

From the inside out

Making cost savings without compromising quality can be a tricky business if you are outsourcing procurement. Angela Cha gives some tips on how to avoid the pitfalls

The main objectives for outsourcing procurement are similar to other types of outsourcing arrangements - to reduce costs and focus on core business. While the potential benefits are generally supported, procurement can be complex to outsource because of difficulties in appropriately incentivising the service provider to achieve cost savings, and the balance between retaining a degree of control over procurement spend while giving the service provider strategic freedom.

Unless businesses have a robust contract with their service providers which contains, among other terms, very prescriptive provisions relating to gain sharing arrangements, commitment to realising savings, agreed spend processes and a clear scope of service, they may find cost savings elusive and the outsourcing unworkable and unsuccessful.

The realisation of cost savings features more prominently in a procurement outsourcing. Unlike IT, human resources and back office administration, where the charges are set and gain sharing initiatives play a smaller role, gain sharing arrangements in a procurement outsourcing often form the service provider's main income/profit. It achieves its margins largely through savings from suppliers and from improving processes and procedures. Typically they would be expected to achieve an annual savings target based on the spend across different categories.

The contract must set out the structure from which target savings are set. In addition, as procurement needs are likely to change over the life of the arrangement, the contract must be flexible to accommodate change but have some degree of predictability in respect of the key areas of service and pricing. By having these provisions, both

parties will be able to avoid full scale re-negotiations each time there is a change.

Businesses can't lose sight of quality of service or category items in their drive to achieve cost savings. Service providers can easily source low quality goods and services to achieve savings targets, therefore the outsourcing contract must include provisions around supplier selection and quality or standards of category items.

Successful procurement outsourcings also require an effective retained procurement organisation and governance regime to manage the arrangement and the relationship with the service provider. A balance is needed between retaining control and recognising that the service provider will require a degree of freedom to achieve savings. The outsourcing contract must be clear about the boundary of responsibilities and also reflect the control and freedom between the two parties in respect of the different goods and services categories.

All outsourcing contracts need to set out potential remedies for service failures, including any fault on the part of the service provider to achieve the savings targets. It may be that the service provider shares in the savings if the target is achieved, or pays a service credit when they are not achieved. However, a commitment to 'hard' consequences can be difficult for both parties to accept where savings estimates are nebulous.

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