Concepts Meet Reality…

Large Scale IT Services Outsourcing – Do's and Don'ts

© 2009 Enaxis Consulting. All rights reserved. This document may not be reproduced without prior permission. The opinions expressed herein are subject to change without notice. All other trademarks and company names mentioned are the property of their respective owners.

Concepts Meet Reality…

Introduction

Large scale IT Services Outsourcing began booming in the nineties and has now resulted in a current state of expiring contracts. This leaves many companies confronting decisions on how to proceed with their IT delivery organization. CIO/CFO's of large organization are facing difficult decisions about the next steps. Offshore Service Providers, political implications, increased security issues and the burden of SOX make the option of renewing contracts a complicated decision.

However, the pressure to consider outsourcing is tremendous if you are a decision maker in medium size enterprise (>$1B - $5B), or you are one of the few Fortune 500 companies that have not outsourced.

In general options are:

- Re-sign with current service provider
- Insource all or part of the contracted service
- Switch providers to achieve cost savings
- A combination of the above options

The primary goal of this research is to address the challenges faced by organizations that are currently outsourced and are forced to look at various options as a result of one of many drivers (end-of-contract, failure of incumbent to perform, adverse business climate, or change in leadership – mainly through acquisition by private equity firms). Some of the same points apply if you are considering large scale outsourcing for the first time.

.

You know you have a problem when ….

1. **Service provider and client regularly refer to Contract, SOW and SLAs**: In our experience of working with large companies, many have outsourced to a prominent provider (such as EDS, IBM, CSC, Accenture.) There is a surprising level of confrontation between the company and the delivery organization that leads to either party referencing the contract or legal agreement.

2. **Meaningless SLAs (or those perceived as meaningless):** Development of SLAs (Service Level Agreements) is generally the last activity that is done prior to negotiating and finalizing an agreement in a contract. At this point, both organizations are usually fatigued through extensive discussions that have continued for months. Additionally, more often than not, the delivery organizations of both organizations are not significantly involved in the development of SLAs (which essentially are the rules by which all sides have to live by).

3. **Total annual cost is substantially higher than initially planned (due to variable costs, extra work, additions to the scope):**

   Three issues drive this:
   - Service provider (sales) organizations have traditionally taken a myopic view of wanting to close the deal at any cost (thereby developing pricing models w/ unsustainably low margins)
   - Lack of comprehensive total cost analysis by the client (usually driven by internal champions of Outsourcing)
   - Service Providers banking on additional business by being present at the client site.

4. **Lack of technical refresh and getting behind on technology curve:** The service providers have little or no incentive to provide preventative technical refresh and to keep up with the emerging technology. This is especially true if the variable portion of their monthly invoice is directly proportional to the number of technical problems the clients face. Additionally the service providers have been squeezed enough on margins that they really have no capability for innovative moves to keep the client on the right technology curve.

5. **Backlog of change request for applications:** Supplier falls behind the number of changes requested by the client (especially in the scenario of turnkey application maintenance).

6. **Layered contracts (sub-contracts to provide various services):** Sub-contracted services under a primary service provider are a double-edged sword. It can be a successful arrangement under the right terms and expectations but could easily develop into a sub-par service environment without the proper oversight and control. *This is especially true if the two providers (the prime and the sub) are working together solely for the purposes of serving that one client (versus having a strategic relationship including other shared clients).*

7. **Unhappy business users:** End business users may or may not be supporters of outsourcing their critical systems or functions. However, they often are drivers of change if their needs are not met in an outsourced environment.

Key areas to watch out for …

1. **Know your drivers**

   Investing time upfront to recognize the drivers for considering any sourcing model is the first step to successful outsourcing. Under a currently outsourced scenario, it is even more important to refer back to the original goals and expectations, and measure results against them. This provides extremely useful guidance even if the strategic direction ends up being renewal of the existing contract.

   Goals and drivers vary by industry, organization, and functions. While cost savings is the most published and recognized driver of outsourcing, all types of outsourcing do not necessarily result in cost savings (insourcing may be inexpensive, yet unsuitable direction for a given function.) Focusing on core-competency, aligning with stated corporate goals, or dissatisfaction with existing providers are other drivers that lead to outsourcing.

2. **Treat it like a 'project' – not a 'deal' and have the right team in place**
   It is interesting to note that companies will take a methodology-oriented, structured approach with all relevant checks and balances for a relatively small application development or infrastructure upgrade project. However the same organization may provide surprisingly minimal structure and organization to an outsourcing project that may have a much greater long-term impact. Usually the outsourcing projects are strategic but not critical to day to day operations.

   It is also common for the evaluation of a large scale IT services outsourcing decision to be driven by procurement, sourcing or finance organizations. While the participation of all these functions is critical, the driver and manager of the process should still be the CIO's office.

   In a large outsourcing contract renewal, the service provider has more time on their side. Most existing contracts may have provisions that automatically renew service at a premium price. It is important to start the decision and planning project at least 12-24 months in advance (based on the size of the project). It is critical to identify termination date, notification of termination, and have a plan in place prior to the notification date. It also is important to assemble the right team including IT, HR, Sourcing/Procurement, legal, business/operations representation as well external consultants with requisite qualification and experience.

3. **Treat the incumbent fairly**
   In a majority of the cases of failed outsourcing relationships, the client and the service provider are equally responsible. It is extremely important to be fair and communicative with the incumbent provider. Based on the terms of the contract, you may be required to provide a certain amount of notice and afford the incumbent the opportunity to regain the business. Additionally, any possible transition to an insourced environment or move to a new service provider will require significant support from the incumbent service provider.

4. **Understand what you have outsourced**
   In situations where a large corporation has outsourced a significant portion-or all- of its IT services, it is not uncommon for the client to have difficulty in understanding the scope of what the incumbent is providing. This is especially true if the original authors and stakeholders of the contract from either side are not a part of the current organizations (which can be a common scenario in a long term contracts.)

   Additionally, most successful outsourcing relationships evolve beyond recognition of the original contract to accommodate the client's new needs and the changing market conditions.

   The first step in understanding the outsourced environment is to segregate the large outsourcing contract into functionally aligned service categories or 'towers'. Limited IT outsource management staff will learn about all the services rendered by working through this step. This practical separation of outsourcing need also allows for future flexibility and different lengths of contracts, should you believe an earlier change necessary

   This permits for all or part of the contract to be preserved, remain with the same service provider, and allow more specialized service providers to respond to individual service categories.

5. **Be open minded about the end-result (Insourcing, Multi-Sourcing, Renewal, New Provider(s))**
   It is important to lay out all realistic possibilities with potential gains and risks as a starting point to the analysis. Most large outsourcing arrangements tend to be overwhelmingly complicated in nature and are not decidedly conducive to any one strategy. This also is a good approach to align the outsourcing strategy with overall IT strategy and governance models that may be in place. Many clients choose to strategically insource several functions such as Architecture Development or Software Design functions. Others decide that some of their industry specific functions (upstream/exploration related applications for energy

companies, customer tracking systems for telecom service companies) are too strategic to continue to outsource.

It also is important to understand the risks of transition to a new provider which can be prohibitively significant in some cases. Having the right data, information, and a measure of risk propensity, all allow the client to be prepared for any renewal negotiations that may be inevitable.

Multi-Sourcing is an increasingly popular model, becoming somewhat of an industry trend, but has its pros and cons. One advantage of a Multi-Sourced environment is for the client to be able to 'plug and play' provider solutions. Such a model comes with the coordination costs, overall accountability and ownership by the client. For the model to be successful, it is extremely important for the client to define the overarching "Process Architecture" – a term for collective understanding and definition of functional processes, organization structures, and various interdependencies.

6. **Use a methodology/process and tools (Ariba, Perfect Commerce etc.)**
   The actual process of defining goals, analyzing sourcing options, performing RFI/RFP (Request For Information/Proposals), managing vendor evaluations, conducting negotiations, executing contracts, and performing transition can complicated and challenging. However, there are many sources, consultancies, and research results available for the client to establish a methodology and process ahead of time. Outsourcing is not a cutting-edge concept. Establishing best practices, methodologies, lessons-learned can be easily accessed and utilized.

   It is important to plan and understand the goal and expected results from conducting an RFI/RFP. Depending on the level of complication of the IT services being acquired, it may or may not be helpful to conduct an RFI. For example, if a significant portion of the outsourced services are standardized application development or IT Help Desk, RFIs will not provide any insight or add to the actual RFP process. This is especially true if the services in question already have a defined market and a list of the primarily used service providers. Alternatively, an RFI may be useful and may provide strategic insight into bundling of offerings and to gauge the market for a complicated set of IT Services.

Several large organizations may have already invested in spend management and procurement software such as Ariba, Perfect Commerce etc. While these tools are very useful to manage data, coordinate vendor interaction, and control the process, it is important to verify that the tool that you own and the configuration that has been deployed will be worth the possible complications that may arise from its usage. A primary benefit of using a sourcing tool is the ability to control the format and pricing structure of the responses of service providers; thereby readily providing the data for comparison. Overall appropriately utilized tools for procurement management can be a great asset in large scale IT services outsourcing procurement and management.

7. **Perform the financial analysis and know what you want to pay**
   Most organizations use the current incumbent cost as a baseline cost. However, it is important to perform the requisite analysis of the baseline costs to understand the breakdown of the costs by categories of services or towers.

   Organizations that invest the time to perform some external benchmarking to establish the cost parameters have an established price range for various services. This lays the groundwork for meaningful negotiations and allows for a more rapid transition.

8. **Competitive bidding – RFP – a must**
   A properly orchestrated RFP process (for large-scale IT Services Outsourcing) is as much an introspective learning opportunity for an IT organization as it is a buying tool. It provides the organization the opportunity to understand and articulate its service requirements and the Metrics and Service Level Agreements around it. A competitive bidding process is strongly recommended, even when the client is pleased with the current incumbent's performance. Ideas and thought provocation questions are raised that would make the existing outsourcing relationship even stronger.

Developing a proper RFP for large-scale IT Services outsourcing is tackled in a different Research Paper. Please refer to Enaxis Consulting website at www.enaxisconsulting.com.

9. **Vendor Selection, Down Selects and Due Diligence**
   One of the key pitfalls in selecting the right vendors is lack of definition of the selection criteria. The issue of selection criteria and the importance of each criterion should be addressed while the RFP is being developed and the Supplier response structure is being defined. This is often not the case. Selection criteria should be chosen with tactical (delivery fit) and strategic (long-term partnering) elements in mind. Common examples of these elements are Pricing, Delivery Capability, Cultural Fit. It also is important to develop selection criteria that are detailed and measurable for differentiating between responding service providers.

   It is extremely important to keep more than one viable candidate in the running through the negotiation phase. Down selected candidates and the client should be given the opportunity to perform the right level of due diligence (including but not limited to: delivery team interviews, yellow-pad sessions, site visits and references). Additionally, it is also important to gain access and commitment from the team that is going to be on ground delivering.

10. **Start on the right note: enough time and budget for transition and communication**
    By the time the decision process arrives to the final selection point, the negotiation teams (including sales and delivery executives from the service provider and the client management team) already have established a working relationship. However, the most important aspect of the outsourcing change often receives minimal attention – Transition Change Management. It is extremely important to engage in communications about the transition at different levels and to various groups. A good transition change management plan should include ways to communicate effectively and often with internal IT

employees, the outgoing incumbent team, and the incoming transition team.

It is also important to communicate to the organization(s) the key drivers, metrics and success factors of the relationship. Starting an outsourcing relationship on the right note can be achieved by a well documented and structured transition and communication plan.

Conclusion

Large scale IT services outsourcing is a relatively simple concept that is extremely challenging to execute. The goal of this research was to give our readers some general experience based guidance of focus areas and awareness of potential issues that may arise. A cross-functional team consisting of procurement, human resources, legal advisors, and IT staff must be assembled and managed. Careful planning of resource requirements is necessary, especially when considering that IT staff routinely carry a heavy work load.

Please refer to www.EnaxisConsulting.com for more details about development of contracts, service level agreement development, business analysis, and other items.

Enaxis Consulting, LP
24 Greenway Plaze, Suite 1505
Houston, TX 77046
713.881.9494
www.enaxisconsulting.com