

# WHITE PAPER

## **Do's and Don'ts of IT Outsourcing**

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### About the Author

Programmer, Entrepreneur, COO, Consultant – Richard Metz spend the best part of a decade delivering transformation projects at General Electric being a buyer of outsourced services. Since 2007 he has been busy selling outsourcing services. So he now uses a unique combination of technology, business, and financial experience to help IT Directors, finance directors, executives, and government officials avoid undue risk when outsourcing IT services

This white paper describes the do's and don'ts of IT Outsourcing

This white paper will discuss some general rules around how to outsource successfully, broken down into the following areas:

Part 1 - Strategy - Deciding What, When and How to Outsource

Part 2 - Sourcing - Executing The Sourcing Strategy

Part 3 - Governance - Service Integration, Performance Management and Supplier Relationships

### **Part 1 - Strategy - Deciding What, When and How to Outsource**

Do think holistically about your entire IT organisation. Why do a large number of IT directors and CIO's wonder about how so many different contracts crept their way into their technology operations? The obvious answer is that many IT service arrangements were written to solve one-off needs or address 11th hour issues, and with little regards to a unified sourcing strategy. While there is no "correct" or even "ideal" number of service providers, deals should always support the overall IT organisation's strategy, but...

Don't outsource holistically. Thinking big does not necessitate acting big. Many companies see mass-tendering IT services as a way to reduce management overhead, capture economies of scale and make a meaningful impact on financials. It takes time and discipline to achieve an envisioned sourcing landscape, and there are compelling reasons to take a pragmatic approach. First, you minimise (if not eliminate) the impact on internal employees and the chance of service disruption. Second, you can adjust and refine your outsourcing strategy and process if your initial deals do not yield the desired results. Third, you retain a competitive edge... despite supplier promises of 'economies of scale' and 'efficiencies', nothing elicits strong pricing and performance like the prospect of additional future work.

Do maintain in-house expertise. In-house professionals with extensive company knowledge are a valuable asset to any organisation - they're often difficult to retain and nearly impossible to recruit. In terms of IT sourcing, these individuals represent an independence. In-house experts allow companies to have vision into the depths of their outsourcing contracts, enabling better relationship management and governance. Lower-level problems (e.g. poor coding standards or inadequate documentation) will be caught much earlier, and with time to

correct. Oversight and guidance can help service providers work more efficiently - which is particularly important in time and materials contracts. In house experts also provide companies with a measure of independence. If key process and technical knowledge is retained, it is feasible to either remove or replace a supplier with relative ease. Which leads to this "don't" corollary...

Don't underestimate the need and value of supplier management. There is often a tendency to take a hands-off approach to managing outsourcing relationships. To be fair, this is a natural attitude to take. Both senior leadership and the day-to-day project managers of outsourced services feel that they are customers - and in most cases, customers are meant to sit back and enjoy the products and services they have purchased. The reality is, suppliers must be supported and managed effectively if they are to deliver a satisfactory service. Despite what we like to believe, even the most rigorous specification or requirements document is not enough for suppliers to succeed without client involvement. As your company and needs change over time, strong relationships will encourage suppliers to move with you, rather than against. Remember - cost, capability, capacity, flexibility are all good reasons to outsource... 'making life easier' should only be an incidental benefit.

Do involve non-IT leadership. It probably goes without saying, but the IT sourcing/outsourcing strategy needs to align with your company's financial, operational and sourcing goals. Sometimes the most important sourcing and outsourcing decisions are influenced by arbitrary policies - such as a moratorium on new suppliers or a mandated minimum number of outsourced personnel. If these kinds of constraints are non-negotiable, they must be worked into the overall IT sourcing strategy - not used as reasons to drive any one particular decision. Furthermore, if you are considering outsourcing any area of IT that may be even remotely customer-facing (technical support, ecommerce, etc), you must have stakeholder buy-in from all relevant functions.

Don't look solely at "the numbers". Consider all of the non-financial implications to outsourcing certain sets of IT services. Look at how those service areas affect internal and external customers. Try to predict how each area will change over time (or at least estimate the variability of each). In determining whether or not to outsource, transitional and ongoing operational risk needs to be weighed against the potential cost savings. I tend to say this ad nauseum, but most unsuccessful outsourcing contracts begin to break down long before

service levels or financial targets are missed. Year-one savings can easily equate to year three losses if you are scrambling to improve a long-eroding service.

There's little argument that outsourcing is an essential tool in enabling IT organisations to focus on what they do best, but as an industry it is both dynamic and complex. The expectations of technology change at a rapid pace, which greatly challenge the industry's efforts to standardise and commoditise IT services. Therefore, the most successful organisations will be those that take the strategic view, but retain the capability to execute a pragmatic and hands-on approach.

## **Part 2 - Sourcing - Executing The Sourcing Strategy**

**Do Consider Multiple Suppliers** Researching & investigating multiple suppliers may seem like unnecessary work - especially if you already have relationships with one or more outsourcers. While there are certainly benefits to working with an existing supplier, you need to at least seriously consider alternatives. Your incumbent providers need to know that your company is not a well from they can continually draw water. By introducing a credible threat, you can at least ensure that your existing supplier will provide a competitive bid for the work. Additionally, no one supplier excels, or has sufficient capacity, in every discipline. Be cognizant of services that may be rendered by a very new or inexperienced team that was put together merely to maintain a monopoly of your business.

**Don't Obsess Over Location.** As cost pressures mount, its easy to make snap judgements around where you need to source services. While we can make fairly accurate sweeping statements about the prices and competencies a particularly country or region, we do not execute outsourcing contracts with the government of that country. In a price-neutral comparison, a highly-suitable supplier from a less desirable location is probably a better fit than a marginal supplier from your ideal location. With most outsourcing arrangements, the majority of your services will be provide from a supplier's location, rather than your offices. While language, culture and time-zone can play a role, physical distance should not. A remote team will be managed in much the same way, regardless of where they are located.

**Do Consider The Integration When Structuring The Deal.** One of the biggest costs to outsourcing is the integration. Not only are there costs to your organisation (e.g. personnel

redundancies, process changes, legal fees), but there are costs to the outsourcer as well (e.g. ramping up new employees, oversight personnel, telecommunications costs, software licensing fees). If these costs are often explicitly laid out in the contract, they can provide a nasty shock in the form of 'additional fees' later on.

**Don't Forget The Future.** As times change, your needs will change, and your engagement will need to move along with it. Your contracts need to address the reality that you may need fewer or more resources supporting certain services, and that certain services may become obsolete. It is fair to have a reasonable transition cost for any such changes, but there should also be limits to the amount of time those changes take. Additionally, be very careful around the termination of your contract - who owns the IP, what documents are owed to whom, what transition work will the supplier be obligated to provide. Good relationships can solve many such problems - but with leaner times ahead, you want to be prepared.

**Do Create Win/Win Scenarios.** As an add on to the previous "Do Not", seek ways to create win-win scenarios. The most common ways to create such scenarios are through 'innovation' and 'efficiencies'. Efficiencies are found when a supplier gets better at providing the same service over time. For example, server support that initially took 10 people, may now take 6. If both parties are trying to refine a process, the results will be significantly better, and both should reap the reward. Innovation is, very roughly speaking, the flip side of the coin. As a supplier gets to know your business, they may be able to offer higher-value services to help improve your company. Granted, these will almost certainly come at an extra cost, but you can make that value-determination when such services are offered. Laying the groundwork for these types of advances can provide a great deal of benefit down the road.

**Don't Select A Supplier Until The Deal Has Been Structured & Negotiations Are Complete.** A supplier should never know that they are the chosen provider until all of the details (e.g. integration, termination, service levels, change request clauses) have been hammered down. Ideally, these should be established with each of your short-listed suppliers, so that you have a relatively balanced comparison on which to negotiate price. Such deal aspects can lead to a huge difference in price, and its impossible to make a valid price/value comparison unless all of your prospective service providers have taken them into consideration.

The goal is to give yourself every advantage during the sourcing process, and to ensure that

those gains stand the test of time. A sourcing strategy centred on hard-nosed negotiation tactics often provide the greatest short-term wins, but those benefits will erode over time if the engagement doesn't have the requisite flexibility on your part and incentives for the supplier.

### **Part 3 - Governance - Service Integration, Performance Management and Supplier Relationships**

**Do Maintain Strong Relationships With The Sales and Operational Managers At Your Outsourcer** While we generally look to minimise the number of "points of contact" that we manage at our outsourcer, there is a very strong case for maintaining relatively independent relationships with both the sales and the operations manager assigned to your account. The sales manager (a.k.a. relationship manager, account manager, etc.) is tasked with keeping you happy and generating additional sales - this is generally the primary point of contact. The operations manager (a.k.a. project manager, engagement manager, etc.) is in charge of doing so at the lowest possible cost. It is imperative that you maintain contact with both sides in order to effectively execute changes and improvements to your service.

**Don't Just 'Throw It Over The Fence'** After months of defining precise requirements, agreeing upon service levels and negotiating price, it is natural to want to step back and 'let the outsourcer do their job'. This is understandable - if you host your servers at an ISP, for example, you don't expect to be responsible for patching or backups... Likewise, why should you be responsible for helping your outsourcer do their job? The reality is that clients can have a great deal of positive (and negative) impact on their outsourced services. Strong involvement is necessary to maintain the governance required to catch performance flaws early, maintain consistent quality and to improve the process over time.

**Do Plan For Change** A corollary to the above "don't". Nearly every application or IT service will change a great deal over time. Unfortunately, this inevitability is often neglected in statements of work or outsourcing contracts. Develop a culture of exchanging (rather than adding) features or services as the need arises. If you share the effort required to shift service offerings so that they meet your current needs, your service provider should be able to accommodate your needs at little or no extra cost.

**Don't Forget Governance** It was recently noted in a couple of industry surveys that roughly 50% of outsourcing contracts were not even being measured! Don't be intimidated by the word 'governance', or the bureaucratic structures and litany of metrics and processes it sometimes implies. Take a reasonable approach towards putting meaningful measures and remediation plans in place, and stick to it.

**Do Empower Your Entire Organisation** The managers, subject matter experts and contributors who work with the outsourcer on a day-to-day basis in delivering IT applications and services are your single greatest weapon in managing performance. These people will be the first to notice if a process is beginning to derail, and they are the most capable people to resolve issues before they escalate.

**Don't Be Afraid To Fail** Outsourcing contracts must have a well-thought exit strategy. There are a number of reasons why engagements do not work out - from cultural differences, divergent expectations, changing market conditions and evolving needs. While we would hope that day never comes, it is essential that you are prepared to look at alternatives or ending an initiative altogether.

One final thought is that you want to ensure that everyone in your organisation to view outsourcing as an opportunity. It's an opportunity for individual contributors to take a larger management role and it's an opportunity to develop staff involved in the core functions of your business. In situations where people move from your business to the outsourcer, they move from a supporting role to a core role, which generally provides greater opportunity for growth. Outsourcing is about as fundamental a business decision as they come, and so your entire organisation needs to fully embrace it.