OneNeck White Paper

Outsourcing Best Practices – A Primer on Outsourcing Governance

By Chuck Vermillion, CEO, OneNeck IT Services

FOREWORD

As described by Mike Atwood, Principal of the Everest Group in his article *The Art of Governance*: "An outsourcing relationship is like a marriage. The romance of the courtship or the airtight codicils of the prenuptial agreement do not contribute to the ongoing strength of the relationship."

And when it comes to the vitality and longevity of today's successful outsourcing relationship – based on a mutual governance framework – it is wise to first look back on the evolution of outsourcing.

The escalating reliance on IT in the past 20 years has brought an entirely new dynamic to virtually every business, regardless of size. The way in which IT infrastructure is managed has taken on increasing importance. So too has the relationship between managers of IT and managers of operational business groups. Today's CIO and teams of IT managers need to run a cost-efficient organization and build an infrastructure that will ultimately help the company increase sales. It's a classic investment-spending scenario. Indeed, a fair amount has been written in recent years about the differences between the mindsets of business managers and the IT managers who work for or with them or their outsourcing partners. Regardless of philosophical differences, it's difficult to dodge the inevitable question: "Who knows best?"

In their management-mandated quest to reign in IT costs, IT executives turned to outsourcing as an effective way to run a state-of-the-art operation without breaking the corporate bank. In many ways, outsourcing is the optimal solution to the problem. In an effective outsourcing relationship, IT organizations can focus on strategic issues and goals, while the outsourcing partner takes on the operation and maintenance of some or all of the company's systems. With outsourcing came the need for effective governance to ensure an appropriate level of control and oversight of a third party provider.

This white paper focuses on ways to eliminate the dangerous question of "Who knows best?" by suggesting ways in which companies can effectively select a compatible outsourcing partner who understands both parts of the equation – business and technology – and create a governance environment that fosters a successful outsourcing relationship.

We believe that the recipients of services should be able to trust the motivations of the provider of those services. This sounds easy but is in reality, very hard to achieve.

THE NEED FOR GOVERNANCE

As technology has evolved and become increasingly pervasive, there isn't a business function that isn't in some way enabled by technology. The point at which business finds itself today is one of "IT is the business," and vice versa. IT cannot be viewed any differently than the fundamental business processes on which the organization operates.

In fact, IT is now as integral a part of business as is financial reporting, manufacturing processes or even chairs and desks. In the coming years, it's possible that the roles of CIO and COO will become one in the same, and IT capabilities will ultimately dissipate into the organization as fundamental operating skills required by any executive. This complete integration of IT into the business causes information to become the driving force, not any specific technology.

To ensure that IT outsourcing companies – who operate with a tremendous amount of responsibility in our new age of compliance and oversight – are indeed working to further the interests of their partners and not just themselves, companies often create a framework within which the outsourcing partner must perform. It's within the bounds of this outsourcing governance framework that many relationships will either succeed or fail.

Since the 1980s, there's been a great deal of discussion and posturing on both sides of the company-outsourcer fence regarding the structure of outsourcing governance. However, we've learned that all the rules in the world won't ensure the successful deployment and management of an outsourced relationship. Clearly, the need for effectively defined mechanics and service levels is important, but all those checks and balances are only as good as the cultural alignment of the two partners.

OneNeck has developed a fairly simple definition of cultural alignment through our years of providing outsourced information technology services to mid-market businesses. We believe that the recipients of services should be able to trust the motivations of the provider of those services. This sounds easy but is in reality, very hard to achieve.

Although it's often misunderstood, outsourcing is not a new concept. The first supply and demand relationship was effectively the outsourcing of a specific set of functions. When you purchase a packet of frozen peas at the grocery store, you have effectively outsourced the growing, harvesting, packaging and delivery of those vegetables. It's just another case of demand aggregation equating to improved price-performance, predictability and quality of service. Or at least that's what it should be.

Many have read the historical and projected statistics for failed outsourcing relationships, as well as the myriad of cited reasons. The bottom line is that IT outsourcing is a maturing industry that requires vendors and customers to recognize the fluid relationship dynamics required to drive a successful partnership.

The skills needed to manage an outsourcing vendor are most likely different from the skills required to run your current IT department. Obviously, the more complex your needs, the harder it is to ensure price-performance, predictability and quality of service on the part of the outsourcer. That's the primary reason for ensuring cultural alignment and a clear process of governance.

THE GOVERNANCE PROCESS

Toward the goal of creating a powerful outsourcing governance environment, we see three distinct phases in the lifecycle of building a trust-based relationship: selection of a vendor, establishment of the process and living within the ongoing partnership.

WHEN SELECTING A VENDOR

> Be informed on both sides. The process of governance needs to start at the selection phase. When selecting a vendor be sure to include criteria specifically targeted at governance. Also, work hard to understand your vendor's business model. If they cannot convey how their business makes money, how could they possibly build a long-term, winning scenario for you? And if you believe your prospective outsourcing partner doesn't understand your business, then keep looking.

> Check your vendor's references. Not the ones they want to give you but the ones they don't want to give you – tell potential vendors you'd like to speak with ex-customers. Review the potential vendor's recent press releases and look at the dif-ferent stages of their customer relationships: transitioning, steady state or contract term expiration. Instead of asking for three references, ask for the complete customer list and select customers that you believe most closely match your profile.

> Look in the mirror – objectively. Consider how your IT department is viewed internally. Is it a department of business-savvy IT professionals who are aligned to the primary objectives of your organization? If it's not, is that what you're looking to find in an outsourcing partner? Do parts of your team function more effectively than others? Understanding what you have is the lion's share of defining what you need.
It's also important to fully understand what your customer – the end user – wants from IT. Is IT viewed positively and as being successful in your company? Is IT a strategic enabler or a necessary evil? The answers to these questions are essential clues to finding the best outsourcing vendor for your needs, and not simply taking the recommendation of one company.

> Turn back to plan ahead. When considering how best to manage your outsourcing services vendor, you should revisit why you decided to, or why you are considering outsourcing in the first place. This primary motivation should then be able to be tracked through all aspects of governance.

Is your primary motivation strategic transformation? Or is it improved quality of service, cost containment, or a combination of the above? With these factors in mind, does your planned or current governance strategy support those objectives?

For example, if your primary motivation is strategic transformation, how are you going to measure the success of that transformation? When are you going to measure it? And what happens if your goals aren't reached? These are all factors that play a role in creating a successful, long-term outsourcing relationship with realistic expectations and well-defined metrics for measurement in place.

ESTABLISHING THE GOVERNANCE PROCESS

As you work to establish your governance process, align on the principles behind specific goals. As with compliance, the best governance structures are built on principles and guidelines instead of rules.

We believe the governance process should not just be focused on the quality of specific services, or the contract terms and conditions. It should prevent value erosion, and the preservation of the end user experience. So, as you work to establish and maintain cultural alignment, don't build a structure that motivates your outsourcer to merely satisfy the contract as opposed to satisfying the customer and delivering value beyond the statistics.

That said, effective measurements are critical. But keep in mind that these programs need to exist to support the primary motivation for outsourcing, which in almost all cases will be to support the company's business model and overall corporate goals.

Following are a number of mechanical and tactical aspects that you should consider wrapping within your governance process, and some questions you should be asking in each area:

Customer care model – Be sure to clearly articulate your expectations when it comes to customer care. How often will there be communication? How many customer managers will be assigned to your account? What kind of reporting structure will be in place? How flexible is the outsourcing partner in terms of adapting their structure and processes to your needs?

Service Level Agreements (SLAs) – The foundation of your services package will be the SLA. It should define the process, service levels, checks and balances, and reporting mechanism for your IT outsourcing agreement. Ask how your SLA will be monitored, and if you have independent access to a dashboard or other monitoring system. Typical SLAs consist of various availability or performance metrics. Also, consider the inclusion of softer SLA components such as number of end user complaints, effective escalation adherence, etc.

Quality of Service reporting (QoS) – What kinds of standards will your agreement be measured against? Are you able to define your own metrics for QoS, or are they all established by the outsourcing vendor? What time frames are involved in the reporting process, and what kinds of problem resolution structures are in place?

Adherence to IT best practices – Ask your prospective provider if they adhere to IT best practices. If so, what's the authoritative source for these practices? All too often, IT providers will claim they follow best practices when what they actually follow are the best practices they've been able to develop internally, An example of an authoritative source of best practices is the IT Infrastructure Library (ITIL), a globally recognized series of documents that are used to aid the implementation of a best-practices framework for IT Service Management.

Problem resolution – Has your prospective outsourcing partner developed clearly defined issue identification, escalation, resolution and communication processes? Is the extent of your desired involvement in the problem resolution process understood and clearly documented? In OneNeck's experience, an exemplary problem management process (and the customer's trust in the process) is a key driver allowing IT management to focus on "strategic" priorities. These processes should go beyond what's normally included as part of your SLA, and are a key component of building and maintaining a harmonious relationship for the long-term. The outsourcing vendor's approach to problem resolution must align with your business needs.

Cultural compatibility — Beyond understanding the nature of your business, your outsourcing partner must understand and be compatible with your corporate culture, regardless of the size of your company. The mechanics of governance are only as good as the cultural compatibility between the customer and the vendor.

Resilience of communication — Another aspect of ensuring continued alignment is a multi-level communications framework. A successful communication structure is best served by multiple interaction points at varying levels of seniority between the client and the vendor.

Face-to-face meetings — As in any good relationship, there's no substitute for frequent, face-to-face meetings. If the outsourcing partner isn't geographically close, work out a schedule in advance for meetings and protect those dates. Video conferencing and collaborative online meetings can also go a long way toward fostering open, honest communications.

Senior leadership involvement – On both sides of the partnership the involvement of strong, senior leadership is paramount to a successful governance program. It's only through this involvement that the needs of the business can align with the service delivery program. Both parties must communicate on a strategic, not cost-center basis.

Key functional users — Your outsourcing partner must possess a fundamental knowledge of your primary business processes that are supported by the enterprise systems your business uses, such as enterprise resource planning (ERP). Unquestionably, you'll want to partner with an outsourcing firm that has a solid understanding of the functional aspects of these complex systems, and recognizes the strategic importance they hold for your business as well.

Advocacy — Does your outsourcing vendor have a separate management structure for customer advocacy in addition to internal operational execution? One person wearing many hats may sound good for economies of scale and price-performance, but it will cost you intimacy with your vendor.

Flexibility — A vendor needs to be able to react to the changing needs of customers. While most vendors are very flexible with regard to expansion of services, few are equally flexible when it comes to accommodating change or reduction of services. This is a key factor to the longevity of a relationship.

LIVING WITHIN THE PROCESS

The four critical components for living within the process are leadership, cost, flexibility and business metrics:

First and foremost, outsourcing elements of your IT infrastructure or operations doesn't mean that the need for innovative leadership goes away. Too many businesses entering into outsourced relationships underestimate the on-going management commitment associated with governance. Ensuring the involvement of the same strong leaders who helped create the outsourcing agreement is critical to effective governance and the continued alignment of principles.

Secondly, since lowering the cost of delivering IT services is often a driver for outsourcing, the outsourcer must deliver services below the cost of what a company can do for itself, while still maintaining a profit. Obviously, the reason a vendor is able to provide improved price-performance is demand aggregation and predictability of demand. Major swings in demand present difficult business issues for the vendor to solve. And their ability to take change in stride should be taken into consideration when setting expectations or crafting the mechanism of governance.

Also, keep in mind that flexibility — along with customer intimacy and effective governance — is a two-way street. An integral part of cultural alignment is understanding the fact that you are effectively creating an extension of your own business within the outsourcer's organization. If you treat it as such you will get significantly more value than approaching the transaction in an arm's length manner.

Lastly, revisit your primary business objective for outsourcing on a frequent basis. Create a non-SLA based score card approach to monitoring those objectives and ensure that your business does not lose sight of the original motivation. Without metrics in place, after many years into a relationship it's easy to forget those objectives and trend towards a dysfunctional transactional approach.

SUMMARY

The cardinal sin of outsourcing governance is one of focusing entirely on the mechanics and the price. By doing that you'll be missing the true potential of the relationship. So spend the time and effort required to ensure an effective governance process, but don't lose sight of the fact that without cultural alignment with your vendor, you'll only be creating ground rules for debate, not agreement.

At OneNeck, we believe that governance in and of itself will not align IT to the business. Strong business leadership at the head of the governance mechanism is key. You can view it in the same context of IT's role within business. The governance process — like IT — is a power tool to be wielded by a competent business leader.

OneNeck® IT Services
ERP Outsourcing Solutions

5301 North Pima Road, Suite 100
Scottsdale, Arizona 85250
Fax (480) 609-4308
info@OneNeck.com