CORPORATE GOVERNANCE

Five Tips for Avoiding Pitfalls in Multi-Sourcing Arrangements

By Christopher A. Seidl and Li Zhu

Today, more outsourcing contracts are being inked than ever before. In second quarter 2014 alone, companies around the globe signed a record 340 commercial outsourcing contracts with an annual value of $5 million or more, totaling $6.4 billion altogether.[1] This represents a 72 percent increase over second quarter 2013 worldwide and a 118 percent increase for North and South America.[2] Information technology outsourcing ("ITO") contracts, in particular, increased globally by a margin of 100 percent over the same period.[3] In the words of one analyst: "We are seeing broad-based strength across the entire global outsourcing market, with growth almost everywhere we look."[4]

One reason for the increase in the number of outsourcing contracts in the outsourcing marketplace is the trend to "multi-source"—as commercial outsourcers rely much less on one major supplier. According to one commentator in the industry, "IT outsourcing contract counts in the Americas hit an all-time high through the first nine months of 2014 . . . thanks to increased multi-sourcing."[5] According to another source, "mega-deals will continue to become disaggregated and resourced in smaller pieces."[6] In fact, only 6 percent of outsourcing contracts in the U.S. currently go to a

---

Christopher A. Seidl is a partner at Robins, Kaplan, Miller & Ciresi LLP in Minneapolis, where he leads the firm's Global Business and Technology Sourcing practice. Contact him at caseidl@rkmc.com. Li Zhu is an associate at Robins, Kaplan, Miller & Ciresi LLP in Silicon Valley and is part of the firm's Global Business and Technology Sourcing practice group. Contact him at lzhu@rkmc.com. Their practices include helping clients avoid outsourcing disputes and resolving disputes when they arise.

[1] PR Newswire, *ISG Index: Global Outsourcing Industry at Record Highs* (July 15, 2014), http://www.prnewswire.com/news-releases/isg-index-global-outsourcing-industry-at-record-highs-267168751.html.

[2] *Id.*; Information Services Group, *The Global ISG Outsourcing Index*, at 3 (July 15, 2014), *available at* http://www.slideshare.net/ISG_Inc/second-quarter-and-first-half-2014-global-outsourcing.

[3] Information Services Group, *Second Quarter 2014 Outsourcing Trends Infographic* (July 15, 2014), http://www.isg-one.com/pdf/index/Second-Quarter-2014-Outsourcing-Trends/IndexInfographicFinal.pdf.

[4] PR Newswire, *supra* note 1 (quoting John Keppel, president of Information Services Group).

[5] Stephanie Overby, CIO, *Number of New IT Outsourcing Deals Hits All-Time High* (Oct. 31, 2014), http://www.cio.com/article/2841915/outsourcing/number-of-new-it-outsourcing-deals-hits-all-time-high.html.

[6] Stephanie Overby, CIO, *10 IT Outsourcing Trends to Watch in 2014* (Jan. 17, 2014), http://www.cio.com/article/2378979/outsourcing/10-it-outsourcing-trends-to-watch-in-2014.html; John Keppel, CIOInsight, *Outsourcing 2014: The New Normal* (Feb. 6, 2014), http://www.cioinsight.com/it-management/expert-voices/outsourcing-2014-the-new-normal.html.

---

single vendor.[7] This article offers tips for companies looking to successfully leverage multi-sourcing arrangements while avoiding potential pitfalls.

I. Multi-Sourcing "Mania"
—Risks and Rewards

Multi-sourcing's popularity can largely be attributed to its significant advantages. For example, successful multi-sourcing allows a prospective outsourcer to obtain expertise from multiple sources, diversify the risk inherent in outsourcing to a single provider, and can compartmentalize and define each vendor's responsibilities. Further, multi-sourcing allows a company to promote competitive bidding between several vendors for each portion of its outsourced areas. And multi-sourcing can allow for more flexibility in the event that sourcing strategies change, because there is less concentration of ramp-up expenses in a single vendor.

Multi-sourcing, however, is not without risk, given the stakes. Multiple vendors mean multiple hands managing the company's infrastructure. Without a strong governance body, the challenge of controlling several vendors can quickly derail an outsourcing arrangement. Further, miscommunication between vendors may also create inefficiencies, especially where each vendor's responsibilities are not clearly defined in a written instrument. Where vendors' responsibilities are not defined with respect to each other, a vendor has an incentive to dodge accountability by shifting blame. In light of these difficulties, companies seeking to craft successful multi-sourcing arrangements should be ready with a well thought-out game plan.

II. Tips for Avoiding Risks and Disputes in Multi-Sourcing Arrangements

Businesses can avoid many of the pitfalls of multi-sourcing by preparing a comprehensive strategy before entering into a multi-sourcing arrangement. This strategy should include leveraging expertise within the company at the start of outsourcing, carefully selecting each vendor, defining each vendor's responsibilities, promoting collaboration between all vendors and periodically evaluating each vendor's performance in the context of the entire outsourcing arrangement.

1. Creating a Strong Foundation
—Recruit Internal Expertise

Before a company tenders its Request for Proposal to prospective vendors, it should already have a strong internal team in place. This team should include the people most knowledgeable about the internal systems that will ultimately be outsourced. These individuals are almost always employees within the company itself and often have mission critical knowledge. Thus, it is important for a business to identify these individuals early when forming a governance team for overseeing the outsourcing arrangement. Reaching out to these individuals will help the organization obtain a clear idea of how services will be performed across the board, antici-

pate potential roadblocks and ultimately streamline multi-vendor coordination.

2. Choosing Your Providers—Diversify Your Options

A potential outsourcer should open up its RFP to a wide range of outsourcing vendors (including vendors of all sizes) and refrain from excluding any vendor category from the selection process. Although larger vendors generally have more capacity to handle bigger pieces of a project, smaller vendors may be more agile with their own niche expertise. During the selection process, the organization should fully investigate each vendor's abilities, including how scalable a given vendor can be when handling projects of different sizes. The organization should also explore whether each vendor works well with others in a multi-sourcing environment and whether there is bad blood between any of the multiple vendors.

3. Clearly Define Each Vendor's Responsibilities and Accountability

In a multi-sourced environment, it is especially important for each outsourcing agreement to clearly define each provider's roles and expectations. Thus, when problems inevitably emerge, every provider is clear about who is responsible for remediation. Further, each agreement should contain a detailed exit strategy in case a party prematurely terminates its outsourcing relationship. That way, if one vendor leaves, it is well-understood who will step in to minimize service disruption (*e.g.*, whether the work will in-sourced or taken on by another vendor).

4. Promote Cooperation and Collaboration Between Vendors

An organization in a multi-sourcing arrangement should also consider contractually requiring its vendors to collaborate with one another. Due to multi-sourcing's popularity, mandatory collaboration between vendors is increasingly becoming an essential part of any outsourcing contract, so that businesses can ensure that their multiple vendors "talk to each other" regarding integration of their services at both an operational and process level.[8] By way of example, in 2013, several outsourcing customers implemented outsourcing "cooperation agreements" contractually obligating service providers to cooperate at an operational level.[9] These agreements defined each provider's responsibilities, as well as how the providers were expected to perform where there was overlap. They should also specify how key interactions between providers will be handled.

Further, where a provider discloses the organization's confidential information to another party (such as a subcontractor), the organization should ask that it be named as a third-party beneficiary to the subcontracting agreement. That way, the organization can enforce the third party's compliance with the organization's confidentiality obligations or have a direct cause of action against the third party.

---

[7] PROFESSIONAL OUTSOURCING RESOURCES, *UK leads the way in multi-sourced outsourcing* (Feb. 27, 2014), http://www.professionaloutsourcingmagazine.net/newsitems/uk-leads-the-way-in-multi-sourced-outsourcing.

[8] OUT-LAW.COM, *Service integration the biggest issue for IT buyers that multi-source, says expert* (Feb. 24, 2014), http://www.out-law.com/articles/2014/february/service-integration-the-biggest-issue-for-it-buyers-that-multi-source-says-expert/.

[9] Overby, *supra* note 6.

5. Evaluate Vendor Performance And Promote Accountability

It is often difficult to define ''success'' comprehensively in an outsourcing relationship, especially where a potential outsourcer wants both quantitative and qualitative performance measurements. Thus, the outsourcing agreement should use unambiguous terms to define the organization's expectations and each provider's responsibilities, and lay out specific performance criteria, success measures and response times for remediation. By way of example, the organization should set out ''benchmarking'' guideposts throughout the transition of services from customer to vendor. The organization should also establish clear accountability for service failures by specifying how a provider can remediate a failure in a timely fashion, and when other providers can step in and take over.

III. Conclusion

The popularity of multi-sourcing will continue to grow as companies increasingly rely on external expertise to manage their information technology and financial systems. Companies seeking to leverage multi-sourcing arrangements should have a detailed strategy for the entire endeavor—so they can enjoy the rewards and avoid the risks.