Profit is not a Four-Letter Word

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When seated across the negotiating table from each other, the client and the candidate service provider for an outsourcing relationship share a few common topics on their respective worry lists. One is profitability.

It's striking to see the changes in body language among the participants in an outsourcing negotiation when this topic is raised. Some view it as taboo — a discussion topic inappropriate for polite company. Others consider it a seminal condition around which great discovery and debate should be engaged.

Years of practical experience in the settings of large outsourcing contract negotiations have revealed some very interesting observations regarding the concerns and interests of the parties on matters of profitability. For the most part, each side is suspicious of the intentions of the other party in even placing the topic on the table for discussion. But, there's a healthy and pragmatic use for a candid discussion of service provider profitability through an outsourcing relationship.

In general, most service providers do not welcome a discussion of profitability related to their proposed outsourcing transactions. They view the topic to be a matter of competitive sensitivity and one that can only lead to greater negotiating emphasis on the part of the client. When a question is raised regarding anticipated profitability, the competing service providers can be curt and defensive with a reply of "it's in our total price."

Sadly, they're missing an opportunity to differentiate their offer and address a key area of concern held by the client. A style of candor and openness would serve them well on this topic.

On the occasions when a service provider might initiate a discussion around the profitability of a contemplated relationship, the client often feels that the challenge is being inappropriately transitioned to the buy-side. Having managed an insourced corporate function to strict budgetary limits, most client executives are not at all eager to carry responsibility for the profitability of an outsourced relationship. Nor should they.

But, that doesn't mean that the topic should not be discussed — in context.

From a client vantage, there are two core questions that should be explored regarding profitability. Neither is "how much profit margin do you have in your price?"

Firstly, most clients want assurance that the price offered by the competing service provider is one for which the provider feels genuine comfort regarding the ability to generate acceptable profitability. Clients are engaging in outsourcing with the belief that their selected service provider is a true expert at the delivery of world-class services. That expertise ought to encompass aspects of efficiency and productivity that reflect the core focus of the service provider.

That said, a sophisticated client understands that the quality of service will be substandard if the service provider is experiencing financial distress in the relationship. There is no worse situation for a client than to be on the receiving end of a contractual commitment that is unprofitable. A range of behaviors results, none of which are viewed as constructive by the client.

This is one reason why many clients award a contract to a competing service provider that is not the lowest price alternative. An offer that is priced significantly under others might be an indication of "buying the business" (which will haunt the relationship over time) or a lack of true comprehension of the service expectations of the client.

The second question appropriately asked by the client is around the essential assumptions being applied by the service providers to achieve its planned profitability. We guide clients to explore the core operating plans of the candidate service provider with an eye towards viability and acceptability. If a provider's profitability is predicated upon closure of facilities, reduction of domestic staff, retirement of legacy assets, etc., it is essential for the client to provide guidance to the competing providers on the feasibility and appropriateness of those actions *prior* to contract award.

In this way, post-contract surprises can be avoided by both parties.

One mistake that a service provider can often make is to attempt to convey the challenge of profitability onto the client. Just because the client has engaged in the discussion around expected profitability does not invite the service provider to infer that the client is accepting any responsibility for the ultimate profitability.

Conversely, we do not recommend that clients invite “open book” or cost-based pricing. While this might provide some comfort that there is no excessive profitability priced into the relationship, it undermines the long-term objective of managing the outsourcing relationship as a set of defined services.

A core tenet of outsourcing is the delivery of defined service at defined prices. The industry’s service providers are expert at the services they offer and should be pricing those services in a manner to yield acceptable profitability for their business. That said, clients owe it to the relationship to engage in an appropriate discussion around relationship profitability to ensure that the competing service providers understand the challenge ahead and are prepared to manage towards a healthy relationship based on sound financial footing.

A progressive service provider will introduce the topic of profitability in a polite and professional manner — demonstrating confidence in and educated understanding of the underlying business foundation of the proposed relationship.