

Human Resource Executive®



Legal expert and HR Technology Conference® speaker Barbara Melby details some of the common mistakes companies and HR executives make along the way to HR BPO—and how to avoid them.

Coming To Terms

Human resource outsourcing is on track to continue record growth in the United States, according to a recent survey of Hewitt Associates, the Lincolnshire, Ill.-based consultant and provider of HR business process outsourcing solutions. The study of 129 large companies, representing nearly 2 million employees, found that organizations are generally satisfied with their HR outsourcing decisions and plan to outsource more HR services by 2008.

That's not to say, however, that the path to HR BPO is easy to navigate. Indeed, as some companies can attest to, it often can be treacherous.

No one knows this better than Barbara M. Melby, a partner with the law firm Morgan Lewis. Melby, who works in Morgan Lewis' Philadelphia office and specializes in advising clients on the legal aspects of HR BPO, has participated in nearly 50 major outsourcing transactions, including

many involving HR. She's witnessed firsthand the varied and significant challenges that await those intent on making the transition.

Melby is slated to address the legal aspects of HR BPO during a session at the 2005 HR Technology Conference and Exposition® in Chicago, which runs Oct. 19 through 21 (www.hrtechnologyconference.com). Among other things, she will explore what companies can expect,

who to involve at each stage of the outsourcing process and how to avoid some of the more common and frustrating traps.

Melby, co-author of two seminal books on outsourcing, recently spoke to *HRE* about some of the common mistakes companies make when it comes to formulating and executing an HR BPO strategy.

When it comes to negotiating an HR BPO agreement, what do you see as the biggest mistakes employers typically make?

I think the biggest mistake is not investing enough time up front, prior to contract negotiations.

It's important to identify what the success criteria are going to be for the deal up front, and then use that as a checkpoint at each of the phases of the transaction. It's important for people to be reminded of the success criteria for the deal. Cutting costs is one example. Or it could be that you wanted better service. Or you wanted a standardized solution across your whole company. Or it could be that you wanted to globalize your HR platforms.

If you don't identify what the success criteria are, and what you really want to get out of the deal on the back end, people are going to start second-guessing you. You want to make sure that you can point to what the success criteria are so you can say, "We actually are meeting what we set out to meet."

What's the typical timetable for negotiating this kind of agreement?

It depends on the size and scope of the deal. Outsourcing one function, such as benefits administration, will typically have a shorter time line than a full-scale HRO, which encompasses most, if not all, of your HRO processes. Generally, I would say it could be anywhere between 90 days and nine months. It's a very broad range, depending on a bunch of factors.

Another [variable] is if you've ever outsourced before. If you're re-

sourcing a function that's already been outsourced, you're going to at least have an educated internal group when you go to the next vendor.

It's important to look at what you have in front of you with respect to scope and the number of vendors you want to talk to, and map out the time line. Then work backwards from the date that you need to have it done by, and start thinking about whether or not you can do it in that time frame.

Who typically are the players involved in the contract negotiation process and what are their roles? And do you feel the right people are typically being included?

From a legal perspective, it's incredibly important to identify and get the right team together early on in the process, during the strategy phase.

To the extent that you can bring in your legal team as early in the process as possible, that's a great thing, because that way, the legal team can help guide you through due diligence and identify any big pitfalls prior to actually going on to the [request for proposal] stage.

For sure, you're going to need your HR team and, if there are any employee transfer issues—people who specialize in employee transfers within your organization. You're going to need people from IT; and most likely, someone from risk management and insurance, if those people exist within your company.

Many companies have privacy officers, and those people need to be involved. And if you're a regulated industry, [involve] your compliance officer. And let's not forget someone from tax.

Are there certain individuals who are being left out of the process who shouldn't be?

Typically, you have the HR manager being brought in, and you have a technical person being brought in. But the other players, who may be viewed as more peripheral, are not brought in until later in the process. And that's

when it gets a little dangerous when you're trying to get people up to speed, and you're already four months into the process. I see tax being left out a lot. I see privacy and risk management people being brought in too late.

So the best strategy is to bring them in early in the process?

I think it's really important to form your team and identify all the players on your team as early as you can, even if they move in and out of the process. As soon as you identify that you want to outsource, you need to get these key players on board.

You also need to identify a project manager who will be there start to finish. Not just someone part-time, but someone who will be focusing on this full-time.

What kind of up-front work should an HR leader be doing before the contract negotiations get started?

As mentioned earlier, one of the key things is to identify the success criteria. What does the company need to see in order for this deal to be successful?

One of the pitfalls I see is that a company goes in and says, "OK, we want to outsource our HR," but then it doesn't really know what the scope of its own HR is when it goes out to bid. So it's really important—and it's going to save time on the back end—if the client can go through and scope out what they do today.

It's very dangerous to say to a vendor, "OK, bid on something," when you don't even know what they're bidding on. That's why it's important to sit down ... and map out the scope of what you do today.

Sure, that effort requires a bit more investment up front, but it really pays off on the back end, because it's going to help you [produce] the service document that gets attached to the contract. It's going to help you compare the bids effectively.

Are there certain kinds of performance measures that should be incorporated into the agreement?

Every agreement is going to have some type of service-level methodology. If it involves a call center, perhaps it's time to answer or response time. If it involves IT, it could be response time or time to fix the problem.

The types of service levels vary, depending on what the scope is, but it's key that the deal has a service-level methodology, so you have quantified service levels. Most deals, if not all deals at this stage, have service-level credits associated with them, so there's a certain amount of the monthly fees put at risk in the event service levels are missed.

How do these agreements address more subjective service measures, things like customer satisfaction?

Besides quantified service levels, there's a number of other checkpoints to measure subjective types of service. One is customer-satisfaction surveys. Either the customer does this, conducts the customer satisfaction survey of their end-users and management, or the vendor does it. Some customers use the results of these surveys as quantified service levels.

That's one way. Benchmarking is another way. It depends on the length of your transaction. What you're seeing now is a lot of clients putting in clauses that [give them] the ability to benchmark their services, fees and service levels against similar deals in the industry. That gives you another mechanism for determining whether or not your fees remain competitive over the term of your transaction.

Terms can be anywhere from one year to seven or 10 years, depending on the scope. So you want to make sure that you have a competitive deal over that entire term. The benchmarking clause gives leverage to ensure that you're getting that.

Then you have management and governance committees, which really are a forum for the customer to express its concerns with respect to performance, relationships and ongoing perceptions of the vendor within their customer's organization. The governance piece is critical to the ongoing relationship, [giving the

client the ability] to share ideas and share concerns around service.

What tends to be the biggest derailers as far as these agreements are concerned?

The No. 1 reason for the deals derailing is that there just isn't a business case for them. There just wasn't enough savings in the deal. Another reason may be there's too much risk, from an internal perspective, around actually outsourcing. But that's secondary.

From a governance perspective, what's the best way to structure these arrangements?

There's a couple of things from a governance perspective that I think are effective. Some can be done prior to contract signing. To start with, I think it's critical for those responsible for contract management and contract administration to sit through the contract negotiation sessions so they understand the contract structure ... what both parties want to get out of the transaction. They're only going to get that if they're sitting through the sessions.

Also, if we're talking about a full-scale HRO, it is important for the vendor to have a dedicated team at the customer's site. That way, they have daily interaction with respect to vendor perception and customer satisfaction.

Another key point is to make sure the customer's team and the vendor's team are aligned. So if the vendor has a project manager, the customer should have a project manager. If the customer has two project managers, maybe the vendor should have two project managers. It's key that there's alignment between the two governance teams, and there's good interaction between each of the players.

What do companies need to keep in mind as far as termination clauses are concerned?

From a legal perspective, I think it's the termination clauses that end up

giving the customer the most leverage at the end of the day. It gives them the ability to say, "I can get out of this transaction," notwithstanding the fact that, from a practical perspective, it may be painful to do so.

Many deals have an escalated termination-for-cause provision, in the event certain critical things aren't happening. So if there are certain critical services that need to happen, like the payroll checks need to be cut within a certain time frame and that's just not happening, [the provision can kick in]. The customer's not going to want to wait 30 days to get out of that contract.

There's also termination-for-convenience clauses that allow the customer to terminate on notice. It's typically anywhere from 30 to 180 days. Often, the termination can be associated with a termination fee. It may just be wind-down fees, and, depending on the type of termination for convenience, there may be no fee at all.

Then there's termination for change of control. So if the vendor gets bought out or there's a change in control, the customer can get out.

Also, if the deal has an offshore component, there may be ways to terminate a contract in the event there are increased risks, such as political unrest, with an offshore component in a certain country—what I would call a force-majeure event.

As you know, some of the early deals are now coming up for renewal. From what you're seeing and hearing, what are the elements that are being revisited and reworked? Have there been certain lessons learned?

I think the deals and the industry are maturing. I think you're seeing more focus on flexibility, because one of the things that everyone's learned in the last couple of years is that nobody's environment remains static. No one's management remains static. So what companies are looking for is a lot more flexibility.

Send questions or comments about this story to hreletters@lrp.com.



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