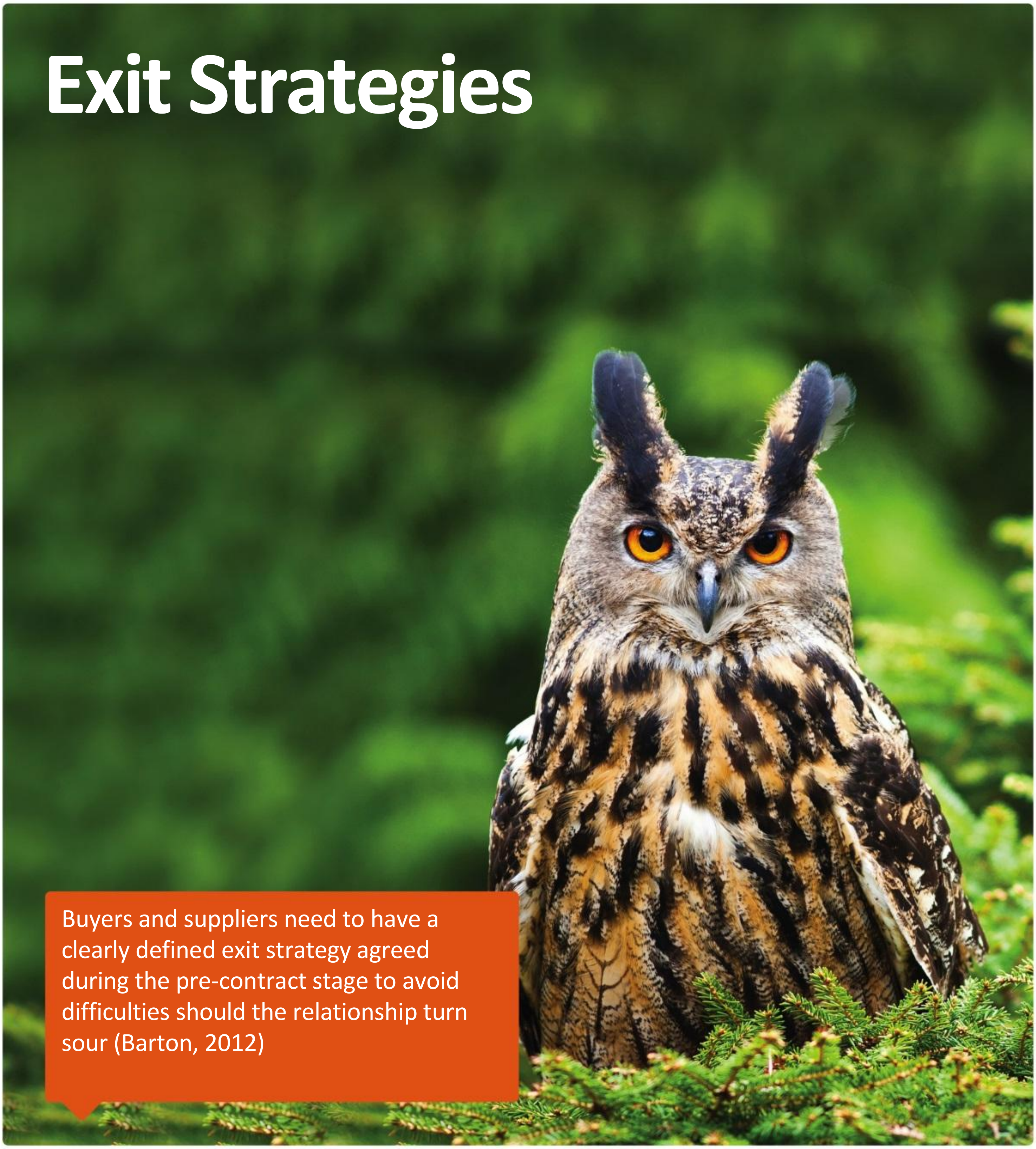
CIPS Procurement Topic

Exit Strategies



Buyers and suppliers need to have a clearly defined exit strategy agreed during the pre-contract stage to avoid difficulties should the relationship turn sour (Barton, 2012)

CPD 1 HOURS

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Introduction

There are many reasons why contracts come to an end, including non-performance by one or both parties, a significant change in the requirements of either party, or that the contract has run its course (Burnes and Anastasiadis, 2003; Elango, 2008). In almost all cases, having a well-developed exit strategy is critical. The strategy is usually developed as the means by which to withdraw from a working relationship with a supplier. It can incorporate the process of returning assets, transferring back key employees and the conditions under which a relationship can terminate, for example, the failure to meet service level agreements, changes in circumstances, and ethical breaches (Elango, 2008; Kam et al., 2011). The strategy usually details timescales for key actions and the party responsible for such actions (Elango, 2008, Kam et al., 2011).

Exit strategies and contract escape clauses are particularly relevant with respect to outsourcing and subcontracting. Outsourcing typically involves restructuring an enterprise around core competencies and external relationships, and demonstrates a long-term strategic commitment - this differs to subcontracting which can be a short-term tactical approach (Elango, 2008; Lysons and Farrington, 2006). There may be a significant transfer of assets and people to the outsource supplier and it is therefore important to establish a contract that entitles the company to re-purchase relevant assets and have key staff transfer back to it at the conclusion of the contract however the contract's end is brought about. The exit strategy, documented in the contract, is a way of ensuring that the supplier is responsible for guaranteeing that appropriate information, staff and other assets are transferred (CIPS: Business Process Re-engineering & Business Process Outsourcing). This transfer process might mean returning assets back in-house or cooperating in transitioning them to a new supplier under an agreed timescale set-out in the exit strategy (Burnes and Anastasiadis, 2003). In discussing exit strategies, there is a tendency to see them as predominantly for the benefit of the buyer. However, there are equally crucial reasons for why exit strategies and escape clauses benefit suppliers.

Definition

An exit strategy details the methods for withdrawing from a working relationship with a supplier (Elango, 2008; Kam et al., 2011). The term is also widely used to refer to the process of business owners exiting or selling a business or business unit, and in the financial markets with the trading of stocks and shares. Here we refer to exit strategies specifically in relation to the ending of contracting relationships between buyers and suppliers.

Successful Application

Fundamentally, the exit strategy should contain concrete details on the timescales for key actions and the party responsible for these actions. Neither the buyer nor the supplier can predict the future, but an exit strategy is a logically sound way to reduce the risks encountered when a relationship ends (Burnes and Anastasiadis, 2003; Elango, 2008; Power et al., 2004). The non-performance aspect of an exit strategy should be based on established KPI that are central to the contract and remit of the project.

Steps to Successful Application

- Hold discussions prior to meeting with suppliers about the nature of the relationship and what the KPIs should be.
- Discuss assets to be held by the supplier that will need to be transferred: staff members; information on any contracts with third parties; data to be held by the supplier; and intellectual property issues.
- Ensure that all parties are satisfied before proceeding to formally draft the exit strategy and before signing any agreement.

CIPS Australia: Where's the Exit?

Hints and Tips

- The practical implementation of an exit strategy is, to a large extent, dependent upon maintaining a working relationship with the outgoing supplier (CIPS Australia: Where's the Exit?).
- It is imperative to avoid terminating a contract in a way that damages the financial integrity of a small supplier (or a supplier of any size for that matter). Ultimately, a reasonable notice period defined within the exit strategy "will assist the supplier to either, seek new work to fill the gap, or restructure" (CIPS Australia: Where's the Exit?).
- For outsourcing activities, penalties for non-performance are common and emphasise the importance of meeting the specified performance requirements (Lysons and Farrington, 2006).
- It is important to include a general clause in the contract to the effect that, "the supplier is required to provide all such assistance as may be necessary to ensure a seamless handover to a new supplier" (CIPS Australia: Where's the Exit?).

Potential Advantages

- An exit strategy can generally reduce the likelihood of legal complications further down the line in the event of a problem with a chosen outsourcing provider (Burnes and Anastasiadis, 2003).
- By enforcing an exit strategy, companies have some degree of control over legal costs that would otherwise arise if problems occurred without implementing an exit strategy (Burnes and Anastasiadis, 2003; Kam et al., 2011).
- Implementing an exit strategy encourages suppliers to act in a professional way and to co-operate (CIPS Australia: Where's the Exit?)

Potential Disadvantages

- Exit strategies must be discussed at the early stages of the relationship and treated sensitively: too much emphasis on the exit strategy or handling discussions unprofessionally

could signal a red flag to the supplier concerning future commitment and cooperation, thus also negatively impacting agreed service levels (Power et al., 2004).
- There are no hard and fast rules for discussing the exit strategy. Timing is an important issue in international outsourcing where business negotiations in some cultures depend strongly on effective relationship management, such as in China concerning the cultural phenomenon of 'saving face' (Kam et al., 2011).
- Because the non-performance aspect of an exit strategy is tied to key performance indicators (KPIs), the KPIs themselves may leave either the supplier or the buyer less than satisfied. The exit strategy therefore might not be viewed as ideal by one of the parties but nonetheless sufficient for the working relationship to commence and the required products or services purchased (Burnes and Anastasiadis, 2003).

Performance Monitoring

- Consider KPI turnaround time or schedule of performance can be suitable for outsourcing relationships, for example, specify a performance time for services (Lysons and Farrington, 2006).
- Consider KPI downtime: how will the exit strategy come into play when measuring the downtime of equipment or when the supplier is unavailable for a specified period of time? (Lysons and Farrington, 2006).
- Conduct cost comparisons: at regular intervals between the current supplier and potential other suppliers (Lysons and Farrington, 2006).

Case Studies

- IBM failed to help energy company NiSource Inc. achieve projected cost savings of US$530m, causing the latter to amend a 10-year US$1.6bln contract after two and a half years. NiSource's exit strategy enabled the company to reconfigure elements of the contract and backsource some of the processes in-house (Nevers, 2008).
- Cable and Wireless signed a 10-year contract in 1998 worth £1.8bln covering IT infrastructure outsourcing. However, the deal ended less than half way through when C&W sought legal action against IBM for alleged overcharging (McLaughlin and Peppard, 2006).
- US financial services firm Wachovia outsourced some functions to Hewitt Associates in a US$450m agreement but then later backsourced some processes in-house, creating a 'blend of in-house and outsourced solutions' (Workforce Management, 2008b).

Further Reading/References

CIPS Source Downloads

- CIPS: Where's the Exit?
- CIPS: Contract Management

Web Resources

- Exit strategies are critical when outsourcing 'problem' functions http://www.supplymanagement.com/resources/q-and-a/2005/outsourcing-a-problem-function/?locale=en
- Bringing a function back in-house http://www.hrworld.com/features/trendwatcher-backsourcing-072508/
- The issue of backsourcing http://www.cio.com/article/10524/Outsourcing_and_Backsourcing_at_JPMorgan_Chase
- Case study highlighting the importance of an exit strategy http://chestertontribune.com/Business/138%20nisource_admits_outsourcing_jobs.htm
- Making an exit: a clearly defined exit strategy http://www.supplymanagement.com/law/analysis/2011/making-an-exit/?locale=en

Books

- Offshoring Opportunities, Berry, ISBN 978-0471716730
- The handbook of Global Outsourcing and Offshoring, Oshri, Kotlarsky & Willcocks, ISBN 978-0230235502
- Outsourcing and offshoring in the 21st Century: A Socio-Economic Perspective, Kehal & Singh, ISBN 978-1591408758
- The Outsourcing Handbook: How to implement a successful outsourcing process, Power, Desouza & Bonfazi ISBN 978-0749444303
- E-Business Strategy, Sourcing & Governance, Gottschalk, ISBN 978-1599040042

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Video

Rights to terminate an English law contract for breach
https://www.youtube.com/watch?feature=player_embedded&v=o-86U4LH9Nk

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