

Outsourcing – Getting it right

By Stephen Ollerenshaw, Director, Technology Law Alliance

A senior executive at services supplier Fujitsu, a primary supplier to the NHS's £12.4bn IT outsourcing, went on record recently to question whether key aspects of the project are going to work. This follows the exit last year of two regional contracts under the Programme by Accenture. Those contracts were only one year into a 10 year term with a value of £2 billion. Accenture agreed to repay £63 million of sums already received from the NHS in a settlement deal. It could have been much worse for the supplier, with the company having made a £240 million provision for potential losses and a reported maximum liability under the contracts of £1 billion.

This is clearly not good business for the suppliers but also hugely disruptive to the potential success of the overall programme and value to the taxpayer. With the amount of resources devoted to putting together these projects, both in the public and private sector, it prompts the question; why are so many technically failures?

The Statistics

As someone involved in working on these deals on a day to day basis (although hopefully the more successful ones) the research makes depressing reading.

For example, research by Gartner has shown that 8 out of 10 organisations attempt to renegotiate their outsourcing deal.

Why such a high proportion? In my view there is a combination of factors: an organisation has realised it has outsourced the wrong type of service; or they have not been clear enough about the objectives for outsourcing; or business goals have changed.

It surprises me that 15 per cent of outsourcing contracts are renegotiated within

12 months according to the above research, given the amount of management effort and external advisers fee are required to reach an agreement. Why is this?

In research conducted by Compass, 80 per cent of respondents cite poor governance as the reason for failure, i.e. the strategy was right, the contract was fine, but the parties failed to operate it properly and build a good business relationship. This is frustrating and surely avoidable.

Other recent examples: Tax Credits, poor IT or poor culture?

The statistics can hide the real picture and it is useful to look behind the headlines at what happened with other high profile projects. Although many of the reported failures are in the public sector (primarily because of the size of these projects and public interest scrutiny) the private sector also has much to learn.

Take the HMRC tax credits scheme, initially it was reported that the system could not cope with the volume of applications and half a million of the poorest households were given

too much in the way of tax credits in 2003-2004, which lead to the headache of clawing back the overpayments. More recently the system has proved vulnerable to organised fraud. HMRC blamed EDS for providing inadequate IT systems. EDS blamed the overpayments on complex policy rather than the implementation of the system and the Revenue for changing its mind while the project was put in place.

Ultimately EDS settled out of court for a reported £71 million. Clearly technology problems were a factor, but were there other fundamental issues with the culture of the customer? OGC did a gateway review of the tax credits system in 2002 and warned that it was a high risk project. Legacy systems have been described as complex, unreliable and fragmented. For example, each of the 72 tax offices process self-assessment forms differently (sometimes there are even different processes within tax offices).

The Child Support Agency: reform through new technology?

The Child Support Agency was beset by technology problems and some have suggested that their major outsourcing project was actually an attempt to reform the CSA through new technology. The system was intended to be fully functional by 2003, but ended up being a factor in the closure of the agency itself which was announced last year.

Ministers blamed EDS as the technology supplier for the agency's problems, however, government reports showed there was an inability to make cultural change. There was a lack of consultation on CSA reforms and design of systems, for example the new system contained no "notepad" where conversations with members of the public could be recorded.

It is likely that a major reason for the failure of the project was that there was too much focus on technology and not enough emphasis on cultural change. For example, the new system was designed to be less flexible to encourage case handling over the phone, however no additional training was provided to staff.

The CSA project is a classic example of where cultural change was not addressed, staff were oversold the benefits of the technology, each grade of staff being sceptical that those above them understood the issues.

What about the private sector?

The private sector does not make the headlines in the same way as the public sector, however, a number of high profile private sector outsourcing deals have been brought back in house which has led to discussions of a new insourcing trend.

The following examples have been reported. Cable & Wireless terminated a 10 year, £1.8 billion deal for IT infrastructure and customer billing citing a desire for more influence over technology decisions.

JP Morgan Chase cancelled a £2.7 billion project and reintegrated its infrastructure including data centres and helpdesk services. Prudential and Sainsbury's have also both brought major projects back in house.

Did these projects go wrong? Was there poor performance? In most cases the businesses acknowledged that the deals were not producing the expected benefits and they wanted more control over rapidly changing markets.

Getting it right

Of course there are many outsourcing contracts that successfully deliver the required objectives. So what are the common themes to projects that are successfully run? These projects tend to have a clear rationale for the outsourcing and they are not over-ambitious, for example they do not typically try to solve other business problems through outsourcing a non-core business function. They tend to establish flexible and partnership relationships rather than adversarial relationships.

A good business plan for the project is the starting point. Maintain a formal risk register and challenge assumptions about risk. A business case should set out stable objectives, clearly defined benefits and measurable success criteria. Link the business case to business

benefits and measure against it. Include contingency.

Due diligence is also critical, listen to the subject matter experts on the risks involved. It is also important to do financial due diligence on the proposed supplier. Outsourcing is a long term game and it is important to ensure that your supplier will be around a few years down the line. A good technical due diligence period will also reduce the opportunity for a supplier to argue for costs increases later.

Think carefully how the services are going to be implemented. Experience says avoid “big bang” implementations and go for a phased approach. Risks can be mitigated by dividing the project into stages such as feasibility study, development agreement and services contract. It is not uncommon to see internal funding approvals linked to implementation milestones. It is important to build in adequate time for testing before go-live. Testing is often under funded and budgets are squeezed.

Another common trap to fall into is to fail to seek end user buy-in (particularly difficult in the public sector where there is more resistance to change). This criticism has been levied at several public sector projects.

One of the most important aspects of a successful outsourcing is a good governance structure that permeates the project. To achieve this, build in clear reporting and governance structures and stipulate the reports to be provided. Governance arrangements should foster a culture of openness. There must also be clear escalation structures and accountability – put someone in charge. There should also be a continual measurement of benefits, linked back to the original business plan.

Because the outsourcing relationship is a long one, effective change control is an essential feature of the contract. There must be a framework for assessing technical costs and legal implications of changes. This must interface sensibly with the other management structures and contract governance.

One-sided contracts are not necessarily the best way of achieving a long term working relationship. Think about how you can create mutual benefit based contracts rather than cost based contracts (i.e. use the carrot as well as the stick). This is a much more effective long term way of managing suppliers.

Outsourcing projects share many of the pitfalls of general IT projects but additional complexities arise from fundamental changes to business processes. If there is one key lesson from the failure of recent public sector IT projects it is not to underestimate the problems of cultural change required to achieve success.

Conclusion

Large outsourcing projects are inherently risky and the statistics show that there is a higher than average chance of failure. However, there are ways to mitigate the risk using good business planning (including selecting the right type of service to be outsourced) and due diligence. Take a long term view with suppliers and work towards flexible partnership style contracts. Strong governance structures and attention to cultural change also vastly increase the chances of success.

What are the key questions you should address when deciding to outsource?

- Choose the right functions to outsource, typically these are commodity and non-core functions. Create a business plan and test every decision against it. Do high quality due diligence on potential suppliers.
- Don't underestimate the need for cultural change that goes with outsourcing, have you allocated sufficient resources for transition, training and internal PR?
- Do you have “buy-in” from key users, it is very hard to deliver a successful project if not. Build and communicate a business case and test every key decision and contractual principle a

What should you look for in an outsourcing contract, what should you try to build into a contract and what should you avoid?

- Pay close attention to end to end governance procedures.
- Flexibility – things change, make sure that your contract has inbuilt flexibility using good change control procedures, benchmark costs and service quality over time.
- Look for a “partnership” type of deal, where there are mutual benefits rather than a win/lose position.

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