# When IT Outsourcing Goes Wrong

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# Introduction

When outsourcing goes wrong, it does so *with a vengeance*. Business operations are impacted, employees become burnt out and the cost of recovery is eye watering. Whereas some contracts succeed others become distressed within months of commencement. For both customer and vendor alike, there is a pressing need to achieve predictable results. This paper explores the misunderstandings and issues that pervade many large engagements. Address these and the outcome of an outsourcing deal becomes less like a roll of the dice

# The Outsourced Delivery Model

Outsourcers court prospective customers with the impression that they will get access to a skills base numbering hundreds of thousands and to a portfolio of best practices borne of the vendor's experience with thousands of clients.

But the reality of the outsourced delivery model is that any given customer is supported by, and only has access to, a relatively small team. Within this account team, seniority of staff is strictly limited according to the *labor pyramid* of the provider with the consequence that most team members are junior technicians or even complete newcomers, the *freshers*. This team has only limited access to higher level specialists within the organization. When those specialists join a call, they are unlikely to have any substantive knowledge of the customer environment or the technical standards and processes in place at that customer.

The account team supporting a customer will not propose a set of best practices. The client base of an outsourcer is extremely diverse and with that comes many different ways of working. Rather than proposing vendor standard processes, the outsourcer will seek to align with the customer's own existing practices. Customers should be prepared to dictate their preferred operating processes and, if they know their existing practices are weak, should budget for validating and improving those practices as part of the transition to the outsourcer.

A successful outsourcing engagement is highly dependent on building a virtual team across both customer and vendor that has a common understanding of processes and responsibilities. Individuals in the virtual team must have a shared understanding of the contract contents and the customer must retain and train a team that will perform in what may be a new capacity - managing complex outsourced services. Failure to build this virtual team will lead to a hostile *Us versus Them* mentality, poor performance, escalating costs and low morale all round.

A customer must also be realistic as to what can be outsourced. While processes and standards for a critical application can be transferred to a vendor, the invisible glue of relationships and influence with the business must stay with the customer's IT staff who commit years, and sometimes decades, to their employer. In contrast to these long serving employees, the outsourcer's team members will be

replaced over time just as surely as planks
on the Ship of Theseus.

# IT as a Service?

The sales pitch for a large outsourcing deal portrays the delivery of IT as an on-demand service model with the vendor providing a turnkey solution of hardware, software and operations. Turn it on, turn it off; pay for what you use. This is a façade. Although the rate card that underpins a customer's invoice will accommodate month-by-month fluctuation in consumption, the customer will unquestionably have to underwrite any investment in hardware or software that the outsourcer makes during the contract. If a customer shuts down an office for which network equipment was purchased the previous year, the customer is responsible for the *stranded costs* of the now redundant equipment and associated licenses. When a contract reaches term and is not renewed, the customer will be required to purchase any assets procured by the vendor during the contract or otherwise make the vendor whole. When an outsourcer owns the IT assets, pricing becomes opaque and the transfer of assets at both contract commencement and termination is a costly distraction. Since customers will find, counter intuitively, that they have buying power just as good as their outsourcing vendor, there is no reason for customers not to retain ownership of assets.

The issues with the outsourcer owning the IT assets goes further. In edge cases, for example in a special economic zone or in a country in which the vendor does not have a legal entity, the customer will be asked to own the assets anyway. In these cases, a special rate card for customer owned assets will need to be negotiated and implemented. Finally, and very importantly, the control of the technology roadmap for a customer is inextricably linked to the ownership of the underlying IT assets. When a customer transfers ownership of assets to an outsourcer, they no longer have the right to dictate the technology roadmap since those assets and future replacements are now part of a pre-priced service bundle. Now, if the customer wants specific technologies that are not the vendor's default, they can enter a negotiation to request these and must expect a cost uplift. Time, money, effort. Control of the roadmap and predictability of cost has been lost.

Another danger of a vendor promoting a pure, on-demand service model is that customer responsibility for oversight and involvement in technical operations becomes unclear. The reality of any outsourced contract is that it is a *shared responsibility* model. The customer will need to retain architects, a core team of talented engineers and highly knowledgeable IT service management staff even as routine day-to-day tasks become the outsourcer's responsibility. In RACI terms, (Responsible, Accountable, Consulted Informed), the customer remains accountable and must be staffed accordingly.

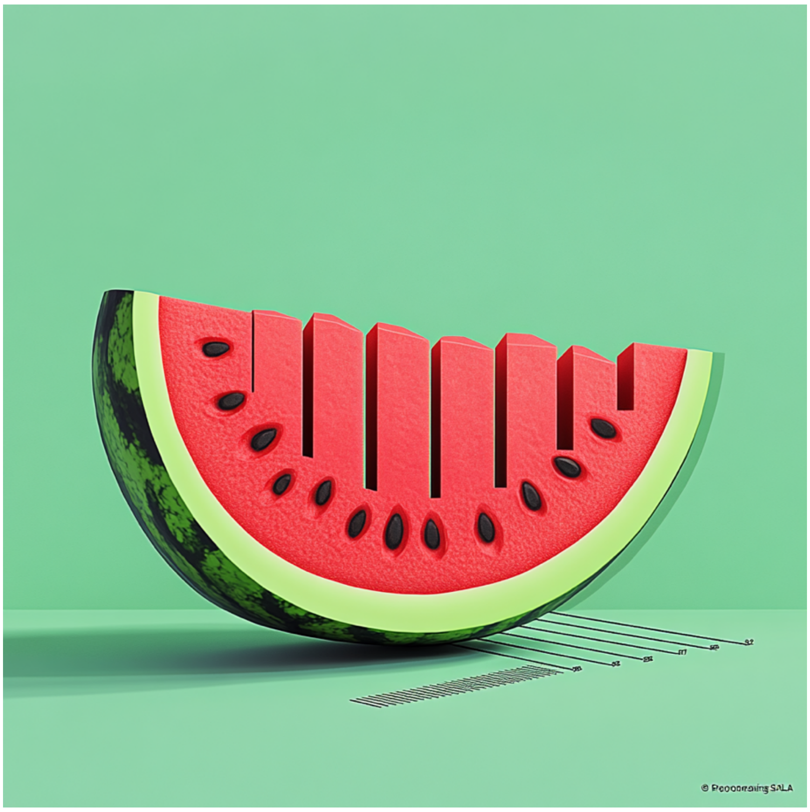
# Scope and Measurement

"One throat to choke" is the mantra of vendors wishing to illustrate their claim that making the contract all-encompassing will improve responsiveness and accountability. Customers should be extremely wary of committing a broad scope to an unproven outsourcer. The IT industry has been managing multiple throats for decades. Vendors routinely hand off tasks to competitors that have different geographic or service responsibilities. It works. Furthermore, customers should choose the right partner for the right service. For example, a vendor known for application and infrastructure services will always struggle to perform at the level of a global telco when it comes to network outsourcing.

Having established the overall scope of the proposed engagement, the customer must gain complete clarity of the committed service deliverables. This is difficult to achieve using a standard procurement process that has a focus on a menu of available services rather than the specifics of a given business. A mismatch of expectations will, the moment the contract is signed, devolve into an ongoing debate as to the distinction between business-as-usual operations covered by the monthly service fees and separately chargeable projects. The customer and vendor can avoid this conflict by extensive planning at the negotiation phase to explore all known activities for at least the first three years of the contract. This should include all software and hardware upgrades and replacements, no matter how large or small.

Anyone involved in a failing outsourced contract is familiar with the term *Watermelon SLAs*. These are Service Level Agreements that show as green on the monthly report but mask the reality of red rated performance. While the mechanics of the measurement of a given SLA may be faulty, the watermelon problem arises from fundamentally misguided metrics. One favorite but utterly meaningless SLA is *server availability*. In the days of the mainframe, maintaining 100% uptime was critical, difficult and worthy of measurement.

Unfortunately, mainframe availability morphed into the *average* availability of a fleet of hundreds or even thousands of servers. The result is a metric which allows for extended outages of multiple servers without the SLA becoming remotely close to a breach. Customers should ensure that IT focused metrics have substance and that there are, in addition, measurements that directly reflect the impact of the outsourced contract on business operations as recognized by business leaders.



# The Contract

An outsourcing contract is long and complex. Oftentimes, there is an urgency to get the contract completed and signed. Despite the time pressure, it is imperative that IT leaders in the customer become intimately familiar will all aspects of the contract and rigorously challenge how it may be interpreted differently if the engagement becomes distressed. Literally millions of dollars may be at stake if a poorly worded service definition becomes subject to scrutiny after the contract commences.

A prudent customer will anticipate the possibility that the outsourcer will fail to deliver to on expectations and will build in contractual measures accordingly. These will range from a time bound escalation process to address issues before they get out of hand, partial termination through carefully crafted *Step-In* clauses and complete termination.

A customer wishing to exercise termination before the contract is at its full term will face several challenges. Two major ones are the return of any assets owned by the vendor and termination charges.

Ideally, the customer would retain ownership of all IT assets and be the contracting entity for any public cloud and SaaS services. Where the vendor does own assets, the transfer back to the customer and associated costs should be clearly articulated in the contract.

Once the matter of the handling of assets has been established, the customer is in the position to ask the vendor what the purpose of a termination charge is. The customer should fully understand and accept the rationale before accepting any termination charges being included in the contract. Purely punitive termination charges designed to lock a customer in should be rejected out of hand.

# Making it work

*First time outsourcer* is a pejorative term in the IT industry, and this reflects how hard it is to transfer the responsibility for established, complex operations to a third party. Customers can take the following steps to stack the odds in their favor for a successful engagement.

- Recognize that outsourcing represents a significant change in direction that requires corresponding organizational change management. The retained IT team needs training in new skills and must be willing to build a virtual team with the outsourcer's staff. The business must accept that services will be provided differently and be prepared for some disruption during transition.
- Understand the limitations of an outsourced service delivery model and develop strategies to reduce any impact on the business.
- Ensure the scope of the engagement and the vendor obligations are fully defined, and ongoing monitoring is through metrics that have meaning and penalties that have bite.
- Ruthlessly stress test the service definitions within the contract and eliminate any ambiguities.

Finally, though, customers must accept that a contract may not succeed and must ensure that there are no commercial impediments to early termination should they face chronic and irreparable failures in service provision.

# About the Author

Robin is a seasoned IT executive based in Tokyo with extensive experience working on both the vendor and customer sides of the industry. With a deep understanding of IT Outsourcing, Robin has successfully managed high-performing contracts and has also been instrumental in rescuing distressed agreements, ensuring long-term value and operational success.