

# Considerations when Negotiating IT Outsourcing Agreements

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## Slide 1

### Introduction

- Information Technology (IT) Outsourcing is the practice of selectively handing IT functions to third party vendors.
- ~ 40% of Australian organisations outsource IT.
- > 50% of IT outsourcing agreements fail within the first year.
- ~ 90% fail to deliver expected outcomes.
- Failure has also been linked to a poorly drafted or poorly negotiated contract.
- This discussion reviews issues relating to IT Outsourcing negotiations. It focuses on the need for a structured approach and the considerations that need to be made.

## Slide 2

### Is Outsourcing IT different?

- IT Outsourcing is distinct from other services outsourcing:
  - IT evolves rapidly making sourcing decisions highly volatile.
  - Underlying economics of IT changes rapidly.
  - IT is tightly integrated with other organisational functions.
  - Switching costs are often prohibitive.
  - IT Outsourcing clients are still highly inexperienced.
- IT Outsourcing is distinct from other IT Agreements:
  - Outsourcing is a long-term alliance between the customer and supplier(s).
  - Management controls for services rendered resides externally with the supplier.

## Slide 3

### Some Risks of IT Outsourcing

- Hidden Costs.
- Cost & Effort of establishing, governing and managing the relationship.
- Complexity.

- Confidentiality.
- Dependence.
- Loss of Control over IT direction.
- Loss of competitive advantage / innovative capacity.
- Additional risks in offshore outsourcing.

#### Slide 4

##### **Internal / External Pressures**

- Customers need to get high quality services at low cost – vs. Suppliers need to profit.
- Business changes that affect both parties Eg. mergers, acquisitions.
- Changes in the market place or business landscape.
- (Rapid) Changes to technology.
- Regulatory changes.
- Economic factors.

#### Slide 5

##### **The need for structure**

- Negotiation of an IT Outsourcing agreement is
  - *not* an intuitive, ad-hoc process,
  - *not* a procurement exercise.
- Need to incorporate complex organisational, strategic and operational priorities.
- Need to understand how the outsourcing vendor can add value.
- Need to withstand long term pressures and changes.
- Need to prevent litigation, unplanned termination or switching.
- Long term nature increases need for rigour.
- Research links failure to poorly drafted contract.

#### Slide 6

##### **What happens when negotiation is not done properly?**

- Confusion on scope/accountability.
- Confusion on objectives & how success is measured.
- Lack of ability to cope with pressures & changes.
- Lack of transparency of costs.
- Escalating costs.
- Inadequate dispute resolution mechanisms.
- Communication or governance issues.
- Breakdown in relationship / termination of contract.
- High switching costs or legal costs.

## Slide 7

### **Negotiation style & technique**

- IT Outsourcing is a long-term ongoing relationship.
- Parties act together for mutual benefit.
- How well the relationship works depends on :
  - communication, contract, governance, management
- Negotiation currently un-structured or focused heavily on price - rather than other important aspects.
- Negotiation should focus on outcomes for mutual gain.
- Integrative methods - considering interests of both parties better suited than positional or power based negotiation.
- Principled style of negotiation:
  - Focus on interests, not positions or people;
  - Some interests may not be aligned - invent options for mutual gain;
  - Long- term relationship

## Slide 8

### **Some negotiation considerations**

- Scope of services/ responsibility.
- Risks – how these will be shared.
- Maintaining currency with technology & skills.
- Flexibility – how changes will be handled.
- Problem/Dispute resolution mechanisms.
- Governance Methodology & structures.
- Pricing schedules and structures.
- Service Level Agreements and how these will be measured.
- Mechanisms for innovation/ continuous improvement.
- Personnel Issues – how to handle these.
- Contract re-negotiation.

## Slide 9

### **Current Research**

- A Framework for negotiating IT Outsourcing Agreements.
- Using existing structured negotiating techniques, industry best practices.
- How? Literature review, interviews with domain experts, study of test cases.
- Evaluation - by industry experts through application to industry based negotiations

## Slide 10

### **Thank You**

- Your Questions / Comments Please.