

I.T. Outsourcing - The Next Generation

Well, we've had Outsourcing, Right-sourcing, Co-sourcing and now we are about to have Smart-sourcing services all designed to transform your business and lever technology to give you competitive advantage.

Trained observers, however, will be asking why it's necessary continually to find new names for what should be the same thing!

The answer, of course, is that I.T. outsourcing is not delivering to anywhere near expectation (and there is plenty of evidence to support that view) but the expectation just keeps on rising. There's a paradox here!

Before trying to unravel it, let me confuse you some more.

In their research paper entitled "The I.T. Outsourcing Market-place : Vendors & Their Selection, Michell & Fitzgerald tell us that

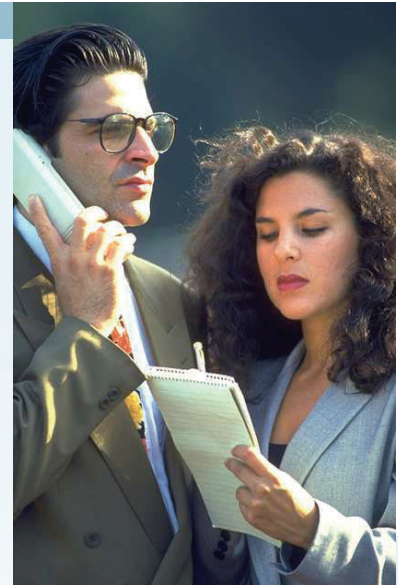
"Against general projections of a rising trend in outsourcing, nearly one third of the organisations who had outsourced had, in the previous 5 years (1989 - 1994), cancelled contracts as opposed to straightforwardly renewing them."

Another article published in the December issue of Templeton College's Journal of Information Technology with the catchy title of "IS Outsourcing Practices in the USA, Japan & Finland : A Comparative Study', tells us that

"Companies in both the USA & Japan desire mean cost savings of about 25% for domestic outsourcing and about 30% for global outsourcing."

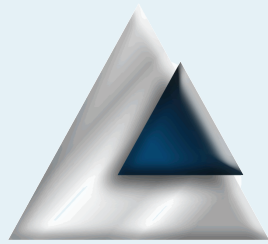
It goes on to say that

"Assuming that a desired level of saving is available to each company in the USA, approximately 90% of companies will be willing to outsource domestically and about 67% of companies will be willing to outsource globally."



"Despite the rapid growth in I.T. Outsourcing, most companies are still seeking the elusive 'added-value' they anticipated"

Lacity & Wilcox



Lucidus

"A complex world means its difficult to assess the nature and degree of the business problems you must resolve and the complexity of the services/technologies that will provide the solution. And some are not well equipped to understand and manage the organisational change issues - and only 'Change' delivers Value. Finally, some may not have the ability to measure and recognize the incremental value provided by the solution supplier."

Jeff Thull
Prime Resource

These two articles would seem to conflict and suggest the triumph of hype over reality. The truth is that I.S. is now clearly so important but for many, apparently, so difficult to exploit, that there is a real need in the marketplace for I.T. outsourcing services to succeed. And those needs are very real indeed as the Templeton College article tells us. They include the need to reduce costs, achieve a focus on the strategic use of I.S., deliver faster cycle times and gain access to a much larger pool of highly skilled I.S. professionals - all very familiar ground.

So, if the need is clearly there, why are there so few, if any, examples of outstanding success for outsourcing agreements?

The answer, as ever, is not simple and both sides to an outsourcing agreement must shoulder responsibility for a lack of real success.

Why so few successes?

As someone who has been in and around the outsourcing business for more than seventeen years as both practitioner and advisor to over fifty major organisations, I am satisfied that the logic for outsourcing is right and, indeed, compelling.

The trouble is that the application of logic is no guarantor of intelligent behaviour! So, what's going on? Let's deal with customers first.

Many organisations outsource their I.T. functions because they believe they are "getting rid of a problem" In these cases, I.T. is seen as an expensive and little understood overhead. It is inevitable therefore, that, under these circumstances, very little attention will be paid to the reasons for wanting an outsourcing deal in the first place and even less attention will be paid to the complex business of procurement. On a more positive note, an increasing number of companies are taking a more sophisticated approach and making a real attempt to get the procurement right so that their I.T. capabilities are positioned to facilitate the gaining of competitive advantage.

In just about every case though, a heavy emphasis is placed on cost reduction. "As it should be" - I hear you cry - and quite right. But look at the facts. There is an acute and growing shortage of the right I.T. skills. Year 2000 problems, the advent of the Euro and a real awakening (long overdue) of the strategic importance of I.S. has created a situation where there just are not enough highly skilled people to go around - and by any measure the gap between demand and supply is huge and will remain so well into the next millennium.

When I went to school, high demand and low supply did something to "cost". Can we really go on expecting higher performance for lower cost in the medium term? The answer is both yes and no but it requires us to take a different view on cost reduction. We are right to expect lower unit costs for "operations" or "utilities" based services. These are now, or are becoming, commodities. We must continue to drive down these costs, because, although essential to the maintenance of effective business process, they are unlikely,

of themselves, to deliver competitive advantage and serve simply to "keep us in the game". Real competitive advantage is more likely to emerge from the innovative use of information. This, therefore, is the higher value territory for both the customer and the supplier, hence the strong move by outsourcing suppliers to provide an "end to end" service. This, however, is exactly the place where skill shortages are at their most acute and where we must expect to pay more not less! I would argue, therefore, that if organisations are serious about gaining competitive advantage, they must be prepared to allocate sufficient funds to place "delivery" of requirement ahead of "cost" all other things being equal. To do anything else in today's marketplace puts "delivery" at very real risk. I accept, though, that you can't play fast and loose with "cost" - it has to be controlled and you have to get a return for its expenditure. So, how do we do that?

From the customer's point of view, I pick out just three of many important things to think about.

The first is that we have to be much clearer about what we are trying to do with I.T. I find it helpful to split the "I" from the "T". All too often, businesses do not think deeply enough about their information needs and choose to believe that it's the I.T. department's job. The I.T. department does its best but is never going to win in that situation. If you are going to use technology of any kind, better know in advance what you expect to get out of it! My clients therefore find it helpful to think in terms of the business owning "Information" and the I.T. department owning the "Technology". If someone wants to use technology they can then be encouraged to come forward with a good value proposition which articulates the benefits of using "Information" juxtaposed with the cost of the "Technology". More important still, they have to say what the performance measures are that will enable the actual benefit to be measured and the programme of events for benefit realisation. That way we have some chance of avoiding technology for the sake of it.

The second point for customers is that all too often, a small group of people negotiate the outsourcing contract without ensuring a wider understanding of its implications. One result is that, when the supplier tries

to reduce the development cycle time, the business is unprepared and unable to respond - back to the absence of a clear view of requirements and a failure to get benefits.

The third point is that, if we are forced to place "delivery" before "cost" and, as a consequence, pay more, it follows that we cannot afford to pay for "non-delivery" - and if you are saying to yourself "well of course we wouldn't" think again. How many software development horror stories have you heard, or worse, lived through? How many contracts are there where service is never bad enough to invoke the breach clause but which just doesn't add real value? - yet we keep paying. The contract must therefore be structured in a way which properly rewards good performance but which absolutely does not reward a failure to deliver. In response to this point, suppliers will argue that they are happy to engage in "risk/reward" deals. I have yet to see a "risk/reward" deal work because the supplier negotiates out most of the risk and the customer removes most of the reward which blows away all of the right behavioural drivers.

What about supply side?

Well, it is easy to bash the outsourcing suppliers. It is true that many of them have a lot to put up with from their clients but, that said, I believe they are their own worst enemy. They are on the sharp end of the skills shortage - they above everyone know just how difficult it is. But the same old sales message is peddled which sets expectations impossibly high. You know the sort of thing - "we have xx,000 people world wide" and "we can fly people in from anywhere in the world to help". They do not lie - all of this is technically possible. The point is that although many of them have large resources, it still does not alter the fact that, globally, there is not enough to go round. The net result is that "delivery" suffers either because sufficient people were not available or, more often, people turned up on-site but were just not up to the job. This situation is made all the worse by the fact that many of the larger suppliers appear to have forgotten that they are "service" companies. This exhibits itself in a number of ways.



- First, ask some suppliers about the criteria used for their staff bonus scheme and they will say "profit, revenue and customer care" in that order of priority. It tells you most of what you want to know regarding their focus of attention. Yes, they have to look after their shareholders, but they would make even more money if they put their clients needs first and made profit as an inevitable consequence of good service.
- Second, many of them are inflexible in their approach and use the contract to govern their response to customer business need. This would be OK if the nature of I.T. was reasonably static and tangible. It is not and never will be. More particularly, it is the case that the exploitation of "Information" demands unconstrained and flexible thinking - something which is unlikely to emerge from behaviour which is driven by a sterile contract.
- Third, such dependence upon the contract inevitably gives rise to contractual disputes. These disputes can be relatively trivial or result in millions of pounds unexpectedly changing hands. Either way, there are far too many contractual disputes and they increase transaction costs and corrode relationships.

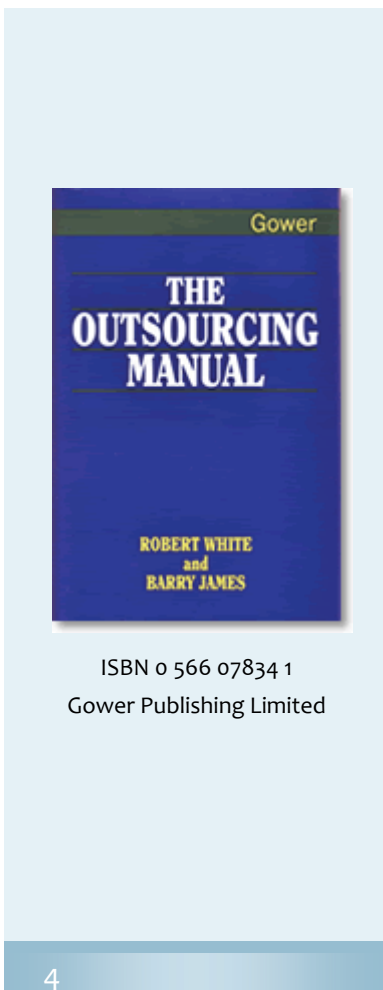
The market sorely needs suppliers who are prepared, in real terms, to put their customers first and make their profit as a consequence of their customers success. There are few signs that this is happening mainly because demand in the market is so great for their services and because customers are not yet sufficiently sophisticated to know how to apply pressure for better service.

So what of the future?

I believe that it is now time for the next refinement in the way I.T. outsourcing services are provided and for the way in which customers behave. Utilities type services, i.e. mainframe, mid range, telecommunications and desktop will continue much as now but their unit costs must be pushed down. This is because they add little in the way of competitive advantage but are essential for effective processes.

Real business value is to be found in refining our processes and thinking about how to innovate with "information" and its "technology" By that I mean using information to create new services and products or using technology to streamline or eradicate processes -particularly across the supply chain where a more open sharing of information with suppliers can deliver huge benefits. In this vein, Lucidus is in the process of implementing I.T. outsourcing models which place both supplier and customer in a position to know precisely what is required, how "delivery" will be measured and on what basis payment for "delivery" only will be made.

I therefore believe that anyone contemplating a new or re-negotiated I.T. outsourcing agreement should think seriously about incorporating some or all of the following characteristics into their agreement.



First, the customer must give the supplier clear development and business innovation targets to hit. Suppliers will tell you that it is part of their job to identify these targets but somehow it just doesn't seem to happen. We have developed relatively simple mechanisms which can isolate those points in the organisation where tangible benefit can be gained from using, or indeed, not using I.T. - and I'm not talking about BPR and associated fashion accessories! - this is something a good deal simpler and quicker than that. Having isolated these points, it then becomes possible to prepare a value proposition which provides a cost/benefit case, a benefits realisation programme and a set of measures which will help to determine when 'delivery' has actually been achieved. The value proposition can then be tested against the business value drivers - no point in expending effort and money on something that looks good but doesn't actually add real business value! A series of quantified 'targets' will emerge from this process, all of which will add real business value and all of which have measures attached so that the extent of actual 'delivery' can be determined.

Second, if we can measure what actually gets delivered, we can relate supplier charges to 'delivery' and, as a consequence, avoid paying for 'non-delivery'. It sounds complicated and unworkable. In fact, our experience shows that, with the right mind set and method, it can be surprisingly easy - it just requires the right focus.

Third, Service Level Agreements have to change. Most measure technology performance or availability i.e. we specify 98% availability.

This takes no account of the business impact which might arise from the loss of 2% - it may be trivial or it may be huge. Again, our experience shows that it is relatively easy to identify the business impact from a loss of I.T. service. Having done that, it becomes possible to link this to some form of service credit given that responsibility for the loss rests with the supplier. Note that I am not talking about consequential loss here since that can place the supplier in a completely unreasonable position. But I am arguing that it is possible to avoid paying in full for a sub standard service.

And finally, contractual disputes are the curse of the outsourcing world - to the point where some suppliers actively use them to improve their margins. We have found that it is possible to create performance measures which regulate some behavioural aspects of the relationship and if you can measure it you can incorporate it into a service credits scheme. It is too early to tell whether our approach to contract disputes can succeed but we have found that just getting the issue out in the open and discussed (before the contract is signed!) has put everyone involved on alert - the customer is more knowledgeable and, as a consequence, the supplier is more cautious.

Conclusion

In conclusion, I am certain that I.T. outsourcing can have a good long term future but it is at a critical point in its development. If it is to fulfil its potential, customers must become much more sophisticated in its use. It is not a panacea - and never will be. Customers cannot abdicate responsibility for thinking about their information needs however much they want to - there is just too much evidence to show that suppliers are not yet stepping up to that particular mark.

My real concern, though, is with suppliers. Although there are exceptions, in general they talk a lot about being customer focused. My substantial experience suggests that they are not and, worse still, are showing little signs of becoming so.

There is a real need for effective 'end to end' outsourcing services. But until this vision can be delivered, I think everyone would benefit from suppliers taking an honest view of their true capabilities - and then only selling what they know they can deliver. Some hope!

Value Based Outsourcing

Assures a strong & clear linkage between your outsourced resources and business performance by:

- Optimising value from your existing programmes.
- Identifying latent value and assessing ROI potentials.
- Simplifying decisions surrounding investment priorities.
- De-scoping programmes by focusing only on the top value drivers.
- Preemptively tracking all benefits in terms of 'value in progress', value delivered and value 'at risk'.
- Optimising the unit cost of your outsourced resources.
- Minimising constraints to business agility from your outsourced resources.
- Providing a strong, clear Value based framework for managing your supplier relationship.

Some Lucidus Clients

Boston Scientific
Pillar Data
BP Chemicals
British Airways
Ministry of Defence
H.M.Revenue & Customs
Manchester United
IBM
EDS
Hewlet Packard
Fujitsu
Kodak
Rogers Communications
Balfour Beatty
Warner Brothers
The Met Office
Pilkington Glass
Lend Lease
Invensys

The Presenter: Robert White – CEO Lucidus Ltd



Robert White—CEO Lucidus Ltd

Robert has 35 years of business experience and founded Lucidus in 1989. His experience includes the creation of a new outsourcing business for one of the global consultancy firms and he was the architect of the first Inland Revenue outsourcing deal valued at £1.7bn. With his business partner Howard Hughes, he has developed leading edge thinking and practical solutions to all of the issues associated with value and how to capture it.

The Lucidus approach to value based selling is deployed across a number of different sectors worldwide and the Lucidus pre-emptive value tracking techniques are currently deployed by the UKs Ministry of Defence to track the value from its top 50 change programmes just one of which is a £4.6bn 10 year programme of IT renewal.

About Lucidus

Lucidus is a privately owned, independent Management Consultancy that was founded in 1989. It provides impartial and objective advice to Government, Agencies and the Executive Boards of private sector companies that recognise the need for robust value management strategies in support of investment in major change programmes.

Lucidus founder, Robert White (CEO), an authority on the emerging subject of Value Lifecycle Management as a critical management discipline, has provided leading edge strategies and advice to some of the world's most successful private enterprises, public sector organisations, and high-value sales and consulting organisations.

As a value practitioner over the last two decades, Robert has made a significant contribution to the de-risking of a large number of high profile change programmes. In 1996, Gower published his book, *The Outsourcing Manual*, the first comprehensive guide for any organisation considering taking this route, which Robert wrote based on many years experience of selling and delivering Outsourcing agreements, including the Inland Revenue, arguably the first and most successful Public Private Partnership let by the UK Government after the announcement of the Private Finance Initiative by the Conservative Government in 1992.

Co-founder, Howard Hughes, is a leader in the science of 'value assessment and measurement' and the visionary architect of a revolutionary benefits assessment, modelling and predictive tracking tool (Integrated Performance Measures - IPM) which he has been developing and refining since 1995. IPM enables and delivers the value management strategies and crucially, deals with the complexity that is inherent in multiple high-value change programmes. This tool and its associated techniques have reached a level of capability and maturity that remain unique and unsurpassed some 10 years later.

In combination, they provide a coherent end-to-end Benefits Lifecycle Management process that is seen as the holy grail of benefits centred programme governance, with emphasis on achieving planned outcomes and a clear understanding of affordability versus capability. IPM has been referred to by academics as a 'thinking technology' based on its exceptional capability as a visualisation aid, enabling stakeholders, technologists and the recipients of the investment to understand how value is derived, measured and what is required of them to assure its delivery.

Lucidus' clients receive this expertise in the form of executive level management consulting that focuses on diagnosis, strategy development, thought leadership and management training, followed by delivery of a customised and appropriate end-to-end Value Lifecycle Management process, enabled by IPM. This is licensed for the lifecycle of the investment programme, and is supported by regular audit of the VLM process.

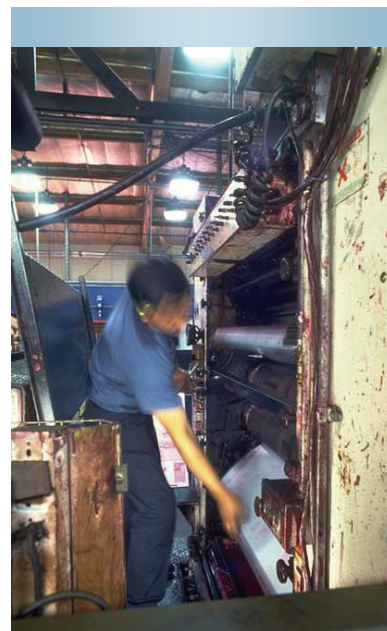
What Lucidus Customers Say

Stephen Hester Director IS&T - global PC manufacturing

“Lucidus have a unique set of skills and I am amazed at what they have managed to achieve. They showed us there was a potential to generate a further \$125 million of profit by using IT effectively. More importantly, they showed us where that value was, how to measure it and how to extract it. The key point was that we were focused on just a fraction of this potential benefit and had no sight of the true potential. It has changed our focus and investment profile.”

Marcus Klein VP Global Marketing Director - MSI

“The tools combined with the structured value presentation review were, to me, very enlightening. I know I felt we were really onto something. I think this is very powerful. The team is no longer thinking feature/function - but value / enterprise. In summary, the Lucidus approach is great! But like any approach, we need to develop the use of it around new, improved processes that I think will be very powerful.”



“Astonishing. Lucidus will enable us to have ‘grown up’ conversations across the Department. We should adopt this across the MoD for all Programmes.”

Director General Information (CIO), UK Ministry of Defence

Robert Musgrove – IBM Business Consulting Services

“Relative to other Benefits Realisation techniques, the Lucidus approach is powerfully differentiated by its ability to:

- 1. Clearly communicate the key value & benefit levers – and the breadth of factors that influence those levers*
- 2. Provide leadership with the granularity to manage a program at a strategic & operational level*
- 3. Show the implication of practical decisions on timing; Capex versus Opex investment; a risk allocation on the business case and benefit realisation profile. (showing benefits delivered and at risk)”*

Jeremy Hudson - Salesman Ark Group (using Lucidus techniques)

“The IT services market is increasingly competitive, and in order to succeed, we need a key differentiator. The Lucidus Value techniques and tools helps us gain access to power, where we can learn about business priorities, position our relevant services, and crucially articulate the business case for change. Having worked with Lucidus on some selected accounts it is already helping us to close more business, of higher value, with shorter sales cycles”



Lucidus Ltd

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Contacting Lucidus

Lucidus are always pleased to hear from our existing and potential partners. If you would like to discuss your particular requirements, you can contact us via one of the following methods:

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Lucidus

Helping with the tougher things