

White Paper: Managed Services



Second-Generation IT Outsourcing: A Primer

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IT outsourcing has generated a great deal of interest in recent times, but has in fact been around in several different guises for more than 20 years.

As with any relationship that involves people and technology at multiple levels within a business, there have been challenges and the results have been mixed. The challenges typically raised with outsourcing are driven by situations such as poor client-vendor relationships, unclear and unrealized expectations, inflexible or “locked-in” contract terms. Despite the sometimes rocky road, outsourcing continues to grow as a business practice, and companies have made a serious commitment to cost savings through outsourcing: according to research analysts at IDC, worldwide spending on IT outsourcing surpassed \$109 billion in 2001, and will grow to \$242 billion by 2006.

As outsourcers and outsourcees have gained experience, the relationships have matured, and we are now seeing the emergence and implementation of a second-generation outsourcing model. More than an evolution, this new model is fundamentally different from first-generation outsourcing, and increasingly focuses on partnering with vendors to boost value within their business.

So how does one define second-generation outsourcing?

While second-generation outsourcing is often equated with the term “second round” outsourcing, it’s actually the type of outsourcing services and relationship that determines whether the engagement qualifies for the term “second generation”.

First-generation outsourcing has been aimed at stabilizing and standardizing the IT environment and offloading non-core business processes. This was a sound way to reduce organizational costs and allow the company to focus on its main business. Non-core business tasks, like accounting, payroll, security, customer interaction, and other processes specific to particular industries, have been offloaded this way. Second-generation outsourcing builds upon this “offload to supplier” practice for IT service delivery and builds a business-focused solution with the client that leverages the IT environment for increased business benefits.

Second-generation outsourcing is designed to facilitate customer intimacy and product leadership for an organization. This occurs through a transformation of IT architectures; alignment of IT with the business; and the optimization of business processes to take advantage of the new capabilities provided. These in turn lead to increased shareholder value. Second-generation outsourcing shifts the relationship between outsourcer and outsourcee from trusted supplier to vital business partner.

Nine hallmarks of second-generation outsourcing

First-generation outsourcing has delivered to the limit of its mandate; however, real benefits will only come from moving to the second-generation model, which has the following attributes:

- Partnership based
- Mature service level agreements
- Mature program governance
- Flexible and innovative structuring
- Cultural compatibility between client and vendor
- Business and IT experienced management
- Value focus rather than cost focus
- Multi-vendor involvement
- Product independence.

1. Partnership based

Many of the current outsourcing “partnerships” can more accurately be described as purchased-provider relationships. True partnerships are those where both the client and the vendor are focused on the same business strategies and accept outcome-based compensation.

2. Mature service level agreements

Service level agreements (SLAs) are a critical component of second-generation outsourcing as they determine responsibilities within the business relationship. They are invaluable in shaping the scope of the engagement and the performance of the parties involved. The SLA is a key metric that drives the behavior of the business relationship. Typical first-generation SLAs are based on indicators such as: MIPS, systems availability, fix times, etc. While these metrics are essential to running an effective IT shop, they do not deliver functionality, availability and business benefits to the organization.

Second-generation SLAs are based on business drivers rather than technology. They focus on measuring results based on a Value Scorecard linking IT service delivery to business solutions. Therefore, in second-generation outsourcing, SLAs evolve into a Service Management approach tracking functionality, availability and applicability to the business. For instance:

- Reduced cost of IT function and improved overall ROI from IT investments
- Increased ability to quickly deliver new functionality and/or systems in response to business change
- Increased overall quality and reliability of business systems in complex environments that extend the organization across the net to its customers and suppliers.

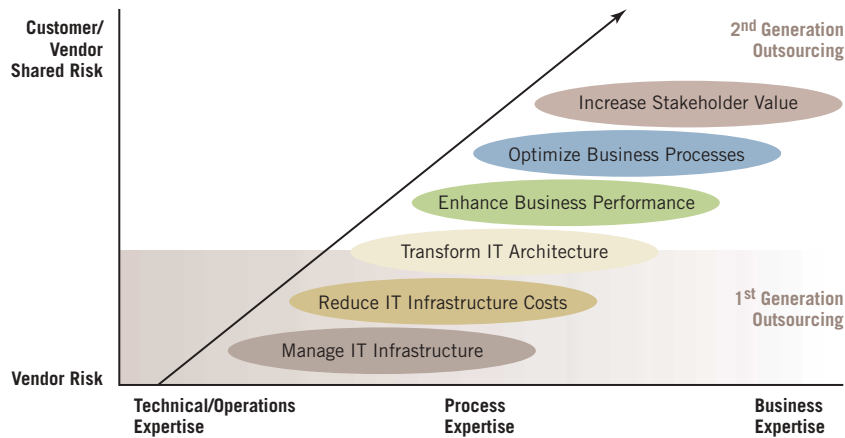


Figure 1. The Evolution of IT Outsourcing

3. Mature program governance

This is possibly the most important differentiating factor between first- and second-generation outsourcing.

Growing from the management of SLAs and resources, second-generation outsourcing delivers governance of the overall IT solution, covering the relationships, structures, systems, policies and procedures needed to manage, deliver, report and continually improve and refine the outsourced processes to deliver value to the business.

The governance structure below illustrates that the Vision and Strategy of the relationship is managed at the Executive Level. This ensures that the business goals and objectives of the outsourcing partnership govern the plans and actions for service delivery. This translates into tactical solutions driven by the Program and Service Management layer to implement the required course corrections as a result of changing business requirements. The Operations level for service delivery executes these plans and changes as part of the ongoing day-to-day activities. In second-generation outsourcing, there is strong alignment and linkage between the Strategy and Operational aspects of solution delivery to ensure that the business goals and objectives are realized.

Another key aspect of a mature governance program is to structure the service delivery organization to be flexible and responsive to the changing business requirements. Quite often the client wants a single vendor to manage the complete engagement from strategy through to operations. However, the governance mechanism needs to allow for the introduction and performance management of best-of-breed partners into the engagement at the service and project delivery level. This second-generation structure allows for this flexibility at the operational level yet maintains a single point of accountability for overall relationship and solution management.

4. Flexible and innovative structuring

Clients have a fundamentally different approach to contractual arrangements in second-generation outsourcing. Contracts are structured to deliver business-enhancing solutions through:

- Clearly defined business arrangements and commercial undertakings
- Focus on business outcomes
- Joint work teams
- Flexibility around scope and term
- Evolution and change as the business changes over time
- Innovative pricing, including risk/reward sharing arrangements.

5. Cultural compatibility

The importance of organizational culture cannot be underestimated when it comes to outsourcing. There must be recognition within both organizations that this is a business relationship not just a project. The interactive and longer-term nature of outsourcing engagements requires the vendor's staff to work at client sites and involves significant interaction with the client's employees. Organizations that have conflicting value sets and norms of behavior have trouble adjusting to each other's expectations. Culture clash results in unhappy staff, which leads to unacceptable staff turnover and spirals downward, affecting service quality, delivery times and overall costs.

Cultural alignment is essential at all levels within the second-generation outsourcing model. Integration begins at the CEO level and flows down through the respective organizations.

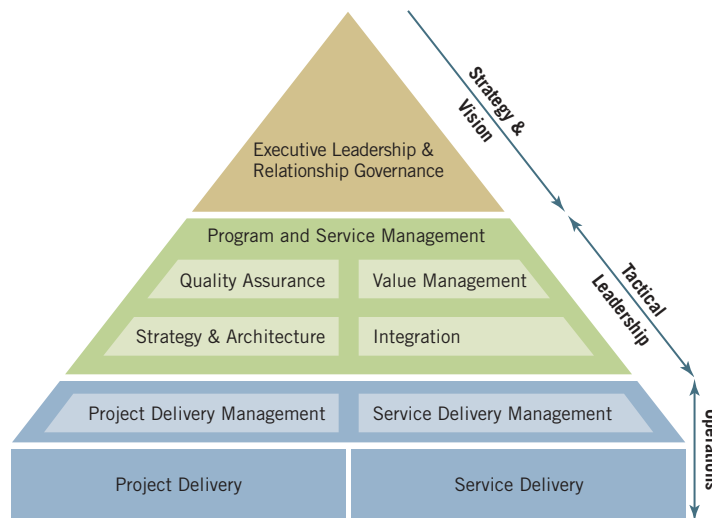


Figure 2. Three-tiered Governance

6. Business and IT experienced management

In first-generation outsourcing scenarios, the emphasis is usually on getting the infrastructure right, with IT managers often leading the engagements. Qualified second-generation outsourcers will always have a senior business manager, experienced with the technology and running complex multi-stakeholder businesses, to oversee engagements. As a matter of course, they have an understanding of the business and the industry in which the business operates. This ensures vendor-side management can have meaningful dialogue with client-side management on how IT should be leveraged to achieve business goals.

Second-generation outsourcing engagements must concentrate on the business requirements that IT supports and focus on leveraging IT capability for business benefit. This requires strong program management leveraging a value management approach to ensure the business priorities drive IT rather than “doing IT for the sake of IT”.

7. Value focus rather than cost focus

The prime driver for first-generation outsourcing is the need to control IT costs. In fact, the client often has no idea of the real cost of in-house IT and only becomes aware once the outsourcing option is pursued. The prime driver for second-generation outsourcing more often than not is the need to leverage the investment in IT for business value. This means the second-generation vendor must be capable of demonstrating a value focus.

Second-generation outsourcing is based on a series of business outcomes mapped out to provide the blueprint of success for the outsourcing relationship, as illustrated below.

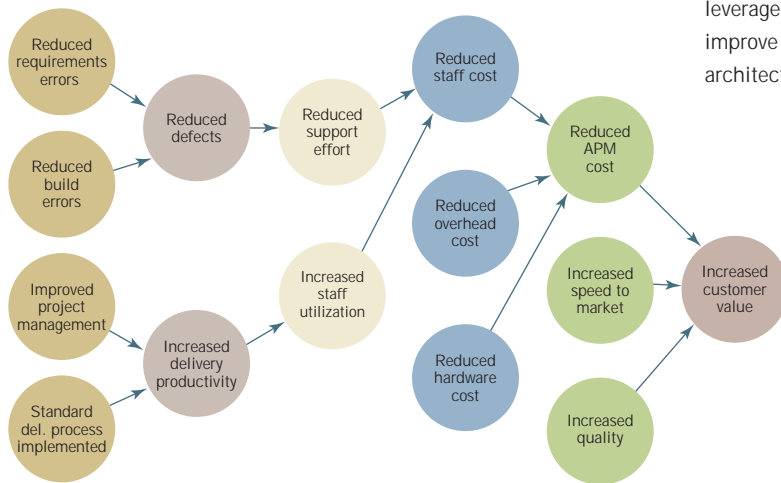


Figure 3. Value Focus Blueprint

8. Multi-vendor involvement

Second-generation outsourcing engagements strive to deliver the right solution that fits the client's business needs over the short and long term. Clients need to know that they have the flexibility in the outsourcing relationship to leverage and tap into new skills and solutions on an as-required basis without disrupting the existing service delivery relationship. This often means a best-of-breed approach where the vendor needs to manage a number of other organizations to deliver on a unified set of services with SLAs and focus the other vendors on the business value sought. A strong and effective governance model is vital for this to occur. In fact the governance model should be such that it easily allows new vendors to be plugged in or existing vendors to be exited out as the business needs and requirements change.

The governance model illustrated in Figure 2 meets this requirement by facilitating the change in service providers at the Service Delivery level. New service providers can be plugged in or out as required. Similarly, as projects are delivered, the best organization to deliver those projects will be brought in. The governance framework, through the Program Management layer, ensures that the integrity of the overall service is maintained.

9. Product independence

While vendors often claim they are product independent, few really are. If they do not have a preference for a product, they often have a preference for a particular technology architecture. While following a consistent set of technologies does have some benefits in driving down the total cost of ownership, there are often benefits in having a vendor who is product or technology independent, as cost may not be the prime business driver.

Second-generation outsourcing engagements are about enabling the business, and sometimes that enablement is best achieved through having multiple technologies at play within the environment. It means bringing forward a best-of-breed solution to help the client leverage existing investments in IT to deliver business results and improve the IT ROI rather than focusing on changing the technology architecture because it is not the vendor's preferred solution.

Challenges to the integration process

The challenges with second-generation outsourcing include:

- Transition from a possible existing supplier or from an in-house arrangement
- Migration of existing staff to the new arrangement
- Mitigating the risk of switch-over
- Defining and implementing a business-driven commercial arrangement
- Establishing and driving a partnership approach to outsourcing.

Each of these is mitigated through the execution of a well-planned, tried and tested transition plan, executed with precision. While each environment is unique, there are repeatable stages and processes common across engagements. Effort expended in the transition phase ensures maximum gain with minimum pain.

Once the engagement is under way, there are further challenges to contend with, including the need to clearly demonstrate business value.

Aligning IT with the business priorities and objectives must precede any demonstration of business value: vendors must understand what outcomes the business is seeking to achieve and then align the current environment with those outcomes. Only then will current gaps be made visible. This alignment is also vitally important when deciding what projects must be pursued to maximize the business value.

At Fujitsu Consulting, our processes rely on two fundamental frameworks: our Benefits Realization™ methodology to manage, prioritize, and align projects and initiatives to harvest the business benefits from ongoing service delivery, and the Macroscopic® toolset, an integrated suite of business and information technology methodologies designed to simplify, proof and streamline key functions, such as strategic business and IT planning, business transformation, IT architecture, application and system development, deployment and maintenance. Leading technology analyst firm Gartner, Inc. placed Macroscopic in its vaunted Magic Quadrant, as one of a select few application development methodologies with “completeness of vision” and “the ability to execute” business strategies.

Once the overall outsourcing vision is determined, this provides the roadmap, or blueprint, to govern and align all projects and continuous improvement initiatives. As illustrated in the diagram below, the specific outcomes identified from each project are linked to the overall program objectives, thus interlinking the business results with IT solutions.

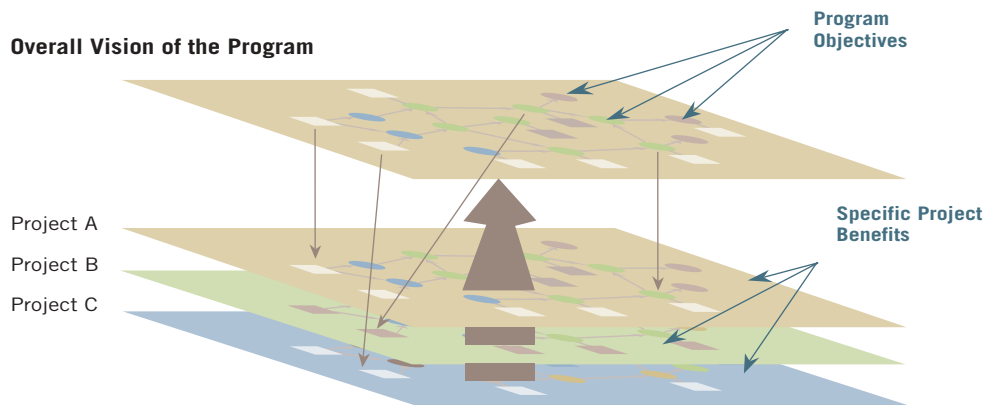


Figure 4. Aligning Programs of Work

Realize business value through second-generation outsourcing

Through management of the outsourcing program from a benefits perspective, a continuous improvement mindset will be a natural outcome as the business and the service provider jointly take responsibility for harvesting the benefits from the IT investment through the evolution of solutions.

Using Fujitsu Consulting's 4 AREs for Value Management, management of the outsourcing relationship and ongoing service delivery will remain in alignment with the overall program objectives to realize the desired benefits through integration and efficiency for IT service delivery with the business.

Keys to success in second-generation outsourcing

As clients realize that outsourcing is the right business solution for their organization to deliver business results, first-generation outsourcing relationships will be replaced by second-generation outsourcing partnerships. For clients moving towards a second-generation solution, the following items need to be considered:

- Choosing the right vendor is also vitally important. The vendor must have the skills, capabilities and attitude required to manage major second-generation outsourcing engagements.

- Outsourcing is all about relationship management and must be based on TRUST; clients need to know and trust the vendor they are entering into a relationship with.
- The vendor's lead manager must understand operations as well as business. This person, who sits at the management table, needs to understand risk management and know how to deliver services.
- Everyone at the vendor company—from CEO down—must be service oriented; the vendor's senior executives must remain "interested" in the client's business over the long term, not just during the contracting period.
- Outsourcing is not a one-shot deal: a continuous improvement and best practices focus must be instilled in the behavior of the service provider and inherent in the expectations set out in the contract.

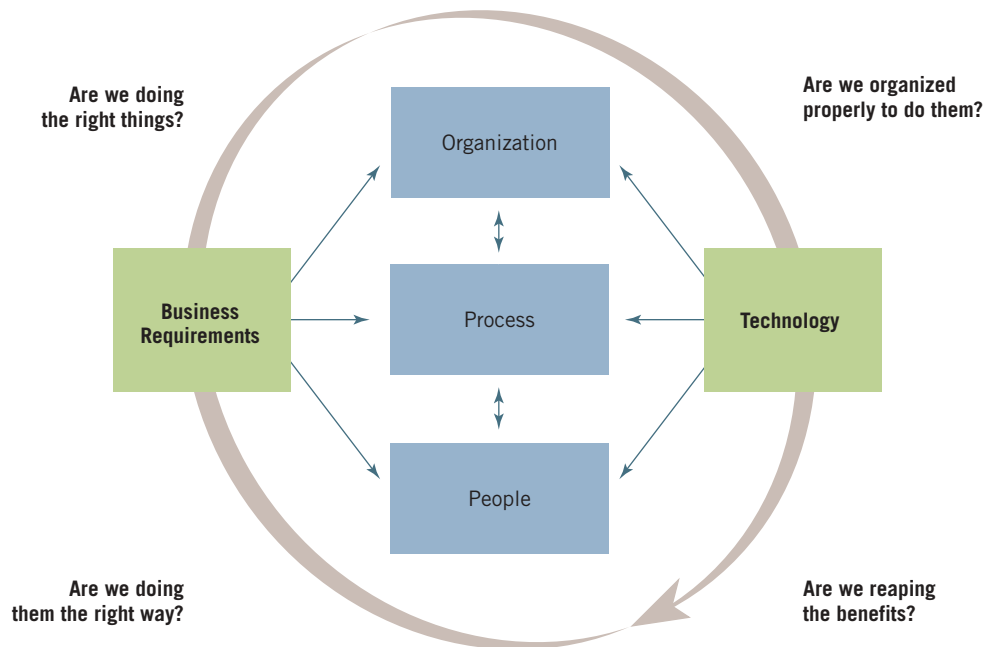


Figure 5. The 4 AREs of Value Management

Your second-generation outsourcing checklist:

Criteria	Second-generation outsource
Partnership based	<input checked="" type="checkbox"/>
Mature SLAs	<input checked="" type="checkbox"/>
Mature program governance	<input checked="" type="checkbox"/>
Flexible and innovative structuring	<input checked="" type="checkbox"/>
Cultural compatibility between client and vendor	<input checked="" type="checkbox"/>
Business and IT experienced management	<input checked="" type="checkbox"/>
Value focus rather than cost focus	<input checked="" type="checkbox"/>
Multi-vendor involvement	<input checked="" type="checkbox"/>
Product independence	<input checked="" type="checkbox"/>

Ensuring your outsourcing relationships meet the second-generation criteria will position your organization to derive maximum business value from outsourcing. With Fujitsu Consulting's second-generation outsourcing solutions, you benefit from our base of international experience in application support, maintenance and enhancement, as well as our expertise in IT governance. As with all critical relationships, choose wisely.



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