IT Outsourcing
A BuyIT Supply Chain Guideline
Forewords

One of the prime objectives of the Government is to secure efficiency benefits from the use of best ICT business practices across the public and private sectors. Outsourcing the IT functions can help achieve this goal as well as provide other clear opportunities and benefits for organisations. New ways of working, however, can also bring with them many challenges. I am delighted that the BuyIT Early Adopter organisations have produced this Best Practice Framework, which provides clear guidelines to help others take full advantage of the many benefits that can be achieved.

Alistair Fulton
Chairman
BuyIT Best Practice Network

Outsourcing has become a well established business practice for many organisations, and IT is often one of the first areas considered when looking to reduce costs or improve efficiency. As the outsourcing market has matured, there is an increasing range of delivery methods and risks that ought to be understood and assessed, for example using offshore suppliers or a network of competing suppliers. We know that many of our clients are dealing with the challenges and opportunities raised by outsourcing and PwC is delighted to have worked with BuyIT and its members to produce this Best Practice Guideline. This should provide an excellent starting point for considering the issues in a structured way.

David Muir
Partner
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Improving the efficiency of IT departments is often the area where great savings can be made within any organisation. In addition, and sometimes more importantly, it can also help to act as a catalyst for other organisational benefits and transformation programmes. The objectives, however, must be developed within the context of an overall strategy so that the goals are properly aligned. Developed by BuyIT members, this Best Practice Guideline provides a clear understanding of all these issues from both a buyer and supplier viewpoint and is an invaluable aid to help organisations gain the benefits of best in class IT Outsourcing.

Frits Janssen
CEO
BuyIT Best Practice Network
Why this Guideline is Important

Today, IT outsourcing is an increasingly important strategy for organisations. Many are either currently outsourcing key portions of their IT infrastructure – or considering doing so in the near future.

Pressures on corporate profitability and on public sector spending have led to a continued growth in entities outsourcing elements of their IT. Chief finance officers want cost reduction and capital efficiency, which outsourcing can provide because it then releases funds to finance growth and pursue fresh business opportunities. Chief Executives are demanding a greater focus on core skills and driving shareholder value through this route. Chief Information Officers are driven by all these factors, plus the need to meet business demands, whilst demonstrating increasing value from IT.

Further, it is increasingly recognised that outsourcing can also act as a catalyst for change within an organisation, allowing fresh thinking, new expertise and the opportunity for a step-up in an organisation’s performance.
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1. Introduction to this Guideline
The aim of this Best Practice Guideline is to provide a structured experiential perspective covering the broad field of IT Outsourcing. It begins with an overview of the key drivers and benefits that can be achieved from IT Outsourcing, a review of what it covers and the various options available. It then provides a set of guiding principles and best practices for the various stages in the outsourcing lifecycle, covering Strategy, Feasibility and budget approval, Transaction / Sourcing, Transition, Optimisation / Transformation, Review / Renegotiation and Exit / Termination.

This Guideline discusses and considers the various risks and barriers faced by an outsourcing project including the issues of operational management, key issues to consider and critical success factors.

This guideline should be read in conjunction with the BuyIT Executive Overview on IT Outsourcing which provides a shorter business perspective on the subject. Both guidelines can be found at http://www.buyitnet.org

2. Key Issues
The experience to date of the BuyIT members has suggested that the following issues should be considered:

- Setting and monitoring objectives is paramount for success to be measured and achieved
- The decision to outsource must consider the overall business strategy
- Outsourcing purely driven by economics rarely delivers the desired cost savings
- Once the decision to outsource has been made, it requires a similar level of executive sponsorship and management time and attention as a major Merger or Acquisition transaction
- Good service management, contract management, governance and active risk management are critical to success
- Forgetting the basics, such as tax, legal, regulation, pensions and accounting issues, is a recipe for disaster
- Early consideration of tax optimisation opportunities and deal structuring can add significant value to the proposition
- People are key both in terms of finding and allocating the right resources for the “transaction” itself as well as the change management and effective contract implementation.
- It’s as much about what’s left behind in the organisation as it is about what’s being outsourced
- Getting the transition right is make or break for the long-term culture and governance
- You can have a subcontractor or a partner – but not both
- The choice of supplier must be the right ‘Strategic fit’
- Outsourcing isn’t for life – what’s the plan for the next step?
- International outsourcing or “Offshoring” multiplies the issues
• Whilst you can outsource the processes, you still retain the regulatory and reputation risks.

3. Drivers and benefits from IT Outsourcing

Outsourcing is:

• an opportunity to transfer non-core business activity to a third party provider who possesses core competence, capability and expertise in the activity being outsourced.
• not always about cost reduction, it can also provide strategic focus or delivery of increased efficiency and effectiveness.
• an opportunity to release cash and provide valuable funds for investment.
• an effective method of accessing specialist technical and market knowledge and expertise in an increasingly fast paced industry.
• just one possible answer and not a ‘panacea for all ills’; if the activity is problematic in-house, outsourcing will only transfer the problem elsewhere.
• not the only path to business transformation, although when properly scoped and managed it can act as a catalyst for change.
• a different experience for every organisation despite all the commonalities

When appropriately implemented, outsourcing of non-core (“commodity”) IT functions can deliver a significant portfolio of business benefits. Depending on the organisation and the scope of the initiative (among other factors) these benefits can include not just cost savings and risk mitigation, but also a fast-track avenue toward achieving standardisation, replacing legacy capabilities with leading technologies if desired, or simply getting ahead of the competition by externalising commodity-like functions that allow the organisation to focus on a core capability. IT outsourcing might even enable the realisation of a major strategic change in the organisations business model, effectively enabling them to operate in a way that was not possible before.

The proportion of organisations without ITOs is an indication that is IT rarely seen as a strategic component of an organisation and more often than not is viewed as a non-core activity and a supporting function managed as an indirect overhead. By carefully outsourcing selective aspects an organisations IT it provides an indication to key internal and external stakeholders (e.g. investors and executive management) that the IT function is proactively looking to improve the value it offers to the business and it’s customers, whilst at the same time reducing costs.

Cost savings can be achieved through reducing corporate headcount achieved through greater standardisation and integration of processes, functions and services. Outsourcing also allows aspects of IT that have traditionally been represented as a fixed cost to the business to become services with a greater degree of scalability and flexibility over the cost structure, through the introduction of variable pricing mechanisms.

As well as providing a mechanism for reducing IT expenditure, IT outsourcing can also provide the ability to improve access to capital through effectively performing a sale and leaseback of IT assets, as well as over the longer term, a reduction in the investment in IT systems and hardware. Whilst providing access to new technology without necessarily
requiring the upfront investment, IT outsourcing also allows access to state-of-the-art IT skills, a reduction in training costs associated to keeping company staff up-to-date and a reduction in recruitment and retention costs.

Risk mitigation can be achieved by taking advantage of the outsource providers scale and their provision of disaster recovery and business continuity plans. Multi-sourcing options can also reduce the dependence on in-house personnel or high levels of staff turnover.

However, an additional benefit that can be derived from IT Outsourcing, if it is done correctly, is that it can assist in transforming the business as a whole. IT software, hardware and systems are inextricably integrated into the business processes in the majority of organisations. If IT outsourcing is done effectively then it requires a full understanding of the processes and services to be outsourced, with any problem areas being resolved prior to handover. Such a review of existing IT processes can act as a stimulus for the rest of the business to similarly review and transform their business processes and operations.

Additionally, visibility also increases management insight, and it can be found that in fact sometimes IT outsourcing is not the right strategy. Increased visibility and transparency can lead executives to conclude that IT outsourcing is not as attractive as might have been thought. One company – a global consumer products company – decided not to outsource after conducting a rigorous analysis of their total IT spend across all business units. The company found that through standardisation, consolidation and prioritisation, it was able to reduce its total IT spending by almost 30%, without impacting service levels.

4. ‘What IT services are suitable for Outsourcing?’

IT Outsource providers offer services for all aspects of an IT function including; Desktop services, Network services (including, WAN, LAN, telecoms), Mainframe, Midrange & Servers, Infrastructure projects, Service Centre/Helpdesk, Disaster Recovery, Security, Strategy & Architecture, systems development, software maintenance and support, hosting of websites, infrastructure and application specific management and 3rd Party IT Procurement.

When considering outsourcing of IT services a number of areas need to be considered including for example:

- Is the outsourcing of IT linked to other functions remaining in-house or being outsourced, e.g. HR, Finance, Operations Management or Customer Services?
- Is the service to be limited by geographic scope to retain an element of proximity to the outsource provider or is a more global approach to be adopted to achieve economies of scale?
- Should any aspect of IT provision be excluded from the Outsourced services to maintain competitive advantage? E.G. Strategy and Architecture.

In many respects it is important to understand the boundaries within which the above questions are to be answered or constructed and to have a clear understanding of the IT strategy for the business. In particular, whether IT is expected to play a strategic role in the development of the business, whether it is to be a partner to the business or whether it is in fact a commodity or service that in its very nature should be provided by an external
agency. This requires an assessment of where IT, and staff that reside within the IT organisational structure, add value to the business. Some IT staff, such as business analysts or technical architects, are in value-adding roles, whilst others may perform more readily commoditised or supporting functions such as IT buyers or account managers.

It is also important to understand the skills and capabilities available in the market place versus those available within the organisation, both in terms of the knowledge, experience skills and capabilities of the IT staff in the organisation or service provider and their capabilities in terms of the level of services that can be provided, e.g. systems and applications support coverage, response times etc. In both cases the cost of providing such skills and capabilities and the level of capabilities provided needs to be assessed and validated in an objective manner.

4.1 What Sourcing Options are available?

As described above there are a number of specific questions that need to be answered merely to understand which aspects of IT service provision could be outsourced. Similarly there are a number of options regarding the potential solutions available, including:

- Joint ventures
- Full outsourcing of IT services (often referred to as single source)
- Selective outsourcing or Multi-sourcing (often referred to as “best of breed” sourcing)
- International Outsourcing or “Offshoring”.

Contributing factors to also consider include:

- The extent to which cost control is the key driver.
- The level of acceptable risk and required governance.
- Ownership of assets, including Intellectual Property.
- The preferred duration of any potential outsourcing contract
- Expected and required service management levels.
- “What will good look like” – how would you effectively measure success.
5. The IT Outsourcing Lifecycle

The IT Outsourcing process or lifecycle covers the following stages:

- Strategy
- Feasibility and budget approval
- Transaction / Sourcing
- Transition
- Optimisation / Transformation
- Review / Renegotiation
- Exit / Termination

These are shown in the diagram below.

Successful outsourcing is about getting it right at each stage of the Outsourcing Lifecycle and the formation of sustainable partnerships.

Executive sponsorship tends to focus around the start of this Lifecycle up to and including “doing the deal” - i.e. strategy development, business case creation and key stakeholder buy-in and the strategic sourcing activity. Experience has shown that executive sponsorship and senior management focus mid contract delivers optimum value throughout the Outsourcing Lifecycle.
5.2 Strategy Process

Successful outsourcing is driven from core business strategy. Getting this right entails:

- Having a clearly identified link from a strategy to a validated business case, being clear about the objectives and required benefits of an outsource, and the criteria by which success should be measured.
- Identifying and validating the options available to meet the strategy.
- Preparing a business model that factors in customer and supplier needs, but also the needs of important organisational stakeholders and internal customers
- Agreeing on a senior sponsor with clear accountability and authority, providing executive support and guidance and a team empowered to deliver the strategy.

Validating the Strategy

Linking the outsourced activities to the business strategy better ensures alignment throughout the lifetime of the arrangement – not just the deal:

- Benefits required must be defined from the outset. This ensures that factors, such as flexibility, carry sufficient weighting.
- Sourcing strategy needs to be linked specifically to the business model for future delivery of services provided by an organisation.
- Sourcing strategy has to answer key drivers relating to cost, headcount and efficiency. A competitive sourcing process in established market conditions will deliver these benefits.
- Needs around removal/smoothing of high IT investment costs and other costs have to be agreed throughout the lifecycle.
- The organisation must consider its requirement for retention and/or creation of key skills, knowledge and competence and should view input from internal and external customers as particularly critical.

Identifying the Options

Identifying and understanding the options available to address the strategy, not just those related to outsourcing, are critical to delivering the strategy successfully, and includes:

- Having a clear communications and change management strategy linked to the complete lifecycle.
- Options should be driven by strategic business requirements and supported (rather than led) by procurement and commercial functions.
- Knowing the implications of all sourcing options.
- Understanding whether the organisation is ready for outsourcing of IT and whether IT outsourcing is really the answer.

Preparing the Business Model

The clarity of the business model is key to the success of every other aspect of the outsourcing lifecycle:

- The model provides the framework for defining the benefits.
- It has to consider direct financial constraints, but also recognise the constraints imposed by tax planning.
IT Outsourcing
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- It needs to capture the legal and regulatory pre-requisites.
- Additionally any accounting rules that apply, particularly if assets are being transferred, should be incorporated.
- Finally, the model should take account of people, HR and communication concerns e.g. TUPE legislation.
- Note – Business Model simplicity facilitates effective stakeholder engagement and eases business benefits realisation.

Agreeing the Sponsorship and building the team
Perhaps the most important consideration is the agreement of a senior sponsor who is linked clearly to the aspects of the business model being considered and who:

- Has accountability for the longer term success of the business and the outsourced relationship.
- Has the authority to enable the success of the relationship and to choose lead advisors.
- Selects a strong, experienced internal team and can ensure that the organisation is properly prepared for the process.
- Can ensure that all the stakeholders are sufficiently aware of their roles.

5.3 Feasibility and Budget Approval Stages
Establishing the feasibility of the options early in the process and defining the longer term benefits to be achieved are fundamental to the success of any sourcing programme. Getting this right entails:

- Building the business model and case that is clearly linked to the business strategy and setting very clear and achievable objectives
- Creating a baseline of current assets, intellectual property and staff, as well as processes and current service levels
- Gaining an understanding of the outsourcing market, the service providers and the commercial models that drive the relationships
- Assessing and benchmarking the options by using the baseline to appraise potential service providers and relationships.

Building the Business model and case
Developing a business model and case that is clearly linked to the business strategy and setting very clear and achievable objectives is key to underpinning both the deal and the relationship and includes:

- Deciding if the relationship is to be one of a subcontractor or a partner.
- Defining and agreeing achievable targets in the context of the outsourcing relationship and knowing what constitutes value for the organisation.
- Understanding the full cost implications of the changes that will take place.

Creating the Baseline
Establishing and agreeing the baseline of current assets, intellectual property and staff, as well as processes and current service levels provides the foundation of future success. The baseline should:
• be clear about how current services are evaluated and measured.
• start to define the magnitude of the change, both organisationally and culturally.
• capture an effective inventory of all IT related assets, with clarity of those which will be included within any Outsource agreement and those which will be retained
• be understood and validated externally in some cases.

Market Understanding
An understanding of the market is critical to structuring any potential solution and deciding if any form of outsourcing would fulfil required business objectives. Market intelligence can be obtained from a benchmarking activity and should include:

• Knowing who the “real players” are with capability in the market.
• Knowing who can deliver in which territories, and the limitations of working in different geographical regions.
• Knowing what the organisation’s competitors are doing in the outsourcing market.
• Knowing what technological options exist for outsourcing IT
• Knowing what different processes exist for outsourcing IT.

5.4 Transaction / Sourcing Stages
Once the decision has been taken to outsource, the deal process itself has to commence and this is likely to be the period of most intense activity. Getting this right entails:

• Structuring the deal to reflect both the current baseline of service offering and the potential market participants – recognising the type of vehicle and service provider relationship to be achieved
• Agreeing the scope of services to be provides
• Identifying the staff involved in the transfers within the agreement
• Negotiating a contract that is both equitable and achievable and which provides the ability to achieve the desired relationship, including consideration of effective exit management at the end of the relationship
• Ensuring that post-contract signature, the commercial and relationship benefits of the deal are realised quickly in preparation for transition.

Structuring the Deal
Structuring the deal effectively to reflect both the current baseline of service and the needs of the chosen supplier should recognise the type of vehicle and service relationship to be achieved. The deal structure should consider:

• That management must understand and adopt a ‘deal mentality’ (especially if dealing with an incumbent service provider)
• It is crucial that performance metrics used to measure the value of the deal are concurrent throughout, Transition, Transformation and ongoing delivery of the service(s)
• That appropriate regulatory, accounting and financial processes are in place
• How effective governance processes and structures will be established in advance of the Transition stage and measured post Transition.
Agreeing the Scope, Service Levels and Assets to Transfer

Clarity of service scope, what will change and how this will be measured is critical to the success of any successful outsourcing arrangement.

- Agreeing the scope of services to be included in the deal and ensuring an effective interface requirement are captured between e.g. retained services and outsourced services and/or for services from multiple service providers.
- Agreeing service level requirements and the process for measuring required service, especially for dealing with defaults, is essential
- Agreeing asset inventories and the movement of assets (including; hardware, software, facilities, people, intellectual property etc.) Where assets are transferred all significant related assets and liabilities need to be taken into account (e.g. pension entitlements)
- Supporting supplier Due Diligence and reacting to any significant findings
- Predicting business volumetrics in the short, medium and long term can be crucial to the viability of the deal.
- Note - Baselining of current service levels and costs should not be underestimated.

Negotiating the Contract

Negotiating an equitable contract which encourages and protects the desired relationship with the provider needs to be treated as more than a legal / purchasing activity. It requires a thorough understanding of the drivers and pressures for the provider as well as for the business. The negotiating process should:

- establish a contract negotiation and management team from both sides, including key individuals who will have an ongoing ownership role post commencement
- Ensure pricing, payment, penalty and credit mechanisms must reflect the realisation of actual value to the business
- Provide clarity of any risks to provide adequate consideration of premiums and appropriate break points.
- Build in flexibility to allow for the impact of future changes in the business
- Ensure cultural as well as financial and technical issues are properly addressed wherever possible to encourage mutual interest in achieving the contract objectives
- Note – the organisation may gain benefit from employing legal representation experienced in IT Outsourcing to provide specific support to any company lawyers and the commercial team in general. Clearly this will require a separate contract negotiation!

Navigating Legal Issues and Contractual Requirements

IT outsourcing arrangements can involve levels of complexity and risk that encompass a wide range of important legal and contractual issues. Take, for example, the inherent difficulties in defining responsibilities across organisations that have not yet worked together before – especially in an environment shaped by rapidly changing business conditions. Or the fact that long-term engagements can be difficult to reverse. Many will agree that a good part of the foundation for a successful initiative is based on the legal
and contractual due diligence conducted before an outsourcing engagement is formalised, because, unless managerial controls are supported by a well-written contract, the key intersections between management and operations may be under-supervised, increasing the likelihood that key processes, quality specifications, service delivery timing, and most importantly outcomes, will be vendor-driven or dependent. Legal and contractual issues that must be addressed in order to define a well-written contract include the following areas:

- **Service Levels and Incentives**: Minimum performance benchmarks must be established, supported by standards and metrics most appropriate to the outsourcing objective – metrics, for example, that are directly tied to operational indicators such as service quality, system availability and response times. Where possible, it is important to avoid exclusivity or preferred provider clauses in order to retain the ability to maintain competitive pressure on the vendor.

- **Vendor Personnel**: People represent a core driver of performance. It is essential that an outsourcer, at a minimum, retain approval rights for the vendor’s key personnel, and optimally, be in a position to define the criteria used to screen replacements. Since the loss of a vendor’s key personnel can affect the vendor’s ability to deliver on its obligations, some outsourcers will insist on having approval rights over the vendor’s retention and compensation strategies – in order to maximise the likelihood that vendor personnel critical to solution performance (and to knowledge transfer) will continue to drive outcomes.

- **Data Protection, Privacy, and Intellectual Property**: Risk is always involved when third-party entities are given access to sensitive customer data, privileged operational details, or intellectual property vulnerable to public or competitor disclosure. Key issues can range from requiring the vendor to maintain specified levels of security to vendor indemnification of the outsourcer for breaches.

- **Price Protections**: Establishing the basis for changes in pricing is one of the most important contract areas in IT outsourcing, if only because small differences in price can affect an outsourcer’s options, choices, and business objectives. Contracts should cover pricing issues such as contingencies with respect to expansions in service scope, pre-agreed pricing parameters, maintenance of preferred or “most favoured customer” pricing, and dispute procedures necessary to accelerate the resolution of pricing disagreements.

- **Third Party Assignments**: A key consideration is the transferring of Third Party agreements to an external service provider and ensuring that all requirement, such as those of rights of use for software licences, or direct access to off site data warehousing, are maintained. It’s one thing to cultivate a well-defined set of contractual agreements with a vendor but what happens to each of those when the service provider contracts those obligations out to a sub-contractor? How do you retain control – not just over service quality, but over an issue that is more important than achieving the outsourcing project objectives – such as risk to broader enterprise performance or management of a critical application by a competitor?

- **IT Outsourcing effects on ownership of Assets**: IT outsourcing vendors sometimes require usage of the organisation’s resources or assets in order to meet
contractual obligations. What are the rules and procedures that define – and even more importantly – create ownership rights when new value is created? What processes are necessary ahead of time in order to minimise confusion and disagreements that can arise whenever systems, resources, and assets are shared?

Asset management is a core component of any outsourcing agreement and careful consideration should be given to the ownership of assets, the financial accountability of assets and the role of asset management – all of which can be independent of each other.

- **Contingency Management and Planning for Change:** Critical to any outsourcing agreement is contractually-protected flexibility to accommodate unanticipated changes in business growth or shrinkage, changes in volumes or changes due to extraordinary events, such as mergers, acquisitions, or sales.

- **Notice of Material Adverse Impact:** A well-written outsourcing contract must ensure the outsourcing organisation’s right to be informed of any significant event that could materially impact the vendor’s ability to meet its performance obligations. Receiving timely notice – not just of impending events, but of the likelihood of an impending event – enables low-cost contingency planning with high cost benefit payoffs should untimely events occur.

- **Right to Audit:** IT outsourcing contracts need to include clauses that provide the company with well defined rights to review and audit a variety of processes, controls, and results associated with what the vendor is delivering on the company’s behalf. This would include SAS 70-type reviews and also address various regulatory compliance issues associated with Sarbanes-Oxley. This should extend down the supply chain where possible.

- **Termination:** Even IT outsourcing contracts developed under the most auspicious principles of partnership and collaboration should stipulate the conditions defining termination under a variety of scenarios. These scenarios range from termination “for cause” to termination “for convenience”. Contract language should define rights and procedures for events such as divested businesses as well as options to purchase or license assets.

**Delivering the Deal and Business Case**

Having established the relationship model, service levels, asset transfer and contractual negotiations the final steps need to be completed in preparation for the Transition phase:

- All loose ends, e.g. regulatory and statutory documentation need to be tied up
- Tax, accounting and auditing structures need to be finalised
- Appropriate retention and incentive strategies need to be implemented to ensure the successful operation of the retained functions
- Effective escalation procedures must be established on both sides prior to commencing Transition.

**5.5 Transition Stage**

The transition is as much about managing what’s left behind as it is about transitioning to the third party. Getting this right entails:
• Delivering the change in terms of managing the project, effecting the transition and establishing the interfaces
• Identifying and getting quick wins to both justify the commercial case and to demonstrate success
• Establishing the culture within the retained organisation and the relationship with the service provider
• Managing the transition of people legally and culturally

**Delivery of the Change**

Delivering the desired change entails not only the project management but also the movement of the people, assets and intellectual property and other considerations and means:

• Being clear about allocation of responsibilities: “who is in charge of what”, including knowing and agreeing who funds the transition.
• Structuring of Tax, legal and regulatory and employment elements to match the transition.
• Shaping and re-engineering the retained function to deliver the value.
• Developing a willingness to be driven by an output based specification.
• Managing the transition as a disposal, not just a project.
• Data migration needs to be carefully planned to ensure completeness, accuracy and no disruption to ongoing business requirements.

**Delivering Quick wins**

Identifying and delivering quick wins serves to both generate financial benefits early in the cycle and to add demonstrable proof of the feasibility, such as:

• Short term tax and regulatory wins which create credibility.
• Identifying service provider management information early creates the structure for ongoing service monitoring.
• Communicating and advertising success.

**Establishing the Culture**

The ultimate success of the outsourcing will rest with establishing the culture within the retained function such that the management of the relationship matches the nature of the vehicle that’s been created, and with creating a sense of joint interest between the customer and the service provider this involves:

• Educating each party and establishing how knowledge transfer will occur.
• Establishing joint governance structure to match the relationship, whether subcontractor or partner and developing effective interfaces between entities in terms of decision making processes, document flows, problem management, archiving, etc.
• Building a relationship based on trust, openness and shared goals and recognising when the relationship is not going well and taking positive action.
• Establishing effective interfaces between entities in terms of decision making processes, document flows, problem management, archiving etc.
Managing the People

Managing the transition of people legally and culturally requires:

- Engaging the affected workforce so that they remain motivated during the period of change to deliver “business as usual” plus the benefits of the outsourcing.
- Managing the legal (such as transfer of undertakings), industrial relations and consultation requirements around employment.
- Understanding the Pension implications and managing any required related moves and changes.
- Management of pay, incentives, pensions, employment terms and conditions, and performance management needs ensuring alignment to meet the new needs of the business and its workforce.
- Managing the communications, both to staff and stakeholders, in a structured, compliant and clear manner, especially in terms of people needing to be sure about whether they’re coming back.

5.6 Optimisation / Transformation Stage

Too often the project stops with the completion of Transition, but the real success comes from the ongoing management and transformation activities. Getting this right entails:

- Managing and monitoring the contract against service levels and resolving disputes quickly, but amicably
- Transforming or optimising the business both retained and transferred to ensure the benefits of the outsourcing are achieved
- Re-assessing the relationship on a periodic basis to identify changes that are necessary in management or contractual details
- Actively managing the delivery of the business case and realising the benefits

Managing and monitoring the contract and resolving disputes

Active management of the service provider, establishing monitoring processes and controls against clearly agreed service levels needs to be driven through joint objectives via:

- A monitoring process which includes people motivation and performance, benefits as well as optimisation of issues around tax, pensions and regulation.
- Building the accounting flows between the organisations.
- Handling archive and historical data.
- Implementing the agreed governance model to manage the day to day business and where possible to anticipate and address potential service level issues.
- Reviewing performance on a regular basis against pre-agreed targets and the outputs fed into the payment mechanism agreed in the contract.

Transforming the Business

The longer term benefits arise from changing the business to take advantage of the opportunities that the outsourcing presents – not just allowing the old routine to perpetuate and includes:
• Being clear about “what success looks like” and setting appropriate measures, which are monitored and reported.
• Delivering the transformation in the retained business via a dedicated programme.

Re-assessing the Relationship

No activity stays static forever and the outsourcing relationship has to be re-assessed on a periodic basis to identify changes that are necessary in management or contractual details and incorporates:

• Ongoing benchmarking linked to a minimum of annual re-appraisals, and re-pricing.
• Revising contract arrangements in light of the changing business circumstances, based on framework principles set out in the contract.
• Establishing a mechanism for empowering staff to share what is going on, and recommend/implement improvements.

Delivering the Business Case – realising the benefits

The benefits will only be provided through active management of delivery of the business case, via:

• Continued running of the governance model for compliance, controls, communication and disputes.
• Allowing flexibility for contract expansion and growth.

5.7 Review / Renegotiation Stage

Many organisations are coming to the end of their first IT outsourcing contract. At this time the business landscape will look different; priorities may have changed. It is therefore time to:

• Reflect on what has and has not worked during the first contract;
• Assess overall quality of service of first generation contract and service;
• Establish where the business is now;
• Identify where the business is going in the next 1, 5, 10 years, and decide how best to handle these changes;
• Identify larger issues surrounding the outsourced function, and ask how those issues and changes will be dealt on an ongoing basis working in conjunction with the outsource partner.

Most importantly, there is a need to identify all of the potential options going forward, and assess their benefits and pitfalls.

Renegotiating the contract and bundling with others as appropriate

Depending on the strategic direction at the end of the contract, it may be necessary to renegotiate the contract, focussing on:

• Rebalancing the volumes and performance levels taking into account updated business requirements and different commercial models vendors are willing to undertake.
• The difficulty in repatriating the service and those actual costs and benefits derived over the course of the contract vs. the original business case.
• There may be a potential need to rationalise the number of suppliers.

5.8 Exit / Termination Stage
No contract or relationship lasts forever and each outsourcing contract will eventually need renegotiation or termination. Getting this right entails:

• Planning for the eventual termination of the contract and the continuing provision of the services
• Decommissioning and/or reallocating the provision of the services to a new third party or bringing them in-house

Planning the termination
Planning for the eventual termination of the contract should have started with the initial transaction, not at the end of the deal and includes:

• Flowing the original tax, pensions and regulatory environment into the termination planning.
• Understanding the ability to bring the service back home or migrate it to another provider.
• Being clear about the dispute resolution and escalation structure.

Decommissioning and / or re-allocating
If the relationship needs to change, decommissioning and/or reallocating the provision of the services to a new third party or bringing them in-house is to be accommodated through:

• Identifying and dealing with the hidden costs of termination.
• Knowing the implications of secondary TUPE and pension handling.
• Returning the IP and the assets back to the home organisation and ensuring business continuity during transitions.
• Factoring in the impact on tax schemes and planning.

6. Offshore IT Outsourcing
International outsourcing or “Offshoring” – a growing component of IT outsourcing – will continue to be a tempting strategy for executives pursuing cost reduction as their key driver. Executives considering this option should recognise that a greater reward usually relies on a greater risk. In this case the rewards are usually linked to low cost, high calibre, employment markets with accessibility to technology. The more common risks associated with Offshoring are those related to managing business relationship and effective contracts at a distance, with careful consideration of cultural differences.

Some aspects such as overall IT governance, IT investment portfolio management, and contract management, can be managed remotely whilst other components, such as cultural and communications management, local IT vendor selection, and local regulatory and tax issues are more effectively managed on-site at a local management office. All of
these elements must be in place and well coordinated to ensure a successful project outcome.

7. IT Outsourcing Governance

The Structural Imperative

For many companies undertaking an IT outsourcing initiative, governance is arguably an area that organisations most frequently underestimate – in terms of time and investment, as well as in terms of the structural architecture necessary to manage accountability. Companies that commit to IT outsourcing without a strong governance capability do not have any appropriate means of controlling performance. IT outsourcing does not change the fact that the customer’s organisation still carries the burden of operational risk. In fact, because the processes, roles, responsibilities, and incentives that determine project performance are now spread across two entirely separate organisations, the need for a clear governance structure is even more critical in IT outsourcing arrangements. It is the customer organisation’s responsibility – not that of the IT outsourcing vendor – to establish a disciplined governance structure that helps the organisation meet the following objectives:

- **Ensure Alignment of the IT Outsourcing Initiative**: Every IT outsourcing contract must be carefully aligned with the organisation’s key business objectives, as well as the needs of the primary stakeholders.
- **Verify that the IT Services Outsourced are being Performed**: At a basic level, the first question is generally simple: “Was the job completed?”
- **Manage Changing Priorities across Complex Portfolios of Discrete IT Projects and Continuous IT Services**: Operating environments change constantly – and in order to remain agile, an organisation must have the managerial levers of control necessary to prioritise, redirect, and manage the performance of any outsourcing contract.
- **Establish Direct, Visible Accountability for Performance Related to IT**: Specific ownership responsibility and accountability must be 1) clearly defined for all parties, including IT, business units, corporate departments, users, and vendors, and 2) appropriately measured using relevant metrics.
- **Define Specific Ownership of the Key Drivers**: The engine of accountability is the ability of management to know precisely – at any time, and for any key stage in the IT outsourcing process, both inside the customer organisation as well as the vendor’s organisation – who is responsible.
- **Craft Well-Integrated IT Management Processes**: Customer organisations must build a culture of accountability and continuous improvement of IT management processes, controls, and support based on internal and external best practices. Too often, IT leaders and managers focus only on a single point within the IT management and delivery framework. Instead, they must concentrate on the need to fully integrate and link strategies, plans, actions, results, and measurement across both the client organisation’s internal processes as well as the outsource vendor’s processes.
• Ensure clear policies, processes and procedures are in place, communicated and embedded within the organisation and with the supplier. The mechanism for supplier non-compliance will be covered in a commercial agreement and a similarly effective internal mechanism is for employees.

8. Maintenance & Relationship Management

8.1 Visibility and Transparency of IT Spend and Performance

Before committing to an IT outsourcing arrangement, customer organisations must have a clear picture of what their current levels of spending are on services targeted for outsourcing – and what that spend is actually delivering to the organisation in quantifiable terms. As important as this visibility is in the beginning, it is just as critical throughout the lifecycle of an outsourcing arrangement. It is also imperative to uncover the real ‘Spend Baseline’. Many of the drivers for spending on targeted outsourcing areas in a large complex enterprise occur outside of the IT organisation itself, and much of the “budgeting” for IT is often ‘hidden’ in business units, manufacturing plants, marketing departments, even facilities and corporate real estate departments. Unless these hidden IT costs are properly uncovered and accurately identified prior to the preparation of RFP’s and the negotiation over service level agreements, this shadow spend will start to show up on vendor invoices. This makes it even more difficult to determine whether or not the vendor is truly delivering according to contract obligations.

8.3 Regular and Continuous Reporting is Essential

Organisations that outsource IT cannot afford to wait until the end of the quarter to assess the performance of the IT outsourcing initiative. In order to identify IT problem areas as they begin to emerge – rather than after they have matured, in-house managers must establish the processes, measurement, and information flows that support continuous “dashboard” reporting, and develop performance metrics that drive real business outcomes, not just operational outcomes. Critical in this regard, is that the organisation avoids simply depending on the IT outsource provider to report problems, and insists on retaining responsibility for collecting, analysing, and acting on key performance metrics for use in driving accountability.

8.4 Measuring Performance: It’s About Outcomes, Not Processes

Integrated performance metrics must be defined for all key processes. These performance metrics should be used by both the customer and vendor organisations – the entire solution team – to learn and improve – not just to beat up the vendor. Sometimes operational metrics may look good but are actually masking problems. For instance, if an IT organisation says, “Look how productive our helpdesk is, we answered 1,200 calls this month,” this may be masking the fact that user training on new software was haphazard; if training were better, the help desk volume would be cut in half. In the future, functional metrics of outsourced areas need to be not only “production” based but also performance based and improvement oriented.
8.5 Building Relationships, Building Outcomes

IT outsourcing strategies are more likely to misfire if executives view the IT outsourcing agreement as a one-off, performance-based contract that gives them the basis to hold the vendor’s feet to the fire. Although such agreements may reinforce a tactical, contractually based, metrics-driven, supplier-customer arrangement, they do not build the trust-based, long-term, partnering relationships that maximise knowledge transfer and improve performance continuously over time. Building the latter requires partnership, leadership, teamwork, and accountability.

8.6 IT Outsourcing as a Long-Term Partnership

In a partnering relationship, the outside vendor is an integral member of the CIO’s team, and the IT organisation, as well as business units in the company, have some skin in the game too. Both sides are accountable for meeting performance measures. Such relationships build long-term confidence and trust, remain focused on the company’s objectives, and create the win-win scenarios necessary to make working relationships most productive. Establishing and building such partnering relationships with outside third parties require hard work on both sides. These relationships do not just happen because a contract has been signed. The key business management liaisons on both sides of the relationship must be able to work effectively with multiple stakeholders and to apply customer relationship management practices, including the identification of appropriate, mutually agreed objectives, levels of service, and costs/service fees, which in turn are defined in service level agreements.

8.7 Making Sure the Management Team has the Right Skills

One of the most important and misunderstood facts about IT outsourcing is that it does not eliminate the need within the company for highly competent and capable IT leaders and managers. Sometimes it’s about changing job descriptions – from managing operations to managing a portfolio of skills, resources, and provider relationships. But it is not always as easy as simply asking internal managers who used to have accountability for the in-house service function to manage the same function now as an outsourced contract. Why? Because while some of these individuals have critical knowledge (such as about how the outsourced capability must be integrated with internal operations), in many cases, some of these individuals may also road-block or discourage the import of fresh, new ideas (especially if they believe the outsourcing arrangement is being engaged at expense of their colleagues or their own reputations, jobs or responsibilities). Assigning new managers, people who were not previously accountable for the functional area being outsourced, is often very important.

What matters is that the internal management team includes individuals with proven skills in effective communication, strategic planning, and project management. Also important are skills in negotiating contracts that provide for long-term, flexible, mutually beneficial relationships in a number of key areas, including acquisition of hardware and software products, a variety of IT services, and the execution of special projects.
9. Risks and Barriers to Consider

IT outsourcing – or more accurately, IT outsourcing’s potential – often makes a lot of sense for business managers. The problem is that the promises that attract executive attention – the potential synergies, and proposed benefits – are not always realised. Indeed, many IT Outsourcing initiatives are far less successful than anticipated in the business case. Some of the less tangible costs of implementation and contract management are often underplayed in original business cases.

Additionally the perception of success is relative. It differs between stakeholders, and what might look like success to the FD from benefits realisation may not be the same success criteria to an end user who has expectations of shorter lead times or greater network stability. Being sensitive to culture and implementing a robust communications strategy can mitigate such risks.

IT outsourcing can have greater risk if it involves parties offshore. It is one thing to pass tasking authority to a separate organisation. It is quite another when the supporting organisation is operating from offshore, or working to support customer operations spread out across a global footprint. The stakes are higher – and the effects of a mistaken or poorly executed strategy can be both magnified, and harder to correct.

9.1 Common Mistakes: - Poor Visibility, Lack of Accountability, Misleading Metrics

From an anecdotal perspective, the evidence suggests that, while in some cases vendors are contributing to the problem, a large majority of the errors being made originate at the customer’s headquarters – within the executive boardroom.

A common mistake is not fully taking into account IT related costs which are not contained within IT budgets which can result in diluting benefits realisation. To mitigate this risk it is prudent to ensure that all indirect IT costs are identified and included in the original business case not just the obvious headcount and IT budget. Examples include Engineering or Production related projects containing an IT element, or the overhead cost of project or contract management.

Companies frequently use the inappropriate metrics which focus on processes, rather than outcomes, frequently aimed at “beat a vendor up,” instead of improving the overall result. This can be mitigated by having clear customer acceptance criteria from agreed stakeholder groups to ensure that metrics remain output focussed and provide required performance improvement.

9.2 Strategic Importance of Management

In a great number of cases, IT outsourcing fails because senior executives:

• Critically underestimate the level of management required to both implement and sustain a successful outsourcing initiative over time,
• Understand the level of management oversight required but do not have the resources and necessary visibility into IT costs and spend performance, and
• Assume erroneously that management of the outsourced IT services is the vendor’s responsibility – a responsibility that executives assume can be tactically
managed through the constraints, benchmarks, and penalties for poor compliance typically prescribed in service level agreements.

9.3 Employee Issues

When proposing to undertake an IT outsourcing project it has to be remembered that there are a substantial number of employee and people related issues that need to be resolved if the project is to be successful. Stakeholders at all levels in the organisation, board, IT management, IT staff, customers of IT services within the business etc all have an interest in the end result. Similarly politicians at local, regional and national levels as well as unions and works councils may wish to be consulted. Hence stakeholder and change management becomes a key activity requiring effective communications throughout the process.

There will inevitably be issues regarding the retention of key staff within the organisation and those that will either be made redundant or transferred into the outsourcing provider under TUPE agreements. The management of expectations and talent, whilst maintaining current system integrity is crucial.

9.4 Commercial Issues

Moving from in-house provision to an IT Outsourcing arrangement requires different skills to be developed by the organisation’s IT management team. A more commercial mindset is required for the management of the supplier relationship.

Similarly the organisation needs to have realistic expectations over the levels of service that it will receive for the price it is prepared to pay and any mismatch of expectations within the organisation will need managing by both the Outsource provider and the IT management. This requires greater degrees of clarity over the ‘as-is’ situation than is commonly known with the business and clarity within the contract over what services will be provided and the level of provision.

9.5 Integration Issues

As previously stated, a company’s IT systems and the extent of their integration within the various functions of the organisation can be pervasive. Management needs to fully recognise both the degree to which IT is a part of the bigger process and the activities and functions it supports and the cost of such provision, particularly if the commercial aspects of the solution are to be appropriate. At the same time, management also needs to be aware that this can be used to obstruct and frustrate the development of an IT Outsourcing solution, and as such needs to develop an approach to the integration of the outsourcing solution back into the organisation.

Similarly an organisation generally possesses a variety of systems and applications requiring technical integration solutions. Outsourcing a proportion of the service requires the transfer of knowledge and skills to the service provider and a suitable platform for maintaining an appropriate degree of connectivity and integration. Any changes or technical updates made to the applications on either side of the outsourcing contract will have commercial implications which will need to be considered.
9.6 Compliance and Security Issues

Where IT Outsourcing involves the ‘physical’ transfer of the organisations applications and databases to an external provider then issues of compliance, security and data protection are key considerations. Data held in the USA for example may not be subject to the Data Protection Act. Similarly it is important to ensure that disaster recovery and business continuity measures are appropriate to the organisation’s requirement and assessed on a cost-benefit basis.

10. Operational Management

It needs to be remembered that an IT Outsourcing provider will have a different organisational culture and a different approach to service provision. The approach is more likely to be more commercial in nature. Where global arrangements or offshoring has been implemented as a solution, there may also be additional cultural and / or linguistic difference which may impact on service levels and end-user perceptions.

It is more practical to adopt standard service models for IT Outsourcing wherever practicable, both for ease of implementation and for ease of operation. It allows for a greater facility for benchmarking performance and for applying standard service level agreements and operating level agreements.

When developing service level agreements, simplicity is the key. Service level agreements should be simple and meaningful, providing an adequate definition of the service to be provided and the performance measures to be applied.

As well as measuring contract execution through specified performance measures, end-customer satisfaction needs to be assessed and their expectations appropriately managed. Where end-customers have been in the habit of requesting services direct from IT these need to be managed and controlled within the governance structure of the outsourcing agreement and escalated to the outsource provider following approval from IT management. Similarly attention needs to be paid to the usage levels of IT Helpdesks and the supporting infrastructure to understand and influence end-user behaviour.

When reviewing the performance of the outsourcing provider, it is important also to assess the performance and costs against the original drivers for the decision to outsource and the baseline business case, to assess the validity and progress to achieving the key strategic objectives and to challenge them. Similarly the commercial arrangements and pricing structure needs to be reviewed on an ongoing basis.

11. The Critical Success Factors

Outsourcing an IT (or any function) is a complex programme and there are many issues that need to be correctly addressed in order to achieve success. The following gives a summary of the key ones of these:-

- A clear and concise strategy
- A compelling Business Case (with the resource available and empowered to realise it!)
- Key relationships at top executive levels.
12. Conclusion

As popular as IT outsourcing is right now, it is often showing up on the boardroom agenda for the wrong reasons. Today, in spite of the fact that many executives view IT outsourcing as a core business strategy capable of delivering a wide range of benefits, many – if not most – step into an IT outsourcing arrangement unprepared and willing to proceed under a false premise: that the management oversight necessary to ensure the success of the IT outsourcing is either 1) adequately retained in-house, 2) unnecessary, or 3) supplied by the vendor as part of its contractual responsibilities.

From a boardroom perspective, the problem is not just that the premise is wrong. The real problem is that the absence of a strong in-house IT management capability over any IT outsourcing initiative increases business risks to the enterprise – IT-related business risks that, if left unmanaged, can have negative impacts on the growth of the enterprise and increases to shareholder value.

A strategic approach to the management of IT in general – and to the management of outsourced IT activities in particular – can pay early dividends. In fact, if companies can establish clear visibility and transparency of both IT spend and performance, they may, in some cases, be able to realise opportunities for cost reductions that, after implementation, eliminate the need to outsource entirely.

The bottom line is this – whether or not companies elect to outsource operational IT activities or address them on an in-house basis, executives must maintain a core management structure based on governance, visibility, accountability, and a commitment to rigorous relationship management. When engaged together, these critical elements put executives back in the driver’s seat – effectively managing their investment in IT outsourcing just as they should be managing all of their IT investments: as a business.
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Frits Janssen, Chief Executive

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