment in Principle" lacks appropriate details in three key areas: 1) the scope and nature of the arrangement; 2) guaranteed levels of services to be provided; and 3) the nature of how the buyer and supplier will share in the value created by the supplier's solution. In these cases, the supplier will have negotiated for terms more favorable, easier to deliver, and less taxing on the supplier – regardless of whether the terms and deliverables fully suit the buyer's expressed or intended needs. Ultimately, the buyer feels locked into the agreement, and can be reluctant to re-open the discussions to address any perceived shortcomings.

Once recognized by the buyer, such negotiations may bog down as both buyer and supplier attempt to inject their goals and motives into the agreement. This can dramatically slow the process, often leading the supplier to enjoy perceived negotiating power in its favor as the buyer becomes increasingly concerned with facilitating a speedy closure to the arrangement. If negotiations do slow down significantly, two additional challenges are prone to emerge.

First, any slowing of the negotiations can lead to a respective “wandering” of focus and attention by both buyer and supplier. The buyer’s lost focus can result in a reinterpreting of the effort’s desired objectives and scope. This leads to a “moving target,” which changes the nature of the effort from the supplier’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. As a result, consensus regarding the project’s scope and objectives is undermined.

Second, idle time during the negotiation phase can lead to the introduction of additional processes by the supplier to broaden the scope of the initiative and inclusion of mechanisms to limit risk to the supplier. Just as the buyer’s organization often senses a lack of firm scope to the agreement, the supplier’s own internal risk mitigation group will seek to insert additional protections into the agreement’s terms and conditions to protect the supplier from perceived financial risk associated with a poorly defined scope or unclear customer expectations.

To avoid these types of issues in a sole source situation, the process must be carefully designed – by the buyer, not the supplier. 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 supplier, and ensures that the decision was made 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. Five factors come to bear in creating a successful sole source approach to outsourcing. Several of these factors are important in multi-supplier 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 supplier 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, suppliers 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 supplier can spend increased amounts of time together.

For example, a sole source situation provides an opportunity to foster intensive collaboration between the buyer and supplier, with the buyer seeking a solution based upon real insight from the supplier – not an “off-the-shelf” solution. These customized solutions demand mutual transparency and information exchange between the buyer and supplier. Through these interactions, the relationship grows with the buyer gaining more trust in the single supplier and seeking that supplier's insights. In a sole source situation, both the available time and the process used to develop the solution can be designed to provide opportunities to strengthen the relationship beyond what is possible in a multi-vendor 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 supplier and buyer, versus a positional-based spec and bid process that tends to agitate differences. An “interest-based” approach¹ to negotiating can be used 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 of a buyer and supplier to work more closely together in a sole source approach often better facilitates this process than would a multi-vendor outsourcing approach.

2. Engage senior leadership

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

This is important for several reasons. Specific solutions often are highly tailored 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 supplier 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.

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.

3. Involve the Board

Different companies have different internal governance guidelines for reporting programs of particular sizes, scope, or impact. Depending on the size and impact of the transaction, the Board of Directors might need to be informed and educated about the outsourcing project in order to understand, agree to, and, if necessary, sign off on the sole source approach. Preferably, this should be done 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 supplier 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 can be spent with a single supplier 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, when a Board is presented for the first time with 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 all options have been considered 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 suppliers. The inevitable impact is that additional time, effort, and resources are invested 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-vendor approach.

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. Compare to ensure value

The parties must adopt a sophisticated external comparative analysis process to ensure fairness of value sharing¹. 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 is seeking from the supplier's services, and how such services will help the buyer achieve its goals. Working in tandem, both buyer and supplier must confer on and set specific targets for the supplier, which requires the buyer to complete analyses that would not be required if the buyer had alternative solutions for comparison.

By comparing each component of the potential solution, the supplier is effectively continuing 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 supplier 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-supplier at any time.

5. Be specific – more specific than seems necessary

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.

¹ Although external comparisons are almost always a part of the decision process, the limits of benchmarking and comparative analysis must be understood. Ideally, services could be treated 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, supplier flexibility) that cannot be captured by benchmarking and the final decision must consider a range of quantitative and non-quantitative measures.

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. Although most companies believe that they provide these inputs to the supplier, the level of detail and thought given to them is often an order of magnitude less than what is actually required.

The scope targets must be set to define which processes are in-scope. This should be the buyer's decision, although the supplier can offer alternatives through appropriate mechanisms. Additionally, the buyer must dictate the level of precision the supplier must use to establish its roles and responsibilities in the outsourced process for the proposed pricing. For example, requiring a supplier to develop a responsibility matrix for the proposed solution can help quickly delineate the critical responsibilities of both the buyer and supplier, thereby allowing the buyer to understand which activities it would retain or lose and the financial impact of each.

Additionally, the buyer must insist that the supplier's proposal detail the metrics that would be used to measure the success of the proposed solution. Forcing the two parties to discuss and agree upon the specific metrics provides clarity that bypasses any pleasant, but non-accountable rhetoric.

Summary

A sole source approach will not be the best solution for every organization; however, it can be a viable approach in the right situation. Many factors must be weighed, including the supplier'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 supplier to adapt and provide new services over time, and acceptance of sole sourcing across the organization.

If a sole source approach is selected, the chance of success is increased by using the sole source environment to begin building or deepening the buyer-supplier relationship, meaningfully engaging senior leadership, involving the Board early in the process, comparing the supplier's solution to external measures, and being specific about what is expected of the supplier during the process. 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.

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Everest Group helps companies create sourcing strategies and outsourcing relationships that deliver total value – improving performance and results throughout their organizations. Since 1991, we've completed hundreds of major outsourcing transactions in more than 30 key business processes. Our breadth and depth of experience enables us to deliver expert analysis and strategic results.

Our flexible, collaborative approach analyzes the specifics of each sourcing challenge. Throughout the process, we encourage collaboration between buyers and service providers to spark creativity and lay the groundwork for long-term outsourcing success. The result is a solution that recognizes the strengths, weaknesses, and strategic objectives of both parties.

About the Authors

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