Elements of Outsourcing Success

The search for continuously contemporary outsourcing

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Introduction

I've worked in and around outsourcing for more than three decades. During that time I've seen a lot of changes and the industry has evolved from basic IT facilities management to highly complex, multi-supplier, integrated solutions. Outsourcing today is almost unrecognizable from the market that Ross Perot created back in the 1960's. World-class outsourcing agreements are now durable, flexible and 'continuously contemporary' – delivering value throughout the entire life of the agreement.

To achieve this level of outsourcing excellence, it's necessary to pay attention to five core things. Ironically, I'd argue that these 'elements of outsourcing success' are the same as they were back in the 1960's.

Sourcing Strategy

Establishing the right strategy is the first step to a successful outsourcing agreement and ensures that everybody is focused on the right outcomes and on *mutual* interests.

There are entire books written on the topic but at the most basic level there are two fundamental questions:

- *What are the primary goals of the organization?*
- *How will outsourcing help achieve them?*

Examples of "goals of the organization" include: market expansion, competitive differentiation, customer intimacy, employee engagement and organizational consolidation? Examples of "how outsourcing will help achieve those goals" include: better cost management, stronger resilience, access to broader skills, improved security, wider scalability and enhanced flexibility. Put these together, and it's possible to develop a powerful direction statement, for example:

> Outsourcing IT infrastructure services from *Treat Digital Inc*. will provide *Aperius Industries* with *a more flexible and scalable infrastructure* that will *reduce technical barriers associated with business expansion*.

Although simple, this kind of statement is extremely useful to all parties. The *client* team gains consensus of what should be accomplished, *suppliers* gain clarity into the expectations of their products and services, and *stakeholders* understand the anticipated benefits (and RoI) of the outsourcing agreement. The strategy statement also provides a 'level-set' for further strategy development. As tactics, timelines, deliverables and responsibilities are created, they can be held up against the core strategy statement to ensure that they support and align with it.

Deal Structure:

The second element of a successful outsourcing agreement is deal structure.

There are lots of ways to structure a deal. The trick is to do it so that it is works for *all* parties and provides *mutual* benefit. In today's multi-supplier environments this means understanding that each organization has its own self-interests that must be balanced with the collective interests of the larger ecosystem.

Outsourcing deal structures are evolving and becoming more aligned with the principles of the '*as a service*' economy with: standard contracts, consumption-based pricing, and minimal (or no) switching costs. This simplifies deal structuring and reduces the chance of misunderstandings, but it doesn't completely eliminate mistakes from creeping in. Three of the more common mistakes to look out for are:

- **Baking transition costs into unit pricing** – Some clients ask service providers to bring the cost of transition/transformation into the unit pricing thereby avoiding an upfront investment bubble. This has a short-term appeal but will inevitably result in the service provider seeking minimum revenue commitments and early termination costs, which could be very costly. Ultimately this may (and probably will) introduce artificially high switching costs.
- **Cross subsidizing services** – Where services span more than one functional area or 'tower' (such as end-user computing, server support or applications maintenance) it is important to ensure the pricing remains aligned with the services. When it becomes misaligned, a client's ability to partially terminate (at a tower level) is compromised.
- **Inappropriate contract terms** – One of the challenges to outsourcing IT and business processes is getting the contract term right. Service providers typically want a long term to recoup their cost of sales and make a reasonable return on investment. On the other hand, when the lifecycle of the product/service is shorter than the lifecycle of the contract, the client can find himself or herself at an increasing competitive disadvantage.

Measurement Framework:

Establishing a sourcing strategy and shaping the right deal structure provides clarity and direction. The result is that everybody is on the same page. However, to ensure that everybody *remains* on the same page it's important to establish an appropriate measurement framework.

Even the most basic of outsourcing agreements will include a set of metrics by which performance will be measured – typically associated with service levels. As the agreement moves from concept to reality, service levels are carefully monitored and any deviation from contractually agreed boundaries triggers discussion – and sometimes penalties.

But, service-levels rarely tell the whole story and an over-reliance on them can result in what's sometimes called 'the watermelon' effect, where everything appears to be going well and dashboards are green, but a look below the surface shows that things aren't so rosy and critical performance metrics are red. This is why it's important to establish a *broad* measurement framework – one that is tied to the sourcing strategy and deal structure. In this way, progress towards the achievement of goals can be scrutinized rather than just whether or not service levels are being met. A truly world-class measurement framework will include a mix of current and *leading* indicators that allow early warning of issues and remedies to be implemented before minor problems become major incidents.

One measurement technique that is becoming increasingly popular is to establish 'shared' service levels. In this kind of approach, multiple parties agree to metrics that require coordinated delivery. Often established within comprehensive operating level agreements, these shared service levels drive collaboration and mutual benefit, since all parties are tied to the same metrics and will therefore benefit from their attainment.

People:

The fourth element of successful outsourcing is ensuring that the right people are involved.

There is really no such thing as a 'simple' outsourcing agreement. Large-scale, multi-supplier integration outsourcing agreements are hugely complex and involve a lot of moving parts. This means that they are heavily dependent on having the *right* people in the *right* roles with the *right* responsibilities. No matter how good the tools, processes and techniques – it requires people to put them into action.

This is often more of on an issue on the buyer side than the supplier side. Suppliers aren't immune to staffing problems, but as specialists they typically have a large pool of human capital with the right technical, managerial and project management skills. Their challenge is coordinating a finite resource pool so that they have a suitable depth of expertise allocated to each client while at the same time providing opportunities for junior staff to build experience.

On the buyer side however, staffing can be more problematic and it is challenging to find people with extensive experience of managing outsourcing relationships. These people need skills that are structured around *what* rather than *how*. They need to be technology-literate, business-oriented direction setters such as performance management experts, contract administrators and financial controllers – people that can establish and maintain relationships that deliver mutual and collective value.

Because outsourcing has been around for a long time, and it is not uncommon for key personnel to be on their second or third outsourcing iteration, many organizations believe that they have an appropriate depth of experience and expertise to undertake large-scale transactions. It's likely that these organizations do have the capability to craft an RFP, select a supplier, negotiate a deal and initiate a relationship. But, it's equally likely that this will not be the best possible deal. Specialist advisors have experience of dozens of transactions and knowledge of both key pitfalls and new approaches to (for example) pricing, integration and relationship management. Not only can they provide invaluable advice as the deal is being formed, they can also help train (or even find new) staff to manage supplier relationships moving forward.

Governance:

The final element of outsourcing success is governance – consistent management, cohesive policies, clear guidance, standard processes and strong decision-making.

Governance is normally thought of as the responsibility of the buyer. But, modern outsourcing agreements rarely take such a one-sided view. Modern governance approaches extend across the entire ecosystem –

buyer, suppliers, partners and stakeholders. Truly *world-class* governance is based on mature organizational structures with well-functioning committees and boards that are collectively focused on achieving the goals outlined in the sourcing strategy and ensuring that all parties work collaboratively – through even the most challenging implementation issues.

This isn't simply a matter of adopting an industry-standard framework. Outsourcing relationships, especially those involving multiple providers, have different levels of maturity and require a tailored governance model. This means blending multiple frameworks to meet the unique needs of a specific situation. It also means building in the flexibility to evolve, since outsourcing relationships rarely sustain the original value proposition and will naturally 'decay' over time. Goals move, new technologies emerge and skills and capabilities change. But, the basics of any good governance organization are focused on establishing control within three layers.

1. **Operational**, which is about day-to-day activities and typically involves dealing with capacity planning, service level management and resolving low-level issues quickly and effectively.
2. **Managerial**, which concentrates on management of agreements and involves dealing with invoicing, contract amendments and deliverables tracking.
3. **Relational**, which focuses on maintaining 'healthy' relationships between all parties and encompasses monitoring business alignment, fostering innovation and resolving high-level issues that are beyond the scope of operational governance teams.

Conclusion:

Organizations that pay attention to all five elements of outsourcing success – *strategy, deal structure, metrics, people and governance* – have a significantly improved probability that contracted value will be realized throughout the full life of an agreement. Get the elements right, and your outsourcing agreements won't be valid for just a single point in time, they will be *continuously contemporary*.

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