Governance: Building Successful Outsourcing Engagements

By Aparna Umakant Katre

What makes a Successful Outsourcing Engagement?

IT outsourcing is growing at a rapid pace and has become a dominant trend across the globe. Companies have engaged in outsourcing for a variety of reasons—it includes reducing costs, expanding capabilities and increasing flexibility. However, anticipated benefits have often failed to materialize, causing many companies to rethink the way they are approaching outsourcing.

Outsourcing services requires a careful balance of competing factors such as cost savings versus growth, speed versus quality of service delivery, and maintaining company cohesion versus knowledge and innovation. Companies and their vendors have inherently conflicting objectives. This often puts a company's need for innovation, cost savings and quality at risk. A recent survey conducted by Deloitte Consulting suggests that there are many points of failure in outsourcing engagements, mostly due to the complexity of outsourcing processes. Most issues arise at the handoff between a company and its vendor, so there is a strong need for companies and vendors to align goals in order to ensure a successful outsourcing experience.

This can be achieved through a governance framework which reflects how the two parties will—

» **interact and communicate** at various levels of the organization

» **handle changing business requirements** and new objectives

» strategically **plan for the future**

» continuously **improve the value** they wish to achieve through their relationship. Governance is a crucial component which ensures a successful, long term relationship. This article explores the role of governance in building successful outsourcing engagements which provide mutual benefits to companies and their vendors.

What Should Your Company Look For in an Outsourcing Engagement?

Clearly, not everything is going right for companies who choose to outsource, as shown in Exhibit 1. Real-world outsourcing experiences have triggered a shift in the approach for outsourcing engagements. Previously, companies emphasized cost reduction due to flat or shrinking budgets. Now, companies are taking a more detailed look at the various dimensions of outsourcing engagements before finalizing deals.

Exhibit 1: Problems faced by Companies in Outsourcing Failures

Source: Deloitte Consulting Outsourcing Study, November 2004

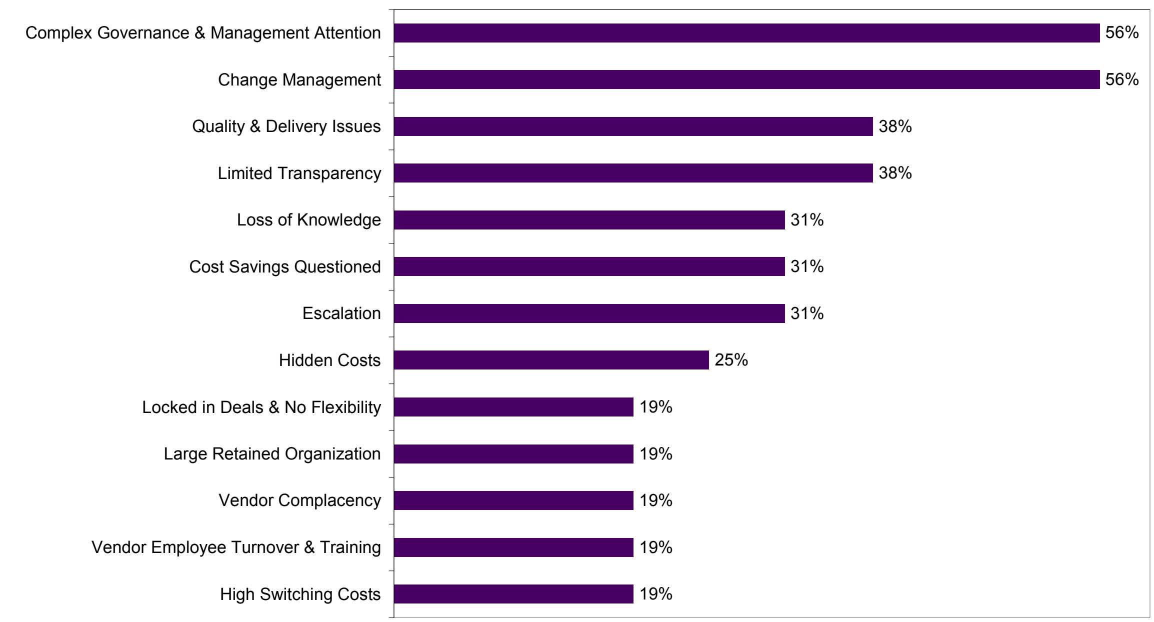


Exhibit 2 illustrates the difference between what companies want and what vendors perceive is important in an outsourcing engagement. It shows that cost is just one of the key factors in an outsourcing engagement. The large gap between the perception of companies and vendors on the importance of various parameters can lead to misunderstandings and incorrect assumptions which results in an outsourcing failure.

Based on recent studies and our own experience with our clients, Kanbay has identified changing expectations for outsourcing relationships—

» **Partnership:** Companies are looking for partners, not just vendors. There is a focus on achieving business goals through outsourcing rather than exploiting wage arbitrage. Service providers must have a good cultural match and be able provide smooth change management.

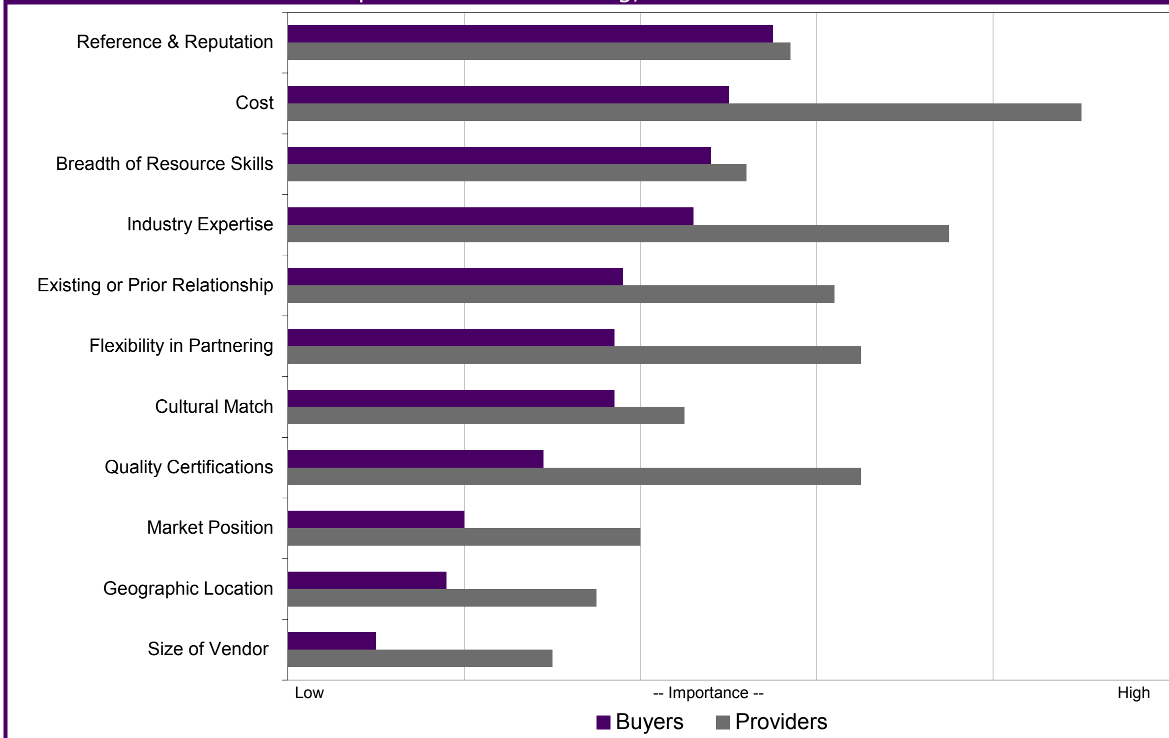
» **Relationship Maturity:** As outsourcing moves to a new level of maturity, relationships between companies and their vendors must be more focused and structured. Companies look to vendors who can understand their business and move across multiple divisions to reach economies of scale.

» **Performance as per commitment:** Many vendors under-perform resulting in loss to companies. Increasingly companies are engaging in SLA based deals to safeguard their interests. These types of engagements require a mechanism to measure, monitor and amend performance parameters.

» **Flexibility:** Flexibility in engagement has become a key criterion of vendor assessment. It's important for companies and vendors to make adjustments in an engagement based on changing market conditions and requirements. Flexibility extends to amending the SLA, building and adapting the engagement model or reviewing costs and other financial parameters. Rigid contractual frameworks often lead to failure as both parties find themselves locked into criteria which don't work.

Exhibit 2: Perception of Buyer Selection Criteria

Source: Diamond Cluster Report on IT Outsourcing, 2004



» **Transparency:** Companies want transparency, which is defined as the exchange of information across various channels and levels of the firm. To ensure that all stakeholders understand the goals, status and performance level of the engagement, vendors must provide frequent and focused information.

» **Transfer of Risk:** Through the outsourcing engagement, companies expect that risk is transferred to the vendor. Outsourcing is about balancing risks and costs to achieve business objectives. Companies want to ensure that the vendor puts 'skin in the game' to share risks. Part of this can be handled through SLA-based engagements.

To address all these parameters comprehensively, an outsourcing governance framework is needed which covers these issues and provides a rulebook for managing the engagement.

Outsourcing Governance Framework: The Key to Success

Governance is a formal management framework and structure that enables vendors and organizations to mutually manage the relationship, expectations, contractual dependencies, and services. Kanbay has identified **six key components** for effective governance which allow us to successfully manage the largest and longest IT outsourcing relationship in financial services. These are—

- Relationship Management
- Contract Management
- Service Level Management
- Communication Management
- Risk Management
- Change Management

These components, which are described in detail in Exhibit 3, make up our governance framework and are customized for each engagement to meet the unique needs of each relationship. For example, a west coast insurer has different risk issues than a large Wall Street firm. Our framework lets us modify our risk management component to meet these different needs.

This framework and structure is supported by a defined set of standards, documented processes, and best practices. Governance is used to bring a company's requirements and vendor offerings into sync.

Governance in Practice

Outsourcing governance has both strategic and tactical dimensions. The objective is to leverage investments while aligning service delivery processes with business needs. This requires a balance between two factors—

- how are the outsourced services positioned for use in the organization?
- how are the outsourced services managed to optimize the return your company?

Often companies already have the capabilities needed to establish effective outsourcing governance. They just don't necessarily understand the importance of institutionalizing a governance structure to continually manage an outsourcing relationship. We've established some key practices for using governance in our outsourcing engagements—

- **Utilize relationship management** to bridge cultural gaps and manage expectations. This is initiated by understanding common aligned objectives for an engagement which are derived from your company's business goals. A relationship management team is developed to ensure expectations, goals and deliverables are managed effectively. We build strong peer to peer connections with various stakeholders to foster a collaborative engagement approach.

Exhibit 3: Outsourcing Governance Framework		
Component	**Purpose**	**Focus**
Relationship Management	Align vendor to your company's strategic objectives	» Peer to Peer collaboration » Journey from vendor to Strategic Partner
Contract Management	Manage contract throughout the lifecycle of engagement	» Rules of engagement » Roles, responsibility and ownership of work
Service Level Management	Ensure that performance levels are met in an engagement on continuous basis	» Performance Definition, Configuration, Assessment & Assurance. » Escalation Procedure & resolution for Performance Violation
Communication Management	Exchange information and promote transparency in an engagement	» Communication Planning across the organizations; Transparency; Information Distribution » Performance Reporting, Scorecards & Dashboard
Risk Management	Address the risks in outsourcing for your company and provide mechanism to mitigate risks	» Risk Assessment & Impact Analysis » Risk Mitigation; Risk Sharing
Change Management	Handle changes brought about by outsourcing engagement	» Cultural Alignment » Focus on business results

- **Mitigate outsourcing risks** through a coordinated effort. We collaboratively identify risks associated with an engagement and assess the impact of all risks. Under performance, loss of control, knowledge loss and loss of intellectual property are some of the high risk factors among our clients. We effectively assess and control these risks through a customized mitigation plan. Tools used for mitigating risks include contracts or service level agreements which minimize the occurrence or dampen the impact.

- **Set up teams and communication channels** to build structural alignment in an engagement. This assures coordinated activity and compliance with common objectives. We pass on accountability and ownership of the engagement to stakeholders at both companies and establish channels of communication at various levels.

- **Create effective contracts** which build flexibility in an engagement. To manage pressures from variable market conditions, merger and acquisition activities and management changes, we must foster engagement flexibility. Complexity of processes and changing market environments can be addressed through the contract which can accommodate changes while safeguarding the interests of both parties.

» **Use service level management** to assure on-going engagement evaluation such as effectiveness and cost efficiency. This starts with identification of metrics to be monitored and includes the creation of a framework to define, measure and monitor those metrics. Communication channels set up during the engagement are used to share information about performance and promote transparency. These metrics are used to benchmark activities and make improvements each year. We use metrics to create monthly and yearly report cards on our activities which are tied to compensation.

» **Practice change management** to bring cultural alignment, address employee resistance and facilitate participation from your company. Change management captures the impact of outsourcing on various dimensions at the beginning of an engagement and then facilitates addressing these issues. 'Re-badging' is an example where effective use of change management can facilitate a smooth transition of skills and knowledge.

The benefits of a governance framework are many. It facilitates delivery as per commitment, mitigates risks, enhances transparency, and ensures relationship flexibility by aligning the goals of company and vendor teams. Overall, a governance framework ensures a successful, long lasting relationship between a company and it's vendor.

Summary

Outsourcing continues to mature into an effective strategic tool to achieve enterprise-wide value and competitive advantage. To ensure successful relationships that endure over time, a framework must be carefully structured which is flexible and aligns the goals of both parties. A key element of this structure is establishing a strong governance mechanism. A governance framework is more than a statement of how both parties want to manage the relationship on an ongoing basis and a list of individuals who can solve problems. In the truest sense, a proper governance framework is a survival kit for successful, long lasting relationship.

ABOUT THE AUTHOR

Aparna Umakant Katre leads Global Business Innovation for Kanbay. She has successfully managed organization change in the area of quality in software engineering. Joining Kanbay in 1996, Aparna served as Chief Process Officer for Kanbay from 2001 to 2004 where she held responsibility for implementing a standard global methodology and certifying Kanbay against international quality standards like CMM Level 5 and ISO 9001.