Multi-sourcing: a different way of contracting

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Today multi-sourcing forms an important part of sourcing strategy discussions, as customers decide which model (prime contractor or multi-sourcing) will work best for their deal.

In this article Rob Sumroy and Natalie Donovan of Slaughter and May's Strategic Sourcing team look at the multi-sourcing approach. We discuss the different contracting approach required, and how customers can use their contracts to drive supplier collaboration and receive the benefits multi-sourcing can offer, while reducing the risks involved.

Given the number of high profile failures in large prime contractor arrangements, it is unsurprising that outsourcing customers looked for different ways of engaging with their key suppliers. Multi-sourcing, which offers an alternative approach to supplier engagement, saw a surge in popularity a few years ago. This reflected a dissatisfaction with the traditional prime model, and a desire among customers to regain some of the control they consider was lost when they relied on a prime contractor to deliver an end to end service. Today multi-sourcing forms an important part of sourcing strategy discussions, as customers decide which model will work best for their deal.

Multi-sourcing involves the customer entering into separate agreements with different suppliers who will each provide a part of the overall service being outsourced. The benefits and risks of this multi-supplier model are well documented (*see box, Some advantages and disadvantages of multi-sourcing compared to prime contracting*). A properly managed multi-sourcing environment maintains an edge of competitive tension while creating a dynamic, direct relationship with suppliers who are leaders in their fields (best of breed). However by splitting the service up, the customer is responsible for any gaps which may arise, for example if the service scope is not properly allocated to the various suppliers or if the interfaces between service towers are not adequately defined. They also lose the central point of contact, or "one throat to choke" that a prime contract provided. This may mean the customer inadvertently finds itself in the role of service integrator, with all of the resource, cost and liability issues this entails.

While popular use of the phrase multi-sourcing is relatively new, multiple supplier environments are not. Nearly all outsourcing customers will have been managing multiple suppliers in some form or other and many have experienced first hand how difficult managing in this way can be. The move towards managing multiple suppliers has only increased as "cloud" and as-a-service offerings become more popular. To truly receive the benefits of multi-sourcing, customers must adjust their procurement practices, contract negotiation strategies and relationship management functions to suit a multi-sourced environment. It is also an opportunity for lawyers and other advisers to think creatively about how to help solve some of the issues raised by a multi-supplier environment. Having recently experienced lots of activity in this area, some of it positive, some not so well thought through, we have seen first hand the importance of both customers and advisers adopting a different approach to contracting: one tailored to the multi-sourcing world.

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This article looks at the multi-sourcing approach, and sets out some tips on how customers can use their contracts to drive the required supplier collaboration and to receive the benefits multi-sourcing can offer, while reducing the risks involved. It also shares the views of sourcing specialists Aecus on how the current multi-sourcing market is operating (*see box, A market view*).

Be clear about interdependencies

When more than one party is providing parts of an overall service, it follows that dependencies will exist. The different suppliers will be dependant on each other, to a greater or lesser degree depending on the service, to ensure that they are able to fully provide their part of the services or "piece of the jigsaw". It is therefore vital that the customer has a clear mechanism for designing, defining and agreeing the different service scopes and dependencies. This is particularly important as one supplier's dependency is another supplier's (or potentially the customer's) responsibility.

There are a number of different ways in which this can be achieved, for example:

- **A matrix:** the customer can design a matrix which the suppliers help complete. Customers will need to get the buy-in of their suppliers to the contents of the matrix, and will need to ensure any dependency is backed off. Failure to do this will often result in the customer being left with the risk.

- **Meetings with all bidders:** meetings with and between the potential suppliers during the procurement process are a useful way to discuss and agree obligations and detailed dependencies. The timings of these meetings are, however, key. While customers will not want to waste time on multiple meetings with bidders who will never make it past the initial procurement stages, they will want to leverage the competitive tension created when multiple bidders are still involved.

Whichever process is followed, agreeing all of the different obligations and dependencies will take time. It is therefore important that sufficient provision is made for these discussions in the procurement timetable. It is also important, wherever possible, that the timetable allows for dependency discussions with the different suppliers to happen in parallel, with the ultimate goal being synchronised/simultaneous agreement.

Plan synchronised and (ideally) simultaneous contract signature

Customers should plan for synchronised and simultaneous contract agreement and signature wherever possible. This assumes that the customer is setting up the multi-sourcing environment in one go, rather than rolling existing contracts into the process as and when they require renewal. This is an assumption made throughout this article, but which we acknowledge may not always be possible. However, where it is possible, for example in a first generation outsourcing or where a large prime contract is ending and the towers are being split, then simultaneous contract signature is an important tool for the customer. It helps keep negotiations on track, allows the customer to ensure it can back off the different dependencies before being locked in with any one provider, reassures suppliers that they are all being asked to agree to the same process and maintains the customer's competitive leverage over the suppliers. It may be tempting for customers to fast track negotiations with one supplier, particularly if there is internal management pressure to save time and money and get things signed, but this increases the customer's risk profile by losing the benefits of signing the contracts simultaneously.

While synchronisity is the goal, it can present significant procurement challenges, even where the multi-sourcing environment is being set up in one go. One of our jobs as lawyers should therefore be to help the client assess the risks and benefits involved to see if one outweighs the other and help tailor the strategy accordingly.

Introduce a regime of "fix first, settle later"

The reality is that often things do not go to plan in complex outsourcing arrangements. In a traditional prime contractor arrangement, the main supplier would ultimately be responsible for fixing the problem, and would need to ensure its sub-contractors provided assistance where necessary. However, in practice, this meant that the customer often had very little visibility as to how the supply chain was managed, and how (or if) problems were being properly resolved. It could be difficult for customers to fully understand the cause of problems, particularly if the prime contractor was keeping the customer at arms length (arguing that the supply chain was its, rather than the customer's, concern), downplaying problems or attempting to avoid responsibility by shifting the blame on to sub-contractors with whom the customer had no direct relationship.

Multi-sourcing can help avoid many of these issues. It can also create new risks. In a multi-sourcing world, the customer has increased visibility of, and direct access to, the supply chain. The lack of a prime contractor to manage issues does, however, mean that the customer will want the arrangement structured so that it is not left trying to fix any problems while the different suppliers point the finger of blame at each other. It is therefore important that suppliers are obliged to continue their service provision even where another supplier is in breach, and to introduce a "fix first settle later" regime. This rests on suppliers accepting that they may be the person best placed to solve an issue even if they were not the cause of the problem. Suppliers are unlikely to agree to this unless they are confident that the customer will ensure they are paid for any "fixing" they do where they are not at fault.

A customer should therefore:

- Give some guarantees to the suppliers around payment for the reasonable costs associated with fixing problems, while ensuring the customer keeps control over the remedies adopted and costs involved.
- Ensure they are able to recover easily costs from the party at fault, for example by setting off the amount against the fees owed to the supplier which did cause the problem.
- Ensure, if a dispute arises over the amount associated with fixing a problem, the customer is able to recover the amount by way of damages, for example by adding this as a loss for which the supplier assumes responsibility in an inclusion clause in the liability provisions. A customer does not want the supplier arguing that the costs are in some way excluded losses which the customer cannot recover.

While suppliers are likely to demand comfort around payment of costs, they may initially resist the other provisions. However, the provisions should be viewed as a package: for the customer to be able to give comfort around payment, it needs the other protections in place.

Design governance structures to suit a new multi-vendor environment

Governance in the traditional prime contractor world often involves separate contract managers responsible for their siloed one-to-one arrangements who are incentivised to champion their "own" suppliers. In a multi-sourcing environment, a more holistic approach to governance is required. This requires an integrated common governance process which works across the different supplier contracts with joint meetings, reviews, reports and escalations (where the customer considers this appropriate) and standardised processes and documentation. It also requires trust:

- Customers must engender trust by giving up some of the more opaque tactics sometimes used to play suppliers off against one another. While retaining competitive tension is an important benefit for multi-sourcing, it is also vital that suppliers do truly work together, and (as competitors) they are unlikely to volunteer to do this unless the customer creates an environment where everyone can be open.

- Linked to this is ensuring that the suppliers have sufficient comfort around IP protection and confidentiality. They may need to use each other's IP and confidential information. They may also need to share views with other suppliers about service issues and how to obtain efficiencies and innovation, and will understandably be unwilling to do this unless there are robust IP and confidentiality provisions in place. For example, the confidentiality arrangements must balance the different needs of the parties, allowing collaborative discussions to take place without allowing the information disclosed during such discussions to be used for other purposes, and in particular, for other client engagements.

Design and implement a proper service integration function (SIAM)

With no prime contractor bound to provide an end-to-end service or tasked with the role of managing contracts and integrating the different service towers, customers must consider SIAM (Service Integration and Management). Some form of SIAM will be required to ensure that the services (and suppliers) work together.

When looking to fill the SIAM role, a customer should consider:

- **What it means by SIAM:** it is important that the customer has a clear definition of what SIAM means to them. Some supplier SIAM offerings may actually be process and procedure driven forms of contract management. However, where the customer is setting up a complex multi-sourcing environment, strategic integration of the different services will be needed to ensure the promised benefits (for example cross supplier innovation and governance) are realised.

- **How much it will cost:** the customer must ensure that sufficient budget is pre-allocated to cover the expanded governance and integration role a multi-sourced environment demands. This may not be easy to secure, particularly where there is an assumption within the customer organisation that savings will be made because the prime contractor is no longer being paid to manage the supply chain.

- **The timetable:** ideally a customer should implement, or at least design, its SIAM function before engaging with the different service (or tower) providers. For example, those carrying out the SIAM function are likely to be best placed to help design and create the cross tower dependency matrix which is vital to the success of the overall service delivery.

- **What it wants the SIAM function to achieve:** the demarcation between the responsibilities of the SIAM provider and those of the tower providers must be very clear in the various contracts to ensure that each party knows its role and to ensure the SIAM provider can integrate the service. Thought should also be given as to how SIAM "success" will be measured: for example are SIAM SLAs, end-to-end service obligations or measures based on supplier collaboration behaviours appropriate?

- **How it will resource the function:** SIAM could be provided in-house, for example by people within the customer IT team where the multi-source agreements relate to technology services (something a number of our clients have done). However, most IT, and similar internal, teams have been decreasing in size as outsourcing has become more common. The customer team may not therefore have sufficient capacity, skills or experience to properly manage a multi-sourcing project. Many customers will therefore need to either hire additional internal resource to create an in-house SIAM function, or engage an external SIAM provider. The SIAM offering is still relatively new in the market, and finding good personnel, or suppliers who actually have the necessary expertise and know how, may not be easy. If engaging a third party supplier to provide SIAM services, a customer will need to consider some additional issues. For example, how will the SIAM provider incentivise the various tower providers and

will it make additional revenue opportunities available to the SIAM provider to offer to suppliers to assist with this? How will it ensure the SIAM provider takes on an appropriate level of contractual risk, for example the supplier may be unwilling to accept a high limit on liability in its contract if the fees involved are not particularly high? Also, is the customer comfortable engaging a supplier who is also providing part of the underlying service – something the other suppliers may object to – or will it need to look for an independent SIAM provider?

Design a contract that drives the correct supplier behaviours

While good governance should drive the correct supplier behaviours, financial incentives are an important additional measure to encourage this. Customers seeking to incentivise suppliers in a multi-sourcing environment will be open, transparent, fair and even handed. Ultimately there will need to be some form of financial incentive for suppliers to collaborate, ideally through both pain and gain share incentives. In our experience it does not benefit the customer in the long run to only have the "pain" elements, as the suppliers will lose trust with the process. There does therefore need to be an opportunity for the suppliers to make some gains.

Customers could include a combination of incentives, for example:

- Collaboration targets which trigger service credits if they are missed. These could include individual collaboration targets (looking at how well a particular supplier has collaborated with others) and additional targets/goals based on how well the general collaboration objectives are being met as a whole.

- A "bonus" for suppliers who meet or exceed certain collaboration based targets, again both on an individual and collective basis.

How do we contract for this new approach?

One particular challenge for customers in a multi-sourced environment is to ensure that the different suppliers work together to provide the overall service. However, there will be no direct contractual link between the suppliers, unless the customer creates one.

Collaboration principles and side agreements (for example non binding operating level agreements or OLAs) requiring that suppliers work together have been in use for some time. However, their importance in a multi-sourcing environment – they are central to the success of the project – means that customers should design an appropriate contracting structure to implement them. It is not appropriate merely to tweak an old, "prime" world, contract which was not designed for collaboration on this scale. There are two main options for drafting a collaboration approach:

- A collaboration agreement which all suppliers sign, with the ability for additional suppliers to be added at a later date.

- A contractual model that instils "collaboration" as an objective throughout the whole agreement and all of its schedules. While there is still technically no direct contractual relationship between the suppliers, each of the various commercial, technical and operational structures within each contract supports the interdependent collaboration of the suppliers within the ecosystem, and contains binding obligations to enforce this.

There are pros and cons to both options. For example, the former is a safer option if it is important that contracts can be signed with minimal negotiation, maybe by procurement rather than legal teams, as it provides a model contract which should not be deviated from and which can therefore provide uniformity. A "standard" collaboration agreement which all suppliers sign may also save costs, provided the suppliers agree to its terms, and more generally to the concept of entering into a binding contract with a direct competitor. The latter

can give the customer better room to negotiate and flexibility where sophisticated arrangements are involved and allows them to take on the risk themselves if appropriate. In our experience this works well for complex multi-sourcing arrangements. However, there is no right or wrong way to structure the collaboration provisions, provided they contain sufficient protection for the customer.

Whichever option is used, when engaging with multiple suppliers and discussing collaboration mechanisms, suppliers will want the comfort of knowing that the customer's other suppliers have signed up to equivalent provisions. One way of providing comfort to the suppliers is to select the key provisions, make them non-negotiable, and apply them across the multi-sourced environment.

This, of course, assumes that those non-negotiable clauses take a sufficiently balanced position so that it is reasonable to expect suppliers to agree them without material change.

From a customer's perspective, it is also important to ensure that any collaboration provisions contain clear obligations which are contractually binding on the supplier(s). For example, in the case of *Fujitsu Service Limited v IBM United Kingdom limited [2014] EWHC 752 (TCC)* wording which required the supplier to "have regard to" collaboration principles which the judge said contained "aspirational and motivational" language were held to lack contractual certainty.

A market view by Aecus

Sourcing specialists Aecus have seen a significant increase in multi-sourcing over recent years. This is partly a result of changes in fashion regarding sourcing strategy – a conscious decision to move away from a single supplier approach to a multi-supplier strategy which can be seen to spread risk, provide access to best of breed solutions and maintain competitive market tension.

But it is also partly explained by the rise of "as a service" solutions which are not necessarily provided by the traditional outsourcing providers AND are not necessarily procured through central IT. The net result can be a plethora of suppliers and solutions which need to be managed and integrated.

So we have got where we are through a mix of accident and design.

SIAM was seen as the solution to this challenge. But we have not seen the rise in "SIAM as a Service" which was anticipated a few years ago. Outsourcing suppliers have not, on the whole, persuaded their clients that they should fill this role. As a result, most service integration is performed in-house, or in many cases barely performed at all. Why hasn't SIAM taken off as an outsourced service? In the end it is probably an accountability issue – how accountable can the SIAM provider be for the services of other providers, if it is not actually the prime contractor. And if it is, then aren't we back to what is pretty close to a sole supplier model? Many organisations are wrestling with this conundrum at the moment, because the skills to perform this function are difficult to source internally. We expect to have to wait another year or two to see if a significant SIAM service provision option is developed and becomes a widely adopted model.

We have heard it said that multi-sourcing plus SIAM is now the de facto sourcing model. We would say that the model and the market is less mature than that – multi-sourcing plus limited integration is where most are.

Rick Simmonds, Managing Partner, Aecus

Conclusion

There are many positive benefits associated with multi-sourcing, along with some particular risks to consider. Successful multi-sourcing requires a sophisticated customer and procurement function, as well as suppliers who have bought into the model, and advisors who understand it. Those advising in this area can help shape the way the procurement process, contracting structures and market practices develop. Lawyers have an important role to play in setting the environment for multi-sourcing to succeed. This involves adopting a creative approach to contracting – it is clear that merely tweaking the traditional prime contractor model will not suffice – and working with clients to ensure the contract drives supplier collaboration and service integration while retaining the benefits a direct relationship with a best of breed supplier in a competitive environment can provide.

Some advantages and disadvantages of multi-sourcing compared to prime contracting

Advantages	Disadvantages
The customer has the ability to engage the best supplier for the particular service – adopting a "best of breed" approach, rather than relying on one general provider who may not have all of the relevant expertise. This should lead to a better standard of service and may also mean experts in their field are better at offering innovation and efficient service solutions.	The customer loses the benefit of "one throat to choke" – the prime contractor was responsible for the performance of its sub-contractors and integration of those services. The customer must now manage this risk, unless a third party is engaged to do so, and risks being caught between two or more suppliers who refuse to take responsibility for a failure and point the finger of blame at each other. If the service as a whole does fail, it may also be more difficult and costly to bring individual claims with the different suppliers.
The model allows increased flexibility. The customer can use its range of suppliers to take on new services or project work as required and may have more flexibility around how the service is structured.	Economies of scale may be lost: if the services are split this means less work is given to any one supplier. The customer may find it is no longer a key customer for any of the suppliers, and may lose some of the cost benefits and negotiation position associated with being a key customer.
Increased control and visibility: in a prime contract world the customer only had a direct relationship with the prime. Often there was little visibility of what sub-contractors were doing or how they were being managed. Here the customer has a direct contractual relationship with each key supplier, and those suppliers in turn are closer to the customer and get to know its business better. The customer can also directly receive any savings or innovations made by the different suppliers.	It is vital the services are properly described and it may be difficult in practice to split the services to ensure there are no gaps (as the customer would have to pick these up) and no duplication (as the customer would be paying twice). Suppliers are also unlikely to accept wide, general wording designed to sweep up any services not included in the detailed description, as this could encompass the services of another supplier.

Advantages	Disadvantages
The customer should save some money on each tower as it is no longer paying for the risk profile and contract management fee the supplier charged. Ideally, this should provide the budget for the service integration and management role which will now be required to ensure the services all work together.	If the customer does not obtain sufficient money savings across the different service towers, the service integration role will need to be fulfilled at an additional cost to the customer. The customer may also not currently have sufficient expertise in-house to fill this role and the market for external advisers is still relatively immature.
A multi-sourcing environment with multiple suppliers should avoid the risk of "lock-in" with one supplier. Competitive tension is also retained by the use of different suppliers for part of the same overall service.	Suppliers may be wary of closely co-operating with potential competitors. It may therefore be difficult to get suppliers to agree to binding co-operation provision which have real teeth, or difficult to enforce them in practice.
Multiple contracts mean each contract tends to be smaller, shorter and more manageable. It also means that the customer should be able to avoid the various risk mitigation methods prime contractors often built into their contracts to protect their margins. These worked to the detriment of the customer and included things such as minimum revenue commitments, long terms, margin stacking and additional costs to cover the risk profile of managing other suppliers.	Multiple contracts mean negotiations with multiple suppliers. This may increase procurement costs and timeframes.

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