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CONSULTING

# SEVEN STEPS TO SUCCESSFUL OUTSOURCING

The last decade saw the rise of major outsourcing efforts with varying degrees of success. The outsourcing arena is changing. Smaller, more selective arrangements, tailored to an organisation's specific needs, are the norm. This paper looks at seven considerations to achieve a successful sourcing arrangement.

Of 700 companies surveyed:

- ▶ 66 per cent of outsourcing arrangements met expectations
- ▶ 8 per cent exceeded expectations
- ▶ 20 per cent failed to meet expectation

## A strategic sourcing activity

Long-running, sometimes stormy, but doing better than most marriages. This was the view of *Information Week*<sup>1</sup> in their analysis of the continuing romance between corporate America and outsourcing companies. They determined that the outsourcing experience of nearly two-thirds of the 700 companies surveyed met their expectations.

Sadly, however, this is still not a very good performance considering the strategic and critical nature of outsourcing to the business outcomes. In the Australian Government at least, the dissatisfaction with outsourcing would seem to be almost universal.

If outsourcing arrangements do not perform well, then is it worthwhile? And if so, how can it be better achieved? This paper looks at seven steps to achieve a successful outsourcing arrangement.

## Step 1 Know why you are outsourcing

Reduce costs

Increase quality of service

Mitigate risks

Reduce distractions

Increase access to  
strategy and innovation

Begin by building a roadmap for strategic sourcing within your organisation, understand what you are seeking to achieve, how you will do so and the associated risks.

The most dominant factor would appear to be cost-saving and it would certainly seem to be an achievable goal. Most outsourcing companies claim they reduce costs by 20–30 per cent with one claiming between 35–50 per cent with the use of offshore resources.<sup>2</sup>

Increased quality of service can be achieved, but quality does cost, so this trades against the savings. Risks, especially the access to expertise and those associated with running the infrastructure can be mitigated. But most risks are not abrogated—the risk continues to exist and is still owned by the outsourcing organisation.

Running an IT or services operation can be a distraction to many organisations. Outsourcing causes a change in management focus from technology management to service delivery and contract management. Support for strategy and innovation becomes available, but unless a separate function is specified, such support tends to be to the benefit of the service provider.

The final outsourcing agreement must ensure that the important factors are understood and expectations clear. Nothing is for free. If a value is not ascribed to expected outcomes, then limited effort will be applied by the outsourcer and disenchantment with the relationship will eventuate.

<sup>1</sup> Robin Gareiss, 'Analyzing the Outsourcers' in *Information Week*, 18 Nov 2002

<sup>2</sup> Wipro Technologies, Total Cost of Management—Cost Benefit of Outsourcing, undated White Paper.

## Step 2 Know what you are outsourcing

IT Infrastructure

Desktop and applications

Telecommunications

Security

Maintenance

Organisational support services

Development and innovation

Research

The last decade saw the rise of outsourcing, especially in government where department functions were bundled and handed over to a third party. The boundary between in and out of scope activities was often blurred and sometimes inappropriate for the service provider's skill set. Some functions, such as firewall, security and telecommunications services may be better procured through another party and managed directly. Others functions might include applications development and legacy system maintenance.

The tendency to bundle dissimilar services should be carefully considered. A service provider can provide cost-saving through the use of common infrastructure and resources. However, if dissimilar functions do not allow for aggregation then little advantage accrues.

Part of what is being outsourced is a level of service. Internal IT departments tend to offer a very flexible level of service, going to great lengths to satisfy the customer. They often do not have defined service levels or they adjust them freely as the business need arises. In-house services are often measured by service satisfaction rather than service level. When outsourced, the provider will meet the contractual obligations. If set too low, expect staff dissatisfaction; if too high expect high cost and failure to achieve.

Concentrate on developing realistic standards of what your organisation needs in service delivery.

## Step 3 Know how much it costs

Total cost:  
*planning and design  
procurement  
capital  
installation*

*operations and maintenance  
decommissioning*

Audit and structure before outsourcing

Continuous measurement

Generally underestimated, it is the total cost of ownership that is being transferred. Undertake an audit and discover what is spent by whom and where. Over time these boundaries become confused as people get on with achieving their goals within your business. Almost certainly the cost structures will not align with your thoughts on the outsourcing structure. You will need to realign the costing to ensure you can measure the value of the offers that are made.

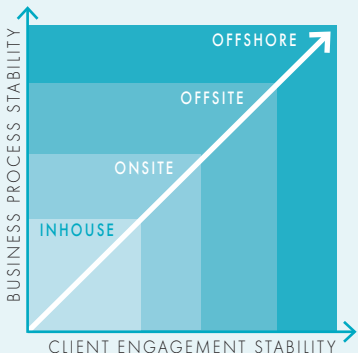
Probably an audit and restructure of costs will highlight immediate savings to cover its cost anyway. Telecommunications is a major contributor to cost escalation with unused terminations, misapplied discounts and disaggregation likely causes of excessive charges. Better to make this saving than hand it to an outsourcer.

Seek completeness and honesty in the costing. Management effort is often discounted or ignored as is the alignment of effort with the real service level that is delivered. Map some of the processes such as moves, adds and changes, to understand how much effort is contributed across the organisation. These processes are going to be remapped when you outsource, so this is valuable to understanding what you will need to do in the future.

Don't stop when you strike a deal. Continuously measure cost, measure performance, measure satisfaction.

## Step 4 Know your constraints

Sourcing flexibility increases with business process stability and client engagement stability



Few organisations can start an outsourcing arrangement without some constraints. The most obvious is a review of existing contracts and the flexibility you have to novate or terminate them. Consideration should include hardware leasing and maintenance, software licensing, telecommunications offerings, project and application development and so forth. Few of these will prevent outsourcing but they will certainly constrain scope and flexibility of the service providers in their solution offerings.

Political constraints and ideology may affect government agencies in their flexibility. This may affect location, human resource, security and data privacy issues.

Finally, understanding the maturity of your business and your systems allows you to understand the options or mix of options that might be appropriate. Stable, well documented systems and processes lend themselves to third-party service provision, maybe even offshore where significant labour cost savings are to be gained. Those organisations or processes that are constantly changing or are intensively managed will be at greater risk in an outsourcing arrangement.

## Step 5 ▶ Communicate

Seek input from industry

Consider a two-pass acquisition

Communicate internally

Information reduces  
*risk*  
*cost*  
*human capital*

Communicate what you are intending to do early, internally and externally.

The service providers are experts at outsourcing. They can give good advice on how best to structure an RFT, what information they need to respond, what the industry standards are and what options allow them to structure a competitive solution. Assumption of risk translates directly to price and the lack of, or ambiguous, information is seen by the outsourcers as high risk.

Consider passing out a draft RFT for comment or, in the most complex arrangements, a two-pass selection process. This gives good feedback and allows early shortlisting, reducing the cost of major tender response preparation and evaluation.

Outsourcing, or the fear of the unknown, is debilitating to organisations. This is a major change in an organisation; people will be fearful for their future. An information void will be filled with rumour. It is likely that some key people may leave early; develop strategies to hold them and to manage their departure.

Be honest from the beginning, communicate your plans, develop and share a retention strategy.

## Step 6 ▶ Build a deal

Establish a team

Use the art and science of negotiation

Prepare, prepare, prepare

Know what is of value to you

Understand what you have of value to the service provider

Trade value, don't haggle over price

Selecting a supplier and signing a contract is relatively easy. Building a deal, where both parties are happy that they are getting value, is harder but significantly more beneficial. A deal of value provides the foundation for a successful relationship.

You need the right team. The right team will include a mix of people who know how the organisation operates, how things happen. You also need people to lead, to determine what needs to be done.

Those within the organisations are generally comfortable with the status quo. Changing the status quo usually means external drive. Don't confuse technical and operational excellence with the ability to change organisations and negotiate lasting supplier relationships.

Look for assistance from those who understand the industry, commercial negotiations and commercial contracts. You need a relationship in outsourcing. Traditional contracts and adversarial negotiation destroy the future rather than providing a solid base for a partnership.

Seek the art and the science of negotiation. Careful preparation is the key to success. The art is in understanding the signals, the differing values and how to move over the negotiating playing field so that both parties are comfortable that they have value and the deal is clear.

The contracts need to be complete and they need to be explicit. The statement of work and the service level agreements must cover this. They also need room for change without fear. Enshrine principles of doing future business. This provides a better long-term footing than a simple service supply agreement.

## Step 7 ▶ Leadership and management

Behave reasonably, be flexible, continue to negotiate through transition

Ensure negotiating team members manage transition and demand the same of your service provider

Establish a long-term management team

Appropriately fund relationship management

Signing the deal is only the beginning. Most outsourcing contracts run for 3–5 years with options to extend. This is a long-term relationship that warrants attention and effort. It will be difficult in the beginning as both parties work with good will but clash over different ideas of delivery and unexpected shortcomings in the contracts.

It takes strong leadership, courage and confidence to keep the organisation on the path. Behave reasonably and be prepared to adjust the contract, the statement of work and the service levels. This is not to give away value, but adjust the value—an ongoing negotiation while the contract and service bed down.

Keep your negotiating team for a few months for this transition. Their corporate knowledge will be invaluable. As an added benefit, if the negotiators know they have to deliver on what they promise, they take more care. Demand the same from your service provider.

In the long term, establish the right management team. It will be different to what you had before outsourcing for they will be managing a service provider not service delivery.

Long-term relationships take effort, so do not skimp. Expect to spend between 5 and 10 per cent of the total deal price on the relationship management.

## Kiah Consulting

Kiah Consulting primarily provides support in the development of concepts and strategy, project initiation and the recovery of misaligned projects. Our focus is delivery in the public sector.

We work in the zone of ambiguity, providing our expertise to clearly articulate the concepts, define the outcomes and structure delivery. We undertake strategy development, concept definition, feasibility studies and business case development. We manage effective project execution through strong leadership and direction.

We provide the foundations for successful delivery through the establishment of project teams with appropriate contracts, resources, structure and processes.

With a mix of permanent staff and associates we can assure access to the right skills at the right time. Our model recognises that no one person or company has all the answers or skills, so we make it easy to access what is required.

Independence of contractors and suppliers, independence of internal organisations and politics allows us to offer untainted advice.