HOUSTON
BUSINESS
JOURNAL
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May 23, 2008

Outsourced relationships demand a disciplined approach

You've heard the horror stories.

The trusted lawyer helps himself to funds held in an escrow account.

The trusted insurance agent forges a policy to fraudulently increase premiums and pockets the spread.

BUILDING BUSINESS

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The trusted financial adviser abuses her discretion by trading in a nondiscretionary account to earn unwarranted commissions.

The trusted tax adviser sells a high-risk tax shelter and earns substantial fees, while the client is left with substantial penalties and fees when the deductions are disallowed.

How can this happen?

What we often find in these situations is misplaced trust and lack of oversight of the relationship.

While growing companies focus on building their business and limiting fixed costs, they are very dependent on outsourced professional resources.

Finance, accounting, risk management, legal and information technology are areas that lend themselves to outsourcing.

To address these needs, companies retain accountants, lawyers, bankers, insurance agents, IT consultants and the like.

This requires that the management team has a disciplined approach to selecting, retaining and managing these critical outsourced relationships.

So how can you effectively hire the right resources and manage these relationships to avoid mishaps and maximize return on investment?

- Research your options: The first step is to select and hire the right firm. Determine your needs and research the alternatives before making your hiring decisions. Don't just hire friends for friendship sake, and don't hire based only on price. Seek value over price. Match culture, competence and experience with your particular needs. When you have identified alternatives, determine which provider has the culture, track record and experience to work well with your team and meet your unique needs.

- Require budgets: Before making a hiring decision, require written bids and budgets for the initial work. A good professional services firm will gladly invest sufficient time in your company and the opportunity to understand your business and your needs and to provide an estimate for the initial work. Also, insist on full disclosure of who will be working on your initiatives and their experience level and rate.

- Require written engagement/service agreements: Before any work begins, insist on having a written engagement agreement that outlines in sufficient detail the terms and conditions of the relationship. Having an agreement can help avoid disputes that could otherwise arise down the road. The services agreement should describe the scope of the work, the team that will be doing the work, the pricing structure and an estimate of fees and expenses to be incurred.

- Require transparency in pricing: Insist on complete pricing transparency. For commission-based providers, this includes full disclosure of all commissions paid and received by all parties. It also means gaining a clear agreement regarding the basis for the commission — what is included and what is excluded from the base, and who is paying what commission to whom. For hourly rate providers, this requires complete disclosure in the staffing and billing process. Insist on detailed invoices showing who did what work, at what rate and on what date, broken down by increments of hours (e.g., quarter or tenth-of-an-hour increments). Do not accept summary invoices.

- Align interests — have a bias for fixed fees or hourly rates vs. commissions: Align your interests with those of your service provider. Challenge the basic fee structure and determine what's best for your company. Are your interests best served with a fixed fee, hourly rates, commissions or success fees structure? Be skeptical of embedded commissions based on what you pay for something. On the other hand, success fees based on the benefits you are receiving, as in an investment banking situation where the fees are based on proceeds from a sale or recapitalization, might make perfect sense. Commissions on the amount you pay for your insurance or the amount of assets under management do not necessarily provide the proper incentives to do the right thing. These are good examples of where fixed-fee pricing might achieve better alignment of interests.

- Require regular reporting and build your files: Insist on receiving regular reports. Commit to taking the time to review the reports. Have regular status conferences with your service providers. Require original documentation and full backup for everything. Get copies of all executed documents, trades, insurance policies, etc. Have complete documentation in your files on a real-time basis.

- Conduct a regular relationship review: No matter how cozy the relationship, always conduct a regular review. Check the market for pricing comparisons. Make sure that your provider continues to develop and retain the level of expertise needed to service your business needs. Assess whether your respective cultures are still in sync and produce a productive working relationship. Assess whether you are getting competitive pricing, sufficient transparency, regular and sufficient reporting and outstanding results. Explore whether you are getting the return on your investment that justifies the relationship. If so, you're on the right track. If not, start over. Go back through the selection process and determine if you have better options that can produce better results and meet your growing and changing needs.

If you follow this protocol, you will have taken important steps to manage the risk in these relationships and maximize the value to your organization.

It's a discipline worth adopting.

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