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History holds key to well-conceived outsourcing deals

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Information technology outsourcing has been one of the most-heralded vehicles for bottom-line cost reductions through gains in productivity and efficiency.

Nevertheless, the first generation of large IT outsourcing transactions produced disappointing long-term results due to two strategic failures: objective definition and relationship management.

Addressing these shortcomings may yield the desired technology-driven cost reductions and productivity increases sought from IT outsourcing.

OBJECTIVES, WHAT OBJECTIVES?

Although intended to provide a means for purchasers to more clearly delineate their goals and objectives, the process generally used in outsourcing transactions often distracts both parties from the strategic objectives underlying the transaction, leaving both the purchaser and vendor with an unsatisfactory relationship.

The most problematic areas are the structure of the RFP process itself; the definition and treatment of cost; and the consideration of strategic alternatives.

■ **The RFP process:** The traditional RFP process focuses on a highly detailed description of the current technology being used and the specifications for the hardware, software and services to be obtained. By focusing on IT-based requirements in the RFP, the purchaser unwittingly gives the vendor home field advantage because the deal is defined in terms of what technology the vendor will provide, not the goals the purchaser needs to achieve.

On the contrary, the RFP process should allow the purchaser to understand, evaluate and select a solution that meets the purchaser's strategic business objectives, regardless of the technology used. The use of the underlying business activities as the frame of reference for functionality, price and performance ensures that the success of the project (for both purchaser and vendor) is defined by the actual value that the technology delivers to the underlying business.

■ **Cost:** Because cost savings are usually the ultimate goal of outsourcing, purchasers of outsourcing services tend to be attracted to outsourcing solutions that promise short-term budgetary and profitability improvements. The "sticker price" (purchase price, implementation charges, payments to the vendor) for these solutions, however, is generally only one component of the overall cost of the solution.

Retained expenses are those costs borne by the purchaser that are necessary to implement the solution, such as transition costs, revised business processes, employee retraining, additional operating costs and interoperability upgrades to other systems.

■ **Strategic alternatives:** A purchaser should always consider the attributes of alternate technologies, alternate business processes and alternate corporate strategies to accomplish the goals sought in an outsourcing transaction.

Critical to a fair comparison of all available alternatives is to factor in all the costs and benefits of competing alternatives, so the purchaser can understand whether value is actually being created by outsourcing. As an example, an outsourcing proposal for a distributed server environment may include the rationalization of existing server usage to increase efficiency. There is no reason why the purchaser can't perform a similar rationalization of its current environment and reap those efficiency benefits without outsourcing. If that possibility is not factored into the evaluation, however, the proposed outsourcing looks deceptively more attractive, even though those efficiency benefits have nothing to do with the outsourcing.

RELATIONSHIP FAILURE

Relationship problems, which can be summarized as the divergence of expectations between purchaser and vendor during the term of the outsourcing relationship, are the second major source of failed outsourcing transactions.

The dissatisfaction with many outsourcing arrangements often stems from the inability of these transactions to demonstrate continued value to both the customer and vendor over the lifespan of the deal.

Because an outsourcing transaction generally requires a significant upfront investment by the vendor in infrastructure, personnel and training, the term length of these transactions has been defined by the period of time required by the vendor to recoup these upfront costs. Due to the pace of technological change, however, the resulting three- to 10-year terms of most outsourcing transactions now overlap several generations of technology. Because generational changes in technology are relatively unpredictable, it is by definition difficult, if not impossible, to balance the commercial terms of any relationship that spans several technology generations and still ensure value to both sides.

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A key factor for a successful relationship involves the recognition of the interest of the other party and the alignment of the interests of the parties to achieve mutual success.

Outsourcing is like marriage: No contractual language is going to make a bad marriage better, but it can make a good marriage worse.

Rather than taking a confrontational, zero-sum approach to negotiations and documentation, purchasers should strive to design business transactions that recognize that the parties are going to be working together for a while and neither knows exactly what tomorrow will bring, let alone next year.

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