# Beyond technology: maximizing return on IT outsourcing investments

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# Outsourcing engagements are an opportunity to transform IT, making it more responsive to business change.

## Executive summary

Today's competitive environment and relentless pace of change require that every enterprise be able to adapt quickly to changes in the business environment. CIOs are no longer able to meet demands for improved performance and lower costs by simply adding infrastructure and headcount. Whether growing internal IT, or moving to outsourcing, CIOs must look beyond cost-cutting measures and aim at maximizing return on IT investment. In this climate, outsourcing is a method—and an opportunity—to leverage service providers' competencies to meet the need for flexible IT services.

Beyond technology and contracts, there are several critical success factors that enable customers to derive greater return from their outsourcing investments.

1. Start with a strategy that will guide all outsourcing decisions.
2. Look beyond short-term cost savings to transformation over the long run. Take advantage of the outsourcing opportunity to increase IT agility.
3. Don't underestimate the importance of a strong client-provider relationship for achieving IT agility and a successful outsourcing experience.
4. Invest in a robust governance model and tools to manage the relationship and tie IT service levels to business drivers.
5. Don't overlook the HR aspects of outsourcing—ultimately, people make it work.
6. Plan to use global delivery in your delivery mix from the outset to create an optimal blend of onshore, nearshore, and offshore resources.

This paper will explore what HP has learned from hundreds of global outsourcing engagements with clients who have used outsourcing to drive IT transformation, IT agility, and increased business value from their IT. It will focus on critical success factors that often lie outside of the outsourcing contract, but should inform outsourcing decisions. These sometimes-overlooked factors, such as relationship-building, governance, and human resources management, characterize successful outsourcing engagements. These elements have proved, time and again, to enable HP clients to boost their return on IT outsourcing investments.

To further illustrate the importance of these factors to outsourcing success, this paper will take a brief look at two contrasting outsourcing engagements in the financial services industry.

# A deliberate and clear IT outsourcing strategy will yield the greatest return.

## Strategy first

After decades of technology-driven productivity gains, IT evolution is now being driven by business strategy. Enterprises are now demanding changes in IT service delivery to allow the business to remain competitive in a climate of relentless change. CIOs must deliver continuous service improvements, with flexibility to scale and align with business objectives—often under tight budget constraints. In an effort to reduce costs or acquire flexible capacity, most organizations today are using some form of IT outsourcing.

Given today's pace of change, however, and the fact that virtually all business processes utilize IT, enterprises cannot afford a tactical approach to IT outsourcing. Surprisingly, the Gartner 2004 Outsourcing Summit Survey[1] reveals that three-quarters of organizations approach sourcing without a formal sourcing strategy. As a first step in any outsourcing initiative, wise organizations will address strategic outsourcing questions.

- How can outsourcing support the broader business strategy?
- Which functions should be outsourced in order to best ensure that business objectives are met?

An explicit outsourcing strategy will enable the enterprise to invest in outsourcing initiatives that will align IT with business and yield the greatest return.

A starting point for developing a good outsourcing strategy is gaining clarity about what is core to the business—and what is critical, but not core. Critical functions are those which need to be done—and done well—in order to succeed, but which are not an area of core competency for the business. Enterprises should renew their focus upon "core" and outsource the "critical" to vendors. Core will then re-emerge as a primary focus for the business as it meets the need of its customers. Depending on the exact nature of the business, brand, image, market positioning, pricing and sourcing management will be core. Everything else should be considered critical—and potentially outsourced.

Even as technology is becoming simpler and more powerful for the end user, it is becoming more complex to deploy, integrate, manage, and refresh. In response to endless technology imperatives, many businesses relegate technology, or significant portions of their technology, to "critical."

**HP learning:** A well-developed outsourcing strategy, with clearly defined goals and an understanding of what to outsource and why, is the starting point for a successful outsourcing investment. This is the foundation for getting good return on outsourcing investments and aligning IT with business objectives.

[1] Adopt These Practices When Picking an Application Outsourcer, Gartner Research Note, July 2004

# The transformation imperative

Traditionally, many enterprises have looked to outsourcing as a way to reduce costs and eliminate some of the headcount and administrative burdens associated with internal IT. This often meant out-tasking limited elements of IT operations in an effort to retain control, or outsourcing ongoing operations on an "as is" basis. In some cases, this resulted in outsourcing inefficiency, yielding limited cost savings and negligible quality improvements.

Plainly put, head-count driven utilization outsourcing—which relies on process and service transition and on related cost advantages—will never meet the expectation of productivity improvement with service quality improvement. The question that enterprises need to ask before they transition their services to a partner is: Why transfer inefficiency? Too many outsourcing agreements in the past have failed because service providers cannot do much better with legacy assets and personnel despite the rod of SLAs and embedded productivity targets.

The need for higher-quality IT that aligns with business strategy and is delivered on a service basis has created an IT transformation imperative. This imperative is driven by

- The acceleration of business change,
- The impact of technology innovation in driving market and productivity change, and
- The reliance on IT for the implementation of virtually all business process.

The new IT services must have the flexibility to maintain alignment through change over the life of the outsourcing engagement.

Outsourcing can provide the opportunity to achieve IT transformation by leveraging the capabilities and expertise already in place with the outsourcing provider, rather than attempting to remold the existing internal IT organization, people, processes and technology. The "steady-state" of the outsourced IT solution must actually be a dynamic state, in which the IT provider is able to deliver and modify services over the life of the contract. This state is known as IT agility, and it requires outsourcing service providers to constantly refresh their service offerings.

## Critical pathway: transition

For clarity's sake, it is helpful to distinguish between transition—the process by which a service provider assumes operational control for the client's existing environment, and transformation—the implementation of defined projects that lead to service enhancements and improvements to service quality, productivity, and technology. The initial handoff from business to outsourcing service provider can be the most delicate phase of an outsourcing engagement. The risks are high, and the process can set the tone for the entire engagement.

Clients can minimize their risks by selecting a vendor that offers expertise embodied in formal, proven processes for transition and transformation. Rigorous planning, client-partner collaboration, and adherence to a tested and proven methodology will lead to an efficient transition that gets the outsourcing relationship off to a strong start. When evaluating potential outsourcing partners, organizations are well-advised to seek a provider who can demonstrate the ability to deliver a smooth transition that will lay a foundation of trust for the longer-term transformation.

**HP learning:** "As is, where is" outsourcing with minimal or no transformation of people, process, or technology is no longer strategic for businesses, or for outsourcing service providers. In order to get the most return on their outsourcing investment, enterprises must leverage the provider's skills and resources to transform to agile IT services over time. In addition, clients need to look for outsourcing service providers who can manage the delicate transition period, as people and technologies are handed off at the beginning of the outsourcing contract.[2]

[2] The Future of Outsourcing: The Transformation Imperative; CIO Magazine, August 2005; David Moore ,General Manager, Managed Services, Hewlett-Packard South-Pacific

# Agility requires trust, collaboration, and open sharing of information.

## Relationship: the heart of an outsourcing engagement

Many enterprises tend to focus on the outsourcing contract as a framework for success. However, it takes more than a solid contract, sound financials, and good business strategy to meet outsourcing objectives. It takes a collaborative partnership, grounded in a shared vision of success.

Numerous industry studies reveal that outsourcing arrangements fail even when both parties strictly adhere to meeting contractual obligations. The fact is, the relationship aspect is crucial to managing through change and achieving agility in outsourcing arrangements. Agility requires trust, collaboration, and open sharing of information as partners work together to identify new business requirements and opportunities. As the degree of change rises, so does the importance of partnership.

According to IDC, "customers will increasingly expect collaborative working relationships with services providers. Such relationships are dedicated to finding the best solution, and the best adjustments along the way, to meet the customer's business objectives, whatever it takes from either party. When a provider with targeted expertise and a customer that is open to airing business issues work collaboratively, a better solution usually ensues."[3]

Communication is the linchpin of a successful relationship. Outsourcing service providers should demonstrate established processes that provide the framework for open, honest, proactive communication. An effective communications framework will enable both parties to measure and monitor the health of the relationship through an organized approach rather than hearsay and opinions, while making sure that issues do not fester but are discussed and resolved on a timely basis and at appropriate levels.

In general, formally established linkages (touchpoints) create the right kind of interactions between the client and provider, fostering strong bonds between key players at different levels of the two organizations and between similar roles. When operating globally, this is especially important so that regional politics and cultural issues of do not get in the way. The establishment of a communications office provides clear accountability for communications regarding IT service changes both within and beyond the IT teams.

When open communications do not exist, the relationship becomes undervalued and underutilized. This discourages mutual risk-taking, stifling creativity and value-creating opportunities.

**HP learning:** Simply performing to contractual clauses will not result in a successful outsourcing relationship. Again and again, we have seen the value of aligning goals upfront and explicitly, specifying the mechanics of the working relationship, and building a common spirit and intent. Not only does a trusting partnership reduce the risks of misunderstanding, but it also increases the likelihood of uncovering new ways to create shared value.

[3] IDC: Customer Needs and Strategies; Getting to Win-Win: Success Factors in the HP/TD Band Outsourcing Arrangement. Copyright 2004 IDC.

# Governance: a vital framework for partnership

In outsourcing arrangements, the service provider and client must jointly manage a unique business relationship. Together, both parties and their employees must develop ways to operate in a mutually beneficial, synergistic manner. Governance—an overarching framework for management principles—is critical to that process. Governance promotes the correct setting, management, and monitoring of the complex outsourcing relationship.

According to IDC, "Successful outsourcing services providers have to establish, at the least, a system for engagement governance that ensures a robust, logical IT and/or business process operations framework for compliance with both contractual obligations and practices that serve the interests of all parties."[4]

A governance model is a set of standard, documented management processes and decision rights, which link to operational processes and procedures. It also envelops a behavioral and cultural approach. Governance extends across multiple dimensions of delivering services, from initial contract negotiation through transition planning and implementation to ongoing management.

Governance enables seamless activity between the client's business and service delivery. It enables a service provider and its client to mutually manage expectations surrounding how the parties will work together to achieve their agreed-upon objectives. This includes agreement on how to audit, measure, and make changes in response to unforeseen circumstances.

In most outsourcing relationships, the client's business objectives and requirements will change over the life of the contract. For example, HP has worked with clients through mergers, acquisitions, and divestitures as well as during budget cuts, rapid expansions, and integration projects. A robust governance model provides a framework in which the client and provider can manage those changes.

What are the critical elements in an effective governance model?

- The governance model should clearly define roles, responsibilities, tools, and processes for operational control, demand management, and reporting. The model should take into account the organizational culture—as well as structure—of both organizations.
- It should spell out ways that the client and service provider will manage issues outside the contract and how they will change priorities if needed.
- In order to maintain IT/business alignment, governance should include periodic, frequent collaboration opportunities between all levels of both teams to allow for adjustments along the way. Change may range from relatively minor continuous improvement efforts, through scaling and technology refresh, to major initiatives that broaden the scope of the engagement.
- Finally, the best governance models will also link into the client's corporate governance structure. This is an emerging requirement within the IT marketplace. With increasing industry focus on business controls, financial data, and performance, IT departments and outsourcing providers are now often required to certify the accuracy of the client's financial data.

These governance features are especially critical in multi-sourcing arrangements. In these cases, special care must be taken that outsourcing governance models include mechanisms for appropriate linkages between the multiple outsourcing providers.

**HP learning:** A partner-based approach is a crucial aspect to success in outsourcing. An effective governance model can provide the framework in which the client-provider relationship can flourish. In a business climate of constant change, governance is critical to managing the "white spaces"—areas and situations outside the language of the contract—as well as assuring transparency in the outsourcing agreement. Governance must extend beyond operation control and demand management to include relationship management and proactive strategic planning.

[4] IDC: Customer Needs and Strategies; Getting to Win-Win: Success Factors in the HP/TD Band Outsourcing Arrangement. Copyright 2004 IDC.

# HR considerations: ultimately, people make outsourcing work

Managing the human side of outsourcing can be one of the most vital aspects of a successful engagement. To lay the groundwork for success, consider the human aspects when planning for, transitioning to, and implementing an outsourcing solution. Industry studies indicate that 60% of outsourcing agreements involve the transfer of some IT staff from the client to an outsourcing partner organization. Even when formal employee transfer is not a part of the agreement, outsourcing the management of IT operations is a significant change that will affect both management and staff. Before, during, and after the transition to an outsourced solution, open communication and management of change processes can support a smooth transition by addressing stakeholder and employee concerns, and by establishing clear sponsorship at the appropriate levels in the client organization.

Management of change can make or break the introduction of any new technology or business process, especially a transition to outsourcing. A recent benchmark report[5] of 288 companies concluded that the primary contributor to major IT project success is strong, visible, and effective sponsorship, while the top obstacle to successful change is employee resistance at all levels: front line, middle managers, and senior managers. These are issues that are directly addressed by management of change. When asked what they would do differently next time, most teams would begin their change management activities earlier in their next project, instead of viewing it as an add-on or afterthought.

Where employees are being transitioned from client to provider, this transition process is critical to the success of the outsourcing engagement. Retention of client personnel, with their specialized business process and applications skills, can be essential for ongoing quality of the services delivered. In many instances, employee retention is mandated and regulated by both labor law and negotiated labor contracts. These regulatory issues must be addressed well before actual transition occurs.

Even when not constrained by regulatory requirements, many employers are concerned with what will happen to their employees after the transition—and with how will that affect morale and productivity. Before, during, and after the transition to an outsourced solution, targeted communications should be deployed to set realistic expectations and to make sure that employees know how they will be affected—and that they understand what is in it for them. IT outsourcing involves a cultural shift in the way transitioned employees perform their work, and dedicated HR personnel should be in place to guide assimilation, which may take from 12 to 18 months. Poorly executed employee transitions can signficantly delay or prevent anticipated efficiencies and savings.

While the prospect of employee transition is often initially upsetting, when well-executed it can be a very positive change—and one that many employers and IT professionals have come to embrace. Employees are transitioning from a company where their expertise is, by definition, non-core to an employer whose core business is IT. Ideally, this can provide greater potential for training, development, and career advancement. The personnel management policy, expertise, and HR track record of the potential service provider should be a critical consideration in vendor selection.

**HP learning:** Experience shows us again and again that ultimately it is people, at all levels, who make an outsourcing solution work—or not. Whether or not your outsourcing engagement includes transfer of employees, management of change should be deployed as early as possible, as well as all along the way. This work has to be done in concert with the technology implementation so that the organization is ready to embrace the necessary organizational, process, and technology changes. When employees are transitioning to the service provider, planning, communications, and dedicated HR professionals can help make the transition a smooth one.

[5] Source: Best Practices in Change Management, published by the Change Management Learning Center, 2003.
**www.change-management.com/best-practices-report.htm**

# Enterprises should ask, "Where are the right skills at the right price?"

## Global delivery: the right mix of offshore, nearshore, and onshore

The emergence of global delivery is the most dramatic change in outsourcing in the last five years, on both the demand and the supply side.

On the demand side, enterprises realize that, to compete globally, they now need skills and resources that may not necessarily reside onshore in relation to the organization. Today's IT services must align with global business needs, including support of vendors, customers, and employees around the world, 24×7.

On the supply side, there is now a healthy and growing supply of lower-cost, multilingual technology expertise in several emerging economies. As these businesses transform the IT labor market, their labor costs may trend upward. At the same time, new providers are continually coming online as skilled workforce and global delivery models emerge in additional locales. While India and Eastern Europe currently play significant roles providing IT services, Gartner predicts that "by 2008, the most likely source of additional labor will include China, Russia, and Brazil." The opportunity to reduce costs, to scale IT resources up and down quickly and to accelerate time to solution is tremendous.[6]

It is imperative that organizations use an optimized mix of global delivery resources, with the right blend of offshore, nearshore, and onshore services. Neither pure offshore outsourcing nor pure onshore solutions can often meet the needs of today's global IT. For some infrastructure tasks, remote execution may require significant investments in process reengineering. Optimized global delivery will match the right skills at the best price to different outsourced tasks—while accommodating language, cultural, and regulatory requirements. For every function, enterprises should ask the following question: Where should we access the right skills for this function at the most advantageous cost?

Some organizations develop a multi-sourcing strategy to leverage global technical resources, matching capabilities and cost to different areas of outsourced services. This tactic can bring its own challenges, as all services need to integrate smoothly—with consistent and proven processes across all locations—to provide seamless service delivery. Good governance and standard process become even more critical; when they are lacking, multi-sourcing may become unmanageable.

Another option is to work with large service providers who have blended global service delivery capabilities and can draw on a rich mix of resources (both internal and external) to provide customers with the best value for their IT investment.

**HP learning:** Whichever path you choose, incorporate a mixed-delivery model from the outset to apply the best skillsets and capabilities in the right locations to specific functions. This is the only way to achieve optimal cost, accelerate service delivery, and support the requirements of a global business model.

[6] Source: "Gartner's Positions on the Five Hottest IT Topics and Trends in 2005," Gartner, May 2005

# A tale of two outsourcing engagements

Two financial services enterprises, two outsourcing engagements, two very different results.

## Outsourcing in financial services: the importance of governance and collaboration

In late 2002, a U.S.-based global financial services company announced a large, multi-year outsourcing agreement. They anticipated a partnership that would cut costs, increase innovation and quality and provide career development for their IT staff. Less than two years later, the firm announced that it was ending the agreement with the outsourcing service provider and bringing its IT back in-house.

Could more attention to some of the elements discussed in this paper have led to a different outcome? Perhaps. According to an investigative report[7] on www.CIO.com, this particular outsourcing experience was characterized by increased IT rigidity and resistance to change, rather than agility and innovation. The outsourced IT actually became less responsive to the needs of the business.

One factor was relentless cost-cutting without clear governance on the part of the outsourcing service provider. The client perceived this as leading to the degradation of its IT infrastructure, while the outsourcer saw it as a way to offer competitive pricing to the client. Clear expectations and a strong governance model, with agreed-upon processes for managing change, seem to have been lacking. At a deeper level, it is apparent that the provider and client did not create a vision of shared success and build a partnership based on trust and collaboration.

The anticipated career opportunities for transitioned employees also did not live up to the rosy picture painted at the time the deal was announced. Employees were required to re-interview for their positions, and many discovered that their employment at the outsourcing provider was not necessarily secure. This poorly executed employee transition process affected retention rates, as skilled personnel chose to look elsewhere for employment rather than risk losing their jobs.

Both employee morale and productivity suffered, with lingering effects. As the insourcing process ramps up, IT project demand is increasing, and many IT staff members now feel utilized rather than threatened.

While the failure of this and other major outsourcing deals has caused some analysts to recommend incorporating dissolution clauses into outsourcing contracts (and that may be wise), when entering an outsourcing engagement, one must not only hope for success but plan for it as well. This engagement might have had a different outcome had there been more attention to:

- Building a strong relationship based on trust and collaboration
- Effective governance that includes a framework for nurturing the relationship
- Shared commitment to mutual success and ongoing alignment of IT with business
- Best practices for communications and employee transition

[7] Source: Stephanie Overby, "Backsourcing PAIN," CIO, October 11, 2005, **www.cio.com.au/index.php/id;1796120911;fp;16;fpid;0**

# Outsourcing in financial services: doing it right

A large, public, regional bank in Asia, facing competitive pressure, looked to outsourcing as a way to achieve IT transformation, while enabling the bank to focus on their core competencies. This enterprise caters to a wide range of banking customers with multiple, specialized branches, including corporate banking branches, overseas branches, capital market branches, and additional branches focused on niche markets.

The bank believed that while its supporting systems for transactional processing were necessary to success, they were not the bank's core competency. The bank went looking for a partner with both the right domain knowledge and the ability to help it evolve a more adaptive infrastructure, aligning IT strategy with business strategy to become more highly customer-focused.

The results, in this case, have been very positive. Through the outsourcing initiative, the bank has not only cut operational expenses, but has gained significant business benefits in a highly competitive banking environment. Twelve months into the outsourcing relationship, bank executives feel that their company has become more agile, with a greater ability to focus on core competencies and provide a better banking experience for its customers.

This particular initiative has garnered an outsourcing industry award as an example of an engagement where the outsourcing vendor and client are achieving IT and business process excellence.

**Secrets of success**

In this case, both client and vendor took the right steps to maximize the chances of success.

- The client started by defining an outsourcing strategy based on a clear understanding of what was core to its business, with explicit goals for IT transformation.
- Both parties focused on building a collaborative relationship using a defined and documented governance model.
- The client and the outsourcer collaborated early in the procurement process on customizing the governance model to design a flexible framework for managing the engagement. The resulting model clearly defines roles, responsibilities, processes, tools, and best practices for joint planning, decision-making, communications, management, and reporting.

# Conclusion

In the current business climate, constant change creates an imperative for agile IT services that can achieve and maintain alignment with business requirements. The intensifying reliance on IT to conduct business leads to ever-increasing pressure on CIOs to control costs and improve return on IT investment. Recognizing that business requirements are more than likely to change over the life of an outsourcing engagement, organizations should take a strategic, long-term approach to outsourcing, looking beyond technology, price, and contracts to consider additional critical success factors.

When entering an outsourcing agreement, client and provider are essentially forming a new business. For this joint venture to succeed, the partners must collaborate and establish a relationship based on trust, open communication, common goals, and shared success. A vibrant client-provider relationship, formalized in a robust governance structure, will enable the partners to meet the challenges inherent in a climate of change, and to derive maximum benefit from their outsourcing service investments.

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