Outsourcing has become one of those concepts that has changed perceptions over time. It has been around in one form or another for many years, but the staggering growth of the market has refocused attention on the reasons, benefits and pitfalls of these increasingly important decisions.

Many large organisations have embarked on huge cost-cutting exercises over the last few years. The glaring exception in many cases has been IT, which in some cases has risen by as much as 20% per year. The argument may be that effective application of IT has resulted in some of these savings, although that needs to be proven or justified in each case.

This has been one of the many factors that has driven a trend towards outsourcing IT services.

An in-depth survey, including numerous workshops, has raised some interesting, yet not unexpected results. However, the emphasis on relationships and the management of expectations has been surprising.

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According to Richard Sykes of Morgan Chambers, “outsourcing is an executive tool that can reduce/contain costs, mitigate risk, eliminate areas of capital expenditure, move fixed costs to variable costs and reduce headcount”.

The reasons given for outsourcing coincide with the expected benefits, and have been discussed together. While cost is often mentioned, it is not the most important reason for outsourcing. On analysis of the various factors put forward, it can be stated that organisational agility, competitiveness and access to scarce skills are top of the mind.

On the opposite side of the fence, organisations outsource tactical and even mission-critical functions in order to ensure that they do not impede efficient and effective operations or to facilitate a merger or acquisition.

The research has shown that there are basically two axes that define the types of
outsourcing, namely strategic versus tactical and full scope versus multi-source. In addition, certain specific types of outsourcing are variations on these themes. Business Process Outsourcing (BPO) and operations outsourcing are variations of the same concepts.

There are many considerations before one can make a decision to outsource, and these will vary substantially depending on the specific context.

A key finding is the importance of relationship building and due process throughout the outsourcing lifecycle. An adversarial approach raises the cost of doing business and is not a substitute for a competent contract management team and a thorough process of engagement. This engagement process should follow its course, during which time the client and outsourcer ensure that they have common objectives.

Cost models, of which the most important are risk/reward and cost plus, drive different behaviours on both sides and a client should not expect collaborative behaviour when the cost model does not allow for it.

The client should always retain control over strategic business direction and those activities that differentiate the business and create competitive advantage. A distinction should be drawn between mission-critical activities and core competencies. Under the correct circumstances, even mission-critical activities may be outsourced, providing there is adequate control over performance and outputs, and there are clear rewards and penalties for adequate or inadequate performance.

Outsourcing will not “get rid” of existing problems; it will merely shift the activity. The change process needs to address ICT issues before outsourcing, to ensure a correct start. A quick map to the suggested maturity grid will determine organisational readiness for outsourcing.

Change of any nature has an impact on the staff of an organisation and this is specifically true of outsourcing. Staff members who move to the outsourcer’s payroll will require support and potentially re-education, as their previous employer is now a customer.

On analysis of the various factors put forward, it can be stated that organisational agility, competitiveness and access to scarce skills are top of the mind.

Once the deal has been struck, the client role for the remaining employees changes to one of contract management and performance measurement.

The CIO retains a primarily strategic role, but will be required to deal with client executives and supplier staff. As such, the role remains critical in an organisation where ICT is considered important.

As in any complex deal, contract negotiation is vital and the suggested approach is for the key parties on both sides to agree in principle on a memorandum of understanding (MOU) before involving lawyers in the detail. The MOU can serve as a reference document in the event of a dispute and could avoid litigation if it is solid enough. The key is a non-adversarial approach, before recourse to legal process.

Once the contract is signed, the real work starts and the onus is on both the supplier and customer to make the partnership work.
Outsourcing can be seen as a means to alter the supply chain or organisational structure for the reasons given below:

**Overt reasons**
The most common reasons for outsourcing, according to our survey group, are to reduce and control costs, to focus on “core” business, and to gain access to best-of-breed capabilities.

What is not clear is whether these reasons will remain the same for the foreseeable future.

Clearly outsourcing needs to be part of a sound business strategy. Even if outsourcing automatically decreases costs, it may not be the right thing to do. It may be ideal if the client organisation is pursuing a “low cost” strategy.

Traditionally, the outsourcing market focused on operations and processing and in many cases on the development of large-scale systems. This emphasis has shifted over the years to where companies are now outsourcing business processes in their entirety. Companies like Dell have outsourced huge portions of their business and have remained competitive. According to Steffano Mattielo, CEO of Sun SA, Sun is committed to outsourcing non-core functions.

Increasingly, outsourcing is evolving into a tool for strategic change - something Accenture calls “transformational outsourcing”. This shift is changing what is being outsourced. There is some speculation that the trends are towards knowledge-based outsourcing, where skill levels and the associated requirements are high.

There has been much discussion regarding outsourcing “added value”, which at this stage is still a nebulous concept. Added value is inextricably tied to perceptions until a tangible effect is seen on the bottom line or in competitive positioning, which ideally also translates into bottom line benefits.

“Core business” is a topic that continuously...
The rationale behind this is that certain reasons are “popular” and others are not openly mentioned.

The argument is that in most cases a company can outsource even mission-critical operations but never core competences. Just because an IT function is mission-critical does not mean it cannot be outsourced. Even this distinction runs into trouble when core competence is not clearly defined. We leave it up to our readers to decide what is core to their specific business and hence needs to remain under management control.

To determine where an organisation is positioned with respect to its Information and Communications Technology (ICT) a simple quadrant is used – see diagram 3. The focus of outsourcing decisions is moving away from purely technological reasons to business results and from isolated technical solutions to entire business areas or processes.

Covert reasons
What is not generally mentioned is that research into the outsourcing market reveals two sets of results namely those which clients and service providers are comfortable mentioning and those that they do not mention.

Issues not raised during our research are:
- Expectations that an ever-increasing percentage of the ICT workforce will be employed by outsourcing service providers.
- Decreasing the pain of ongoing mergers and acquisitions. Outsourcers are by nature skilled at dealing with multiple clients and the associated applications and technology.
- To assist with the implementation of major technological change or a “catch up” requirement. This particular view is supported by our findings in the area of organisational maturity.
- The “masking” of ICT non-performance, where relationships or competencies are not at the required level and outsourcing is an attempt to “get rid of it”.
- Liberation of capital tied up in expensive technology.
- To deal with anticipated changes in legislation.

Experienced outsourcers are obviously trained to be on the look-out for such hidden reasons and agendas and our research has shown that these need to be dealt with early in the relationship-building process. This subject is dealt with under rules of engagement.

While reasons to outsource are relatively easy to separate into strategic and tactical (or operational) reasons, this distinction has not been drawn in our research. It is, however, clear that the two primary groupings will drive different behaviours. This is perhaps a subject for further research.

Impact on financial performance
While the reasons given for outsourcing often include topics such as “bottom line benefits” and “increasing shareholder value”, the relationship between successful outsourcing and financial performance is as difficult to prove as when ICT was managed in-house.

Financial analysts of listed organisations may react with disinterest or seek to find “hidden” or unstated reasons for outsourcing. A shrewd analyst would look for sound strategic or tactical reasons for outsourcing.
Types of outsourcing

Strategic and tactical drivers may conflict with each other and it is recommended that the reasons for outsourcing are clarified early in the process.

Strategic versus tactical

This distinction crops up in many of the discussions regarding reasons, approach, style and relationships. A strategic decision to outsource may result in a competitive advantage for the client, whereas a tactical decision generally focuses on an isolated area of ICT operations. Strategic and tactical drivers may conflict with each other and it is recommended that the reasons for outsourcing are clarified early in the process.

Tactical outsourcing is not necessarily a “poor” decision; in fact it may be the best decision at the time, but the decision should be made within the broader strategic process. The viability of a tactical outsourcing decision is dictated to a large extent by whether a system or process is considered mission-critical or not.

The decision of strategic versus tactical outsourcing will influence the nature and expectations of the transaction.

The decision is clearly dependent on a number of factors and is unique to each transaction. There is no “recipe” for outsourcing decisions. It is simpler to treat tactical outsourcing on a fixed-price basis than it is for strategic activities. Strategic outsourcing activities require a more flexible and collaborative approach to planning and implementation and they are often dealt with on a project basis, where the objectives, costs and measures are justified and agreed jointly.

Single- or multi-source?

- Power balance
- Risk reward
- Accountability
- Best skills
- Cost of service
- Cost of management
- Cost of measuring
- Cost of exit
- Focus
- Economies of scale and scope

PostScript Picture

5963–CSC Compwk Ad 12–02
Full scope versus multi-source and best of breed

There are a number of terms bandied about in this definition or distinction. The core question is whether the client deals with one or many suppliers. There are variations to this concept.

The supplier may be the sole supplier of services (single source) or the primary contractor, being responsible for managing specialised sub-contractors or “best of breed” niche specialists.

The client may decide to identify its own “best of breed” or “multi-source” suppliers, whereupon the contract management role rests with the client.

There is a distinct trade-off between simplicity and accountability, cost of management and measuring, balance of power and cost of supply.

In either case, the client and vendor will perform different functions and have a different level of authority, accountability and structure.

A rule of thumb is that a multi-source contract costs twice as much to manage as does a single-source contract. This needs to be balanced against the potential savings of a multi-source contract. In addition, switching suppliers or bringing a service back in-house is simpler and less expensive under a multi-source arrangement.

The final decision may be dictated by the required balance of power, which may swing in favour of a powerful vendor. In addition, it is more complex, if not impossible, to adopt a risk/reward approach with multiple vendors, as it may not be possible to separate outcomes based on individual vendor performance.

In large and complex deals, complexity and scale of the technology and applications tend to favour the use of single-source global partners.

Single source or multi-source arrangements can be specific to a particular function, service or process, as described below:

**Business process outsourcing (BPO)**

Business Process Outsourcing is where the vendor takes responsibility for a business process or unit in its entirety. By definition a process has a defined start and end point. This means that the measurement of outcomes is simplified.

**IT infrastructure outsourcing**

This is a fairly traditional and typically tactical approach, where the outsourcer becomes responsible for managing technology infrastructure. This is particularly applicable to e business transactions, providing the interfaces to legacy or back office systems are manageable.

**Application outsourcing**

The entire systems or application development lifecycle or key components thereof may be outsourced. This can include development, maintenance, hosting or a combination.

The drivers, benefits, structure and relationships can vary substantially between these approaches.

**Positioning the outsourcing types**

The types of outsourcing can be positioned on the continuum of the two grids as indicated in diagram 4.
There will be times when the choice is a hybrid between strategic and tactical components and single- and multi-source options.

The positioning of each component on the grid is dependent on the organisation and its approach to outsourcing each activity type.

Making the choice

In this turbulent age, the decision as to which route to follow (and the term of contract) is not simply a choice of models, it should be driven by a number of key factors:

1. Is this a strategic or tactical decision?
2. Is cost an important driver?
3. Will this decision support my strategic direction or hinder it?
4. Will I be increasing my organisation’s flexibility?
5. Will it result in increased control? 😊

A company’s primary objective should be to optimise flexibility and maximise control as its environment and circumstances change. The question of whether ICT is to be treated as a community or a strategic operation is not as important.
Cost models drive behaviour

The client and SP can only discuss partnership or collaboration when both risk and reward are shared

A recurring theme that requires emphasis is that the costing model and charging mechanisms drive client behaviour and that of the service provider (SP).

There is consensus that more than one pricing model may be applicable in the same outsource environment.

Cost models

- Fixed price
- Risk reward
- Usage based
- Joint venture

The client and SP can only discuss partnership or collaboration when both risk and reward are shared. Attempting to hybridise these models for the same service may lead to disaster, starting with an increase in aggressive negotiation. Flexibility tends to decrease with increasing price pressure. The opposite is true when the client and the SP start negotiating on a win-win basis.

Attempting to hybridise these models for the same service may lead to disaster, starting with an increase in aggressive negotiation.

Fixed price
Fixed price contracts are applicable to well-defined operational services and where Total Cost of Ownership (TCO) is clear. Fixed price contracts drive low cost, efficiency driven relationships and that will be evident in the behaviour of both the client and the outsource. There should be little talk of “value-add” and most of the talk should be about lowest cost of service delivery.

The client will be focusing on maximising output at the lowest cost of service delivery and the supplier will be seeking to minimise service delivery at the agreed cost. There should be no real problems providing that this behaviour is acceptable to both parties and is identified during the contractual phase.

In this scenario the service and related financial value need to be identified up front. Because of this, there are typically many variation orders or situations that trigger variations. This can lead to disagreements regarding inclusion or exclusion in the primary agreement. The relationship typically revolves around the contract and its stated service levels. Careful contractual preparation is required to pre-empt the above conditions.

This is not likely to be a partnership arrangement between the customer and supplier, although lessons can be learnt which lead to improved relationships on re-signing.

<table>
<thead>
<tr>
<th>Fixed price</th>
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</thead>
<tbody>
<tr>
<td>Client</td>
</tr>
<tr>
<td>Try to extend to maximum</td>
</tr>
<tr>
<td>Where is the value add?</td>
</tr>
<tr>
<td>Focus on inputs</td>
</tr>
</tbody>
</table>

There should be little talk of “value add” and most of the talk should be about lower cost of service delivery.

Risk/reward
The risk/reward relationship and continuum is most suited to a partnership approach between customer and vendor. Ideally both parties should be driven to the same outcomes, as their rewards lie in the same targets and results. The success of the SP should be tied to that of the client.

In the words of one of T-systems’ customers: Dave Burke, CIO of DCSA: “We trusted each other, in the confidence that we were all working together to achieve the same goal.”

The definition of benefit/target eg, share price, procurement, negotiations is critical – although there needs to be some control of the process.

Typically a baseline service contract is required; beyond which rewards should be
based on a clear understanding.

Risk reward agreements require a more mature partnership relationship. As a result, lengthier negotiations and time to build a relationship are required. It is difficult to measure success in terms of EVA, ROI etc and the two parties are rather dependent on each other to work on joint success as a result of beneficial collaboration. This does require a mature approach to ICT and this is discussed further on.

### Risk / reward

<table>
<thead>
<tr>
<th>Client</th>
<th>Vendor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Looking for improvements</td>
<td>Looking for economies of scale</td>
</tr>
<tr>
<td>Looking for direction and expertise</td>
<td>Looking to leverage scarce resources</td>
</tr>
<tr>
<td>Strategic advantage</td>
<td>Satisfy an important client</td>
</tr>
</tbody>
</table>

### Usage- or consumption-based

Usage- or consumption-based charging has been around for some while and is better suited to tangible or commoditised services.

**The pricing mechanism**

The pricing mechanism is typically a cost plus mechanism, although this is not transparent to the customer in all cases. Transparency on the part of the supplier may lead to cherry picking on the part of the customer. A commoditised costing approach such as this does not lend itself to a partnership approach and each party is trying to maximise benefit at least cost.

There are few guarantees regarding the quality of outputs, as there is no value adding service, unless this is contracted for separately. The quality of inputs is generally strictly monitored.

### Usage- or consumption-based

<table>
<thead>
<tr>
<th>Client</th>
<th>Vendor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wants max output at lowest cost</td>
<td>Leverage lower cost resources</td>
</tr>
<tr>
<td>Selection or cherry picking of inputs</td>
<td>Wants to max good resources</td>
</tr>
</tbody>
</table>

### Infrastructure Services

<table>
<thead>
<tr>
<th>Client</th>
<th>Vendor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instant scalability, no responsibility</td>
<td>Minimise cost of infrastructure - drive utilisation</td>
</tr>
</tbody>
</table>
The outsourcing engagement process can be a complex transaction and commits both parties to an extended relationship. There will be a fundamental shift in structures and responsibilities as a result of a major outsourcing deal.

**Typical concerns**

It is understandable that client management will be concerned about business and financial risk and the impact on the business as a result of outsourcing decisions, especially those that are strategic or mission-critical. It is important to identify which business functions will be affected, in order to plan forwards.

Another concern is that of potential "loss of control". This can be a real concern or merely a perception that needs to be managed. Irreversibility of the decision is often raised as a concern that needs to be addressed.

There will be a fundamental shift in structures and responsibilities as a result of a major outsourcing deal.

Dealing with the concerns

One way of dealing with concerns regarding any complex decision is to be informed about the options and consequences. Quantification of risk and an associated risk mitigation or management plan is a recommended approach and is standard project management practice, which should be part of any formal and well managed approach. An independent outsourcing advisor can be invaluable at this stage.

Careful planning and management of the outsourcing process is vital and some pointers are given under rules of engagement below.

**Roles and responsibilities**

There are four identifiable phases through which the client organisation proceeds during an outsourcing journey. These are:

1. Investigation, fact finding and option seeking
2. Planning, negotiation and contracting
3. Execution or implementation
4. Renewal and renegotiation

For each of these primary phases, the client performs different tasks and needs to assume different roles.

- During the information-gathering exercise, the team needs access to as much information on the subject as possible.
- The negotiation phase requires a balance between the supplier’s expertise and the inexperience of the client team. This is where some external advice may be required.
- While the deal is being planned, there are some critical planning roles. These relate to issues such as defining expectations, relationship building, cost models, structure, human resources, measurement and monitoring and the legal process.
- Part of the planning process includes planning for the impact on culture and people. In a non-adversarial role, it is recommended that the planning process takes place with the outsourcing service provider. This process will build the relationship and understanding between the two parties.

The structure required for implementation is radically different to that of the ICT department prior to outsourcing and emphasis needs to be placed on those skills that interface with the supplier and the management of performance and relationships.

**Issues**

Many issues are raised during an outsourcing process and some of the more important are discussed below:

- It has been stated that cost models drive the behaviour of both the client and the outsourcer and this will drive the relationship from incep-
ition. Due to the extended nature of the average contract, supplier selection and the resultant relationship become increasingly important. The choice between an adversarial “procurement” oriented approach and a collaborative approach can mean the difference between success and failure.

The client organisation needs to clarify its purpose and direction before embarking on an outsourcing venture. Outsourcing components of the business does not resolve the problems caused by poor strategic clarity. A clear purpose and expectations drives a clear arrangement, even if the purpose is clearly tactical in nature. The alignment of expectations, measures, benchmarks and the type of relationship could result in a collaborative success as opposed to an adversarial failure.

Whether or not to outsource to a single provider is both a strategic and technical issue. It relates to complexity, capability, single point of contact, power of supplier and customer and cost of measurement and management. This is a complex issue that is not resolved on a checklist basis, as there is no simple recipe. It must however be resolved early in the process.

Collaboration does not imply soft negotiation but a complex contract is not necessarily the best defence. The client management needs to focus on important measures and on meeting stated and unstated expectations. Hence the requirement for a flexible approach to measurement and reward/penalty. Part of the measurement conundrum lies in determining what to measure and how much measurement is required. Detailed measurement does not guarantee success. It is therefore important to invest the time and effort in establishing a sound legal contract, which will address these issues.

Timing and phasing of the outsourcing contract becomes an issue in times of major organisational change. Change can be compounded under the pressures of mergers and acquisitions. Radical change resulting from organisational and technological change is both an opportunity and a threat of too much too soon. Any change affects people and it is wise to consider staff perceptions, communications and their ability to sabotage a project they do not buy into. Moving staff from a customer to a supplier environment is not an insignificant change and needs to be handled adeptly.

A major factor in dealing with uncertainty is the ability to build flexibility into an arrangement, and this is core to a successful outsourcing contract. This means flexibility to scale up or down or even enable a major change in strategic direction. Inflexible approaches become a noose around the client’s neck and could result in organisational collapse.

The bigger the deal, the more lengthy, complex and time consuming the negotiation. This translates into cost for the client and the service provider. Negotiating an outsourcing deal is not simple and will require top-level management sponsorship and commitment of resources to see it through to its logical conclusion.

Identifying those ICT functions and business processes that will be affected is a key step in the process. This will enable sound forward planning, preparation and communication with affected staff. The impact on the business value chain and the handovers where an entire process is not outsourced, will be key. This will avert disasters resulting from “dropped catches” that were not anticipated.

In planning for a successful relationship, negotiations should lead to a “memorandum of understanding” (MOU) or “heads of agreement” which is clearly understood by business executives and which guides the principles of the agreement, before spending too much time on the legalities.

In order to quantify financial expectations, it is important to identify total cost of ownership or TCO. TCO refers to the total cost of Information and Communications Technology (ICT), which includes all spend on applications, desktops, servers etc. This will be crucial for comparisons before and after the deal. If the TCO is fuzzy before outsourcing, comparisons and benchmarks may be meaningless.

Depending on how mature the organisation is with respect to ICT, these figures can vary from 60% to 100% of real cost. Given this huge anomaly, the percentage variation between the pre-outsourcing and post-outsourcing figures can be staggering.

When outsourcing to a service provider, protection of intellectual capital (IC) should be included, especially where there are concerns about competitive advantage. A key concern for knowledge-based or knowledge-intensive businesses is the potential for loss of control over the most valuable asset, such as client information. The “disconnect” that the client had with its internal IT department will not disappear without careful management and a behavioural change on the part of management.

This is a particularly important consideration for organisations that consider ICT a “necessary evil”.

Client maturity is important
Organisational maturity and IT maturity within the organisation are key influencers in outsourcing decisions.

They affect what can be achieved by the outsourcing contract and the effectiveness of the partnership or collaboration.

The determination of organisational maturity with respect to ICT is a complex process.

It is recommended that the following scales are plotted on a three dimensional graph: ICT maturity, complexity and strategic importance.

ICT Maturity indicators
- QO’s reporting position
- IT governance
- Age of computer systems
- Business literacy of IT
- IT literacy of business
- IT/ business relationships
- Cost focus
- Partner vs adversarial
- Islands of automation

These three indicators have a bearing on the dependence on and attitude to ICT, the organisational capability, the state of ICT within the client and the relationship between ICT management and business management. The industry sector and strategic positioning of the organisation will influence complexity of ICT infrastructure.
Clarify intent

Before commencing with an outsourcing process, it is vital to clarify the business purpose and objectives of the outsourcing process. It is also important to decide early on the selection and acquisition process to be followed. At this stage, the client should establish an outsourcing team. This team will be tasked with information gathering, determining the approach, identifying and negotiating with the service provider.

There are many important issues that need to be addressed, such as

Identification, selection and engagement of an outsourcer

Some key steps in the outsourcing process are:
- Identify potential providers
- Determine culture fit
- Establish collaborative mindset
- Choice of acquisition process
- Making the choice of provider
- Plan approach jointly
- Consider legalities
- Contract

There are many methods of identifying a potential service provider, ranging from requests for information (RFI) to requests for proposal (RFP) or tender. The client should be seeking to establish reputation and capability of the service provider in the specific area of service required.

The client could choose to initiate a fact-finding mission at this stage.

In addition, the culture fit between vendor and client is considered highly important. This implies that referencing, research and building a relationship are more important than a technically sound acquisition process. One way of mitigating risk is to “ease” into a relationship over an agreed period of time.

Competitive requests or tendering processes do not guarantee the right results. They do guarantee to increase the cost of acquisition for both client and vendor, especially those losing the bid.

Accenture’s local survey identified the following factors in choosing a partner:

- Cultural fit
- CSC identifies four criteria for ensuring a cultural fit between vendor and customer.

Criteria for culture fit
- Planning
- Communicating
- Transition management
- Leadership skilled in transition issues

The research confirmed that ICT problems do not disappear when ICT functions are outsourced, and highlighted the fact that the same functions that were performed before are still performed after outsourcing. What has changed is the ownership of the resource and expertise.

Rules of engagement
There are two major culture shifts that need to be catered for, namely the cultural match between vendor and client and the assimilation of client staff into the vendor culture. There is a fundamental shift in philosophy when moving from a customer to a supplier.

Bloor Research has found that one of the biggest reasons for failure of outsourcing deals is a mismatch in cultures.

The negotiation process
The nature of the negotiations between vendor and client are dependent on a number of factors as identified previously. The key drivers will be culture, costing models and the calibre of the respective teams.

The more seriously the client takes the outsourcing negotiation process, the higher the probability of success – there is no substitute for clarity of thought. The negotiation phase should end with a contractual agreement as discussed earlier.

The negotiations should deal with issues such as cost, business impact, people impact, change management approach, roles and responsibilities, performance measures and monitoring and should culminate in a memorandum of understanding (MOU).

The MOU should then be translated into a legal document, which is discussed further on.

Setting performance standards
If one of the original objectives is to achieve better performance after outsourcing, this should be reflected in the performance measures. World-class outsourcers should perform according to world class standards. It is sometimes attractive to set measures as they were in the past and waiting to see “what happens”. The client should be set stretch targets that are not likely to be punitive and result in the wrong behaviour. It is important to remember that the contract is a commercial one and that the outsourcer is in business to make a profit.

A word of caution: it is dangerous to assume that the service provider will automatically outperform the internal ICT department. This result requires effort on both sides, including allowance for a learning process. Effective performance measurement requires effective measures and these are not always easy to identify and specify appropriately.

In most cases, comparative measures, or “benchmarks” are utilised. Benchmarks are notoriously difficult to come by and to apply appropriately. There are many organisations and individuals measuring nearly all aspects of the ICT industry who can make such benchmarks or research findings available (at a cost).

There are two types of performance measures, namely those that are operational and hence tangible in nature and those that are strategic and more difficult to measure. Client expectations are often set at the intangible level and measured at the easy-to-see, tactical level. This is true of most projects and it is important to balance the two.

A useful means for separating the two is to arrange separate operations and strategic meetings between the outsourcer and the client. Strategic meetings will only discuss operational trends and unresolved issues and conflicts.

Service level agreements should match the business needs as closely as possible. A service level agreement for system availability could be critical, or it could be a detail in the bigger picture. On the other hand, the business may require that immediate response times to support customer activities 24 hours a day, seven days a week (24 x 7 x 365).

Objectives should be set in line with business objectives. Having objectives and metrics alone is not enough to guarantee customer satisfaction. Successful service level agreements (SLAs) remedies and penalties for not achieving agreed service levels.

These penalties should motivate the vendor to achieve the objectives, and the remedies should be designed to ensure speedy return to normal operations.

Regardless of the magnitude of the penalty,
it is undesirable to repeat these experiences. Prospective vendors should participate in the process of designing SLAs and metrics that are achievable and result in a win-win for both parties. This will drive the future behaviour of the arrangement. It is simpler to request samples of SLAs from suppliers that have been used with other customers who had similar business needs. It is advisable to obtain and check references and the associated metrics in order to ascertain the success of previous engagements.

The contractual arrangement
The final step before engagement is generally the formal contract. At the time of contracting, there should be no doubt as to the objectives of and approach to outsourcing.

By the time the legal process is initiated, the client and supplier should have clarity on the business terms and expectations of the transaction. This is generally termed “heads of agreement” or MOU. These documents should be in plain English and should cover all the salient portions of the contract to follow.

The contract should be used to ensure due legal process and not to raise the stakes.

A typical contract should address the objectives, rules of engagement, performance measures, cancellation terms and conditions. Cancellation terms and agreements need to be reciprocal and should build in enough time for the client to re-establish any functions that are recovered.

There are diverging opinions on the term of contract. Due to the complex and long-term nature of risk reward contracts and the cost of engagement, suppliers tend to favour longer contracts. Clients tend to favour shorter contracts, fearing a “lock-in” over time. It is true that the longer the contract, the greater the resistance to change. The same is true for major systems implementations. The best advice that can be given to a client is to enter into an arrangement carefully and over an extended period of time, whereby the supplier and client get to “know” each other and their respective cultures. This does imply a non-competitive relationship during this phase, which will only be terminated in the event of material non-disclosure or non-compliance.

<table>
<thead>
<tr>
<th>Key client roles</th>
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<tbody>
<tr>
<td>• Business leadership</td>
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<td>• Business systems thinking</td>
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<td>• IT governance</td>
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<td>• Architecture planning</td>
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<td>• Short term systems integration</td>
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<td>• Astute buying</td>
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<td>• Contract management</td>
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<td>• Vendor relationships</td>
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<td>• Contract monitoring</td>
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Elements of the typical contract
• Objectives
• Rules of engagement
• Cost model
• Roles and responsibilities
• Change control rules
• Measures & controls
• Cancellation terms
• Protection of IC, confidentiality
• Duration
• Licensing arrangements
• Assets
• IT governance
• Staff and transfers
• Transition process
• Confidentiality

There is one school of thought that espouses multiple contracts even for single source providers. The logic behind this is the focusing of effort on discreet service parcels and in so doing building flexibility into the arrangements.

Post contract client roles and responsibilities
Post outsourcing, the client retains certain critical functions with some variations when an entire business process is outsourced. The direction of the business and ICT, business systems thinking, architectural planning and the procurement function cannot be outsourced.

The relationship needs to be managed by a dedicated team of individuals, probably headed by the CIO or a contract executive. Clear executive sponsorship is vital to outsourcing success.

These activities dictate the vital roles that remain with the client, many of which will sit squarely with the CIO or his equivalent. As a result, and depending on the individual, there may be unexpected pressure on the CIO to perform tasks that he may not be comfortable with.

After outsourcing, the CIO is required to focus on roles that are primarily strategic and of a relationship-building nature. Depending on the scope of outsourcing, the following roles are considered mandatory: business and strategic leadership, architectural planning and all the activities related with the procurement and monitoring of complex services.

Effective performance monitoring is dependent on the establishment of reporting processes and structures
Service level agreements (SLAs) are applicable primarily to those things that can be easily measured, but it is important not to over measure as the cost of measurement becomes prohibitive in relation to the value added.

Some critical measures need to be managed and these can be summarised from detailed sources. The focus should be on management and not operational information. Measuring operational performance is the subject of a more detailed discussion and is not dealt with here.

The results of monitoring processes should be fed back in summative format to executive management of both client and outsourcer.

Performance monitoring should ideally be to ensure that business strategic and tactical objectives are achieved. This task should remain the responsibility of the client management team and should be a key input into management meetings between vendor and client.

Effective performance monitoring is dependent on the establishment of reporting processes and structures. These need to be agreed early and implemented at the time of outsourcing. The results of monitoring processes should be fed back in summative format to executive management of both client and outsourcer.
Critical success factors

Aiming for mutual benefit or a win-win situation, ensuring client sponsorship at the highest level, a focused and dedicated contract management team, a balance between hard and soft metrics and contractual flexibility are seen as the critical success factors of an outsourcing deal.

The following have been identified as critical success factors for a successful outsourcing arrangement:

• Aiming for mutual benefit or a win-win situation between the client and the outsourcer, which requires the establishment and maintenance of a healthy balance. Adopting an adversarial approach does not work for either party, including the client. The client team needs to focus its pressure on obtaining the best price at a level that does not hurt the supplier.

• Client sponsorship is required at the highest level. This will ensure commitment, the allocation of the correct resources and ongoing involvement at the right level.

• A focused and dedicated contract management team is critical to the success of the fact finding, acquisition and engagement process. The correct resources after the engagement process are key to ensuring that the right quality is maintained.

• Balance hard and soft metrics - this will ensure that detailed measures are seen in the light of the bigger picture. Include involvement of the supplier in strategic matters. This will ensure that the supplier is clear on the objectives and impact of key decisions.

• Build in contractual flexibility for the full period of the contract and allow for realignment when the business changes. The contract must allow for change when business direction changes or market conditions dictate a change.

• The contractor must have the capacity, skills and business knowledge to perform at the required level.

The success factors dictate a balance between relationships and technical excellence and are very similar to the success factors for any IT project.

Lessons learnt

It is important to relate the type of outsourcing contract to the business requirements, ICT maturity and its culture.

What lessons have been learnt both in SA and overseas, primarily Europe and the US?

It is important to relate the type of outsourcing contract to the business requirements, ICT maturity and its culture. The client should not expect supplier behaviour that is contrary to the essence of the type of agreement being entered into. A pure cost focus will not lead to a collaborative approach.

Outsourcing agreements are getting longer and the exit options for the client tend to get fewer with time, due to the cost of exit. It is thus necessary to be committed for the long haul.

Requesting open market responses to requirements is an inefficient means of gathering the information and ammunition required to make a commitment, especially for complex single-source deals.

Stepping into the commitment gradually by building relationships is a good idea.

Using independent advisors is useful, especially where the client skills are limited and some resistance is expected from internal staff. Independent parties can smooth the transition process and avert adversarial scenarios.

It is important to get sound legal advice but it should be limited to contractual matters and the negotiation process should be managed and conducted by business executives.
A number of key trends are not being repeated in SA, namely the single-source route and the length of contract being signed. The findings below indicate that the respondent group is, however, considering some of these trends.

The research group agreed that SA is between five and 10 years behind Europe and North America with regards outsourcing trends. This presents an opportunity to learn from these experiences.

The skills shortage seems to be more real in SA than abroad although the major SPs don’t agree. Senior account management skills are in demand, as they are the primary interface with the client.

Business Process Outsourcing (BPO) is clearly on the increase both worldwide and in SA. A number of larger consultancies are focusing their efforts on outsourcing in a number of process areas and even in infrastructure outsourcing. This builds on a trend by the larger firms to pursue higher revenue opportunities than management consulting in its pure form.

IBM, aided by its acquisition of PwC, has outstripped its competitors in sheer revenue, although the pecking order in the North Americas, Europe and SA is somewhat different. Provision of independent advisory services is small compared to the revenues offered by outsourcing and application implementation services, although the provision of outsourcing advisory services is currently on the increase. Accenture recently completed a survey among 71 companies on the subject of outsourcing in SA. An extract of the key findings can be seen in diagram 5.

The outsourcing market will continue to grow until it reaches saturation, whereupon new sales will slow, but established revenues will remain constant in real terms. A consolidation of service providers will take place and more collaboration between otherwise fierce competitors will occur, as clients demand single-source accountability in the larger deals.

### Strategic growth agenda

Outsourcing will play a significant role in driving profit improvements:

- 79% say it is important that a outsourcing contributes to increased profits
- However, only 26% agree that outsourcing has impacted profits
- Outsourcing activity has far from peaked:
  - 33% who already outsource expect to increase their level of outsourcing activity within the next year
  - 59% will keep their current level of outsourcing at its current pace
  - 45% agree that the level of outsourcing will increase, regardless of economic conditions
  - 37% agree that outsourcing is a platform for growth

Source: Accenture

### Bottom line:

Outsourcing will become an ever more important weapon in the CEO’s armoury to drive profit growth.