THE ULTIMATE GUIDE TO SOURCING ICT SERVICES

Contents

THE MONTROUGE PARTNERSHIP

HARBOUR IT

1. What Drives an Organisation to Outsource?

To “follow thy neighbor” or “copy another business” are not valid reasons to adopt an alternative to in-house operations. Rather, the sourcing of services should be viewed as strategic and be driven by clear objectives where KPI’s can be measured to help ensure success. For this paper, strategic sourcing is seen as the provision of services via a long term outsourcing arrangement, that may have involved the sale or transfer of assets and people via a third party.

The early and main reason to adopt this course of action was cost reduction – these days this is well down on the list of priorities as organizations realize there are strategic benefits to this form of service delivery.

Key drivers to adopt this form of service delivery can include:

- Need for improved service levels
- Access to newer or better technology
- Access to talented people
- Expense management
- Risk mitigation
- Allow a focus on core business activities
- Avoids expensive facilities (e.g. data centers) and assets from building up
- Flexibility with ability to handle variations in business levels
- When organizations are going through change or desire to bring about change
- Release worth of ICT assets
- Management of service levels not technology and other resources.

2. Balancing Benefits and Risk

These drivers should form part of the assessment of benefits that organisation’s look for. Whilst key drivers to outsourcing are seen as the need to increase efficiency and cut costs, the final decision to outsource must not be made without considering a balanced result of benefits and risk:

- ♦ Risks must be identified, mitigated and managed throughout the life cycle. Pre-emptive and proactive actions are the most cost-effective manner to lessen the probability and the potential impact.
- ♦ Outsourcing should result in financial, technical, organizational and strategic benefits. The best way to ensure such benefits are achieved is to identify them, benchmark them prior to outsourcing and continuously measure their achievement.

3. ICT Outsourcing – 15 Common Myths

#1 – Outsourced services and related activities will be out of our control

#2 – Outsourcing stands for low price and low quality

#3 – Outsourcing is only good and only works for big organisation's

#4 – Our risks will increase

#5 – There will be cultural and language barriers

#6 – Our intellectual property will be stolen

#7 – We will not own our data

#8 – We do not know what or who we will be getting

#9 – The technical infrastructure will be poor

#10 – Outsourcing for us is not suitable as we are highly skilled

#11 – Outsourcing will cause security issues and problems

#12 – The outsourcer does not know our business

#13 – We cannot trust the outsource people

#14 – Fixed fees are better

#15 – Our costs will increase once the contract is signed

These are just a few of the many myths that exist in the ICT world of outsourcing.
All are false. They do however provide a guide to matters that need to be communicated to management and to staff and to help eliminate the FUD factor.

A good project that follows a mature process will ensure that none of these myths eventuate. They are basically excuses for not examining outsourcing as an option.

4. Common Issues

Outsource with Care

Outsourcing can be a major weapon in the battle to improve efficiencies and reduce costs - its benefits are real and achievable. However, all organisations must examine outsourcing thoroughly and be aware of the challenges it presents. Our experience has shown that most problems are often the result of:

- Viewing outsourcing only as **a cost reduction exercise**, ignoring the full transaction costs and the costs of introducing changing requirements.
- Outsourcing services **in isolation** rather than as a part of the overall business strategy. Strategic flaws cannot be sold off.
- Adopting **a piecemeal approach** - a fragmented approach may not represent best overall value for money and increases the management effort required.
- Outsourcing before considering **other options** that can produce the same objectives. The business case should address the options available and justify the solution based on strategic, economic and tactical bases.

- Failing to plan and adhere to a **robust methodology** that plans for the entire life cycle. Outsourcing is only a tool and its effectiveness depends on how it is designed, implemented and managed.
- Failing to plan and implement a **human resource and communications strategy** focusing on minimising the FUD factor (fear, uncertainty and doubt).
- **Unrealistic expectations** of the benefits of outsourcing. Desired benefits must be articulated and measured to ensure they occur.
- Not drafting the **contract and service level agreement** before selecting the supplier. Organisations are at their strongest negotiation position prior to awarding a contract and lose considerable influence once the competitive process ends.
- Failing to **recruit or retrain** for the new skill sets required including negotiation, contract management and relationship management.
- Not developing and/or communicating the new model of service provision and the **"rules of engagement"** to the business.
- Expecting a **business partner** when the relationship is contractually structured as that of customer and supplier.

5. Essential Aspects to be consider:

- **Size and duration of contract** - outsourcing contracts are ongoing; typically covering an initial period of three to five years with options for further extensions.
- **Transfer of assets and resources** - the transfer of people, equipment or facilities used to provide services from the customer to the supplier is common and presents many issues regarding valuation, intellectual property and personnel transitioning.
- **Breadth of responsibilities** - the supplier accepts responsibilities and risk for the activities associated with the provision of services. However the purchaser is always ultimately accountable for ensure the specifications are appropriate and the outcomes are suitable for the business needs.
- **Styles of relationship -** outsourcing agreements typically assume a partnering style of relationship within expectations set by the service level agreement.
- **Performance based services** - the focus is on the output/outcome of the services with minimal prescription regarding the basis of delivery or assets to be employed. Performance measurements based on key performance indicators (KPIs) are a primary tool in assessing suppliers' fulfilment of their responsibilities. Such KPIs must be meaningful, measurable, readily available and within the supplier's control.
- **New skills** - under outsourcing, the organisations focus shifts from managing inputs (the tin) to managing outputs (the services). ICT department becomes a contract manager rather than a resource manager. Skills in the areas of negotiation, contract law and administration, performance measurement, finance and audit all become critical to success.
- **Flexibility** - as the organisation's needs change so must the arrangement. Contracts must be adaptable to changing circumstances and requirements refreshed on a continual basis.

6. Types of ICT Services

Suppliers can offer specific services where they are specialists in their field – there are also those suppliers that provide complete end to end services covering the full range of ICT services that any organization requires. The degree of market coverage varies in order of:

- Infrastructure support, including LANs and WANs
- Asset ownership
- Application development
- Application support

Key tasks that involve strategic planning, information retention, project control, contract management, are seen as being core and are generally retained in house.

7. Nature of the Market

Over recent years the local ICT market has matured and is now firmly established as a viable alternative to in-house operations. The market includes organizations that specialize in one or more services to the large multi-nationals capable of providing full services covering all facets of large and complex businesses.

There are also many services providers addressing the small to medium businesses. The last few years have seen enterprises of all shapes deciding to take an alternative course for the sourcing of their ICT services. The issues and concerns associated with the early years have well passed. The early concerns about outsourcing and vendor lock in can be addressed and managed.

8. Financial Implications

There are a number of financial matters that must be considered in any assessment in relation to the sourcing of the ICT services, including:

- Assets can be sold providing a cash injection or the proceeds can be used to offset against future expenses
- Refreshment programs can be established to avoid large capital expenditures, or incur leasing penalties when components are no longer required before lease expiry
- People costs can be better managed
- Penalties for non-performance of delivery can be embedded in to the contract
- Incentives can be established for innovation, value adding services and for sharing risk and reward
- Agreed financial budgets and targets – the $ are known in advance
- Incorporate agreed unit cost reductions over the life of the contract

9. Stumbling Blocks and Barriers

The best opportunities can be lost for many reasons however early consideration and planning can avoid these issues having an impact on the outcome. The barriers to success can arise from:

- Lack of executive buy in and ownership
- Resistance from departmental management
- Senior management and ICT staff having the “FUD” factor
- Staff resistance to change
- Misleading internal service levels – usually overstated
- Misleading internal costs – usually understated
- Lack of assistance
- An unstructured and or rushed approach
- Poor communications
- Not seeking help when needed
- Poor preparation.

We have witnessed all these issues in many prior projects.

Using a mature structured approach where the issues are identified early and can be managed will help ensure the most appropriate outcome is arrived at. This may or may not result in any form of outsourcing.

What the process will do is to accurately define what the ICT operations are of the enterprise, what the services and service levels are and provide a detailed cost breakdown of all components. Just completing the A-Z of the ICT operations can be a beneficial outcome.

10. Consider the Pro's and Con's

Potential Advantages	Potential Disadvantages
Financial	
♦ **Cost savings** through economies of scale. ♦ **Cash flow** relief by supplier buying your assets and hiring your staff. ♦ **Predictable** costs-either through fixed or usage based price agreements. ♦ **Costs are known** as an invoice is paid for all costs, avoiding the traps of inappropriate or non-existent internal cost allocation. ♦ **Rebates or** liquidating damages for non-performance of agreed service levels.	♦ **Unexpected costs** - for those that are not explicitly in the scope of the agreement. ♦ **Higher per unit of service costs** - if usage projections are above or below those agreed. ♦ **Cost of outsourcing** itself - planning, investigating, tendering, implementation and ongoing management. ♦ **Once off personnel** related costs – outplacement, remuneration payouts, and union negotiation. ♦ Cost of **additional skills and resources** required to manage the relationship. ♦ **Potential litigation** costs for contract breaches. ♦ **Leakage of confidential information** resulting in competitive disadvantage, adverse media, or legal liability.
Flexibility	
♦ **Catalyst for organisational change** - behaviour, restructuring, rationalisation, etc. ♦ **Shifting of expenditure** from the capital to the operating budget, which is usually less rigid. ♦ **Remove inflexible work practices** mandated by the public sector and unions. ♦ Access to leading edge, specialised **skills**. ♦ **Shorter lead times** to take advantage of new technology and ideas. ♦ **Economies of scope** (the variety of services able to be produced). ♦ **Access to technology** without capital investment.	♦ High **exit barriers** and irreversibility - reduced cost-effective options if arrangement fails. ♦ **Loss of control** over decision-making, resource management, and daily operations. ♦ **Supplier inflexibility** to economically meet changing requirements on a timely basis. ♦ **Exposure** to suppliers' financial strength and profit motive. ♦ **Supply restrictions** - locked into a single supply source. ♦ Possibility of being **tied to obsolete technology** for supplier to achieve economies of scale. ♦ Possibility of being **forced to upgrade** for supplier to comply with maintenance provision or to gain operating efficiencies.
Efficiency and Effectiveness	
♦ **Predetermined service levels** - parties are forced to define and agree as to what is expected. ♦ With pay for performance, suppliers are more **responsive to performance complaints** if it will affect profitability. ♦ **Centralised support** - often there will be one point of call at the supplier. ♦ Enables **technology catching up or leap frogging** - if converted to the supplier's state-of-the-art infrastructure. ♦ **Efficiency motivation** by converting internal cost centre to a supplier profit centre, however the supplier tends to receive the cost savings. ♦ More **frugal use** of ICT resources - when paying "real" money, users change their behaviour.	♦ Exposure to **suppliers' lack of commitment** - they may focus their attention on larger or more strategic customers. ♦ Suppliers are not motivated to improve **customer efficiency**, as it will lower their revenue - unless they receive a higher margin. ♦ Supplier will **only meet service levels**, not exceed them, without incentives. ♦ Loss of **in-house expertise** - if it is allowed to happen. ♦ **Homogeneous** orientated services - pay more if a tailored service is desired. ♦ **Service changes must be negotiated** - suppliers have responsibilities to other customers and must make a profit.

The matters raised above as concerns can be addressed and should be to ensure an effective arrangement with the supplier(s). The key message is to recognize the matter and to take mitigating action during the assessment and planning processes.

None of the matters listed above are considered to be “show stoppers” – but care is required to ensure that those opposed to this form of service delivery do not use these issues to undermine the outcome of any future arrangement.

11. Recommendations

- ✓ The opportunity should not be ignored – considering alternative forms of service delivery should be viewed as a normal management assessment process
- ✓ Communicate the decision or outcome to management and where appropriate, to all potentially affected staff
- ✓ If proceeding to any phase of the assessment, establish a small internal team that is representative of the enterprise and all factions
- ✓ Conduct a high level assessment to determine candidate services and processes
- ✓ Use a mature and sound process
- ✓ Take your time and be thorough in the level of detail
- ✓ Be realistic and honest, it will only come back to bite if not correct
- ✓ Seek assistance/guidance if not familiar with the process and how to reach a final supported position
- ✓ Look carefully at the market offerings
- ✓ Due diligence is an essential part of the process
- ✓ Establish reasonable service levels and a contract that will see all parties benefit – a good outcome is a “win win”.

12. Attributes of a Best Practice Outsourcing Arrangement

Some Overriding Factors

- Genuine desire for both parties for a firm commitment to collaboration
- Establish a framework where underlying qualities enable a true win-win relationship
- Accept that change is inevitable so plan for change
- External sourcing is not an abrogation of responsibility or accountability
- Should be viewed as a normal form of undertaking the delivery of services and be part of a strategic approach to the sourcing of services

RELATIONSHIP (BOTH PARTIES)

- ❑ Mutual respect and Trust
- ❑ Willingness to work hard together
- ❑ Aim for continuous improvement
- ❑ Proactive and reactive to other party's needs/concerns
- ❑ Regular and ongoing monitoring and evaluation
- ❑ Frequent and open communications
- ❑ Works seamlessly
- ❑ Clear protocols for all key administrative processes
- ❑ Clearly defined objectives the client wants to achieve by outsourcing
- ❑ The client/purchaser should outsource for the right reasons
  - ❑ The reasons for outsourcing should be known and results assessed on a regular basis
  - ❑ Cost reduction alone is most likely going to cause problems
  - ❑ Benefits to be managed to an outcome
- ❑ Outsourcing should be assessed along with
  - ❑ Understanding whether it fits within the corporate culture – are there any barriers to success?
  - ❑ Knowing the objectives/goals to be achieved
  - ❑ Ensuring existing problems are addressed/resolved
  - ❑ Alignment to corporate strategy
- ❑ Determining what style of relationship with a vendor is most appropriate

- One extreme is project driven
- Other extreme is long term relationship where mutual benefits are sought
- Seek rewards based arrangement rather than penalty driven
- Encourage relationship building at multiple levels of management

Service Provider

- Client needs are sought and addressed
- Satisfaction is assessed and actioned
- Honest in reporting
- Opportunities to solve business issues sought
- Proactive is delivery of service and solutions
- Uses high quality people and measures their performance
- Can bring best practice
- Is not seen to use the profit element to drive all decisions
- Seeks regular feedback
- Will see you as an important client
- Wants to engage
- Will take prime role and be held accountable

CLIENT

- Recognises Service Provider's right to make a profit
- Early warning of major issues impacting the services
- Prompt payment
- Smart and regular planning
- Respect for the service provider and their personnel
- Involvement of Service Provider in planning process and communication of clear business goals
- Open communication

PEOPLE

- ❑ Get the right people involved – not everyone is suited to management roles
- ❑ Ensure top management is involved in all key decisions and does not abdicate responsibility
- ❑ Should ideally be part of the business of the purchaser and not at arm's length
- ❑ Emphasise the development of the people responsible for relationship management
- ❑ Manage the people issues – people make and maintain the relationship - it is not done by the contract
- ❑ Purchaser should not replicate what the service provider should otherwise be doing
- ❑ Ensure good communication lines are established
- ❑ Consider the human factors

FINANCIAL

- ❑ Demonstrated value for money and competitiveness at regular intervals
- ❑ Level of transparency enabling Client to assess cost drivers and react
- ❑ Trends following general industry trends
- ❑ KPIs improving over time within same price or price reducing over time within same KPIs
- ❑ Preparedness to share in significant financial benefits from new initiatives
- ❑ Flexible to allow for changing environment and business needs

CONTRACTUAL/SERVICE LEVEL AGREEMENT

- ❑ Flexibility to add and remove services
- ❑ Has underlying tone of partnering, not solely adversarial
- ❑ Not exclusive to one but allows flexibility to have different service providers for out of scope/additional services should they be deemed best of breed or best value
- ❑ Incentives (e.g. Bonuses) to exceed expectations in key areas for value added services, penalties if below expectations
- ❑ The incentives of the individual managers on both the customer and service provider sides are consistent with overall goals and with each other's incentives

- Regular and meaningful reporting with regular reported follow up

- Scorecard approach for over (value add) and under performance
- Outcome/output based expectations, not prescriptive
- Measure the few truly critical KPIs that drive the perception of value, not everything that can be measured
- Establish a relationship management structure and processes as part of the contract
- Benchmark factors other than traditional quantitative measures to include qualitative aspects of the relationship

TECHNICAL

- Flexibility on platforms, hardware, software
- Reliable and predictable services
- Not prescriptive on how the service provider should deliver the services
- Hardware and software at industry standard (current release) or industry standard – 1 (last release)
- Matching of supply and demand (minimise paid over capacity, high cost under capacity)
- Appropriate skill sets
- Able to bring value added services
- Has access to global knowledge and resources if needed

About Russell Brewer

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When a partner of Deloitte Consulting Russell designed and lead the development of their "Outsourcing Life Cycle Methodology" still used extensively by the Public and Private sectors within Australia and internationally.

Today Russell is one Australia's leading advisors in the key area of ICT Strategy and Strategic Sourcing and today is a speaker, commentator and advisor on the subject.

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