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Report to the Chairman and Ranking Minority Member, Subcommittee on Readiness and Management Support, Committee on Armed Services, U.S. Senate

November 2001

INFORMATION TECHNOLOGY

Leading Commercial Practices for Outsourcing of Services

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Accountability * Integrity * Reliability

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November 30, 2001

The Honorable Daniel K. Akaka
Chairman
The Honorable James M. Inhofe
Ranking Minority Member
Subcommittee on Readiness and Management Support
Committee on Armed Services
United States Senate

The Department of Defense (DOD) is the federal government's largest consumer of information technology (IT) resources, spending almost $22 billion on IT in fiscal year 2001. For this reason, it is critical that DOD adopt effective IT acquisition practices.

To better understand commercial IT acquisition practices and how they potentially compare with those used at DOD, we reviewed existing research, held discussions with academic and professional authorities, and interviewed executives and managers at leading commercial organizations about their IT acquisition decisionmaking and management activities. We used this information plus the extensive research and trade literature available on IT acquisition practices to develop a consensus view of what is critical to success when acquiring IT services.

On October 31, 2001, we provided the results of our study to your offices via electronic mail. These results are included as an appendix to this letter. The purpose of this letter is to officially transmit the information to you in published form.

In brief, we present a generic framework of practices from leading commercial organizations, which use the term outsourcing to describe activities associated with acquiring IT services. The framework is composed of a set of leading practices that represent those most critical to successful outsourcing. Grouped into seven common phases, the practices and underlying critical success factors define an IT outsourcing process.

We would like to thank the Private Sector Council and the commercial organizations that participated in our study. We would also like to thank academic and professional experts for providing comments and suggestions during the development of the framework.

Should you or your offices have any questions concerning this report, please contact me at (202) 512-7351 or Lester Diamond, Assistant Director, at (202) 512-7957. We can also be reached by e-mail at mcclured@gao.gov and diamondl@gao.gov, respectively. Copies of this report are also available on GAO's Web site at www.gao.gov. Key contributors to this report were Michael P. Fruitman, Tamra Goldstein, Sabine Paul, and Catherine Schweitzer.

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Appendix

Leading Commercial Practices for Acquiring Information Technology Services

Briefing for the Subcommittee on
Readiness and Management Support
Committee on Armed Services
United States Senate

October 2001

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Briefing Overview

- Background
- Objective, Scope, and Methodology
- GAO's IT Outsourcing Framework

Background

The Department of Defense (DOD) is the federal government's largest consumer of information technology (IT) resources, spending $21.7 billion on IT in fiscal year 2001. For this reason, it is critical that DOD adopt effective IT acquisition practices.

Since 1996, GAO has conducted a series of studies for the Senate Armed Services Committee concerning how DOD can improve its acquisition of major weapons systems by adopting certain practices of leading commercial organizations. Based on such studies, GAO has made recommendations intended to improve DOD processes for increasing productivity and reducing costs. While the department is making efforts to improve its practices for acquiring major weapons systems, concerns remain about IT acquisition management improvements and outcomes. For this reason, the Subcommittee on Readiness and Management Support requested GAO to examine a full range of IT acquisition issues, including defining requirements, capital planning and investment controls, and performance-based information management.

To address these broad IT acquisition issues, GAO began work to identify leading commercial practices for acquiring IT services. These practices are expected to form a basis for comparison and contrast with existing DOD IT acquisition practices.

Objective, Scope, and Methodology

Our objective was to identify leading commercial sector practices for acquiring IT services. We were interested in identifying effective practices used across a variety of organization types and structures. We wanted to address the full range of activities, beginning with how organizations make sourcing decisions to managing relationships with selected providers.

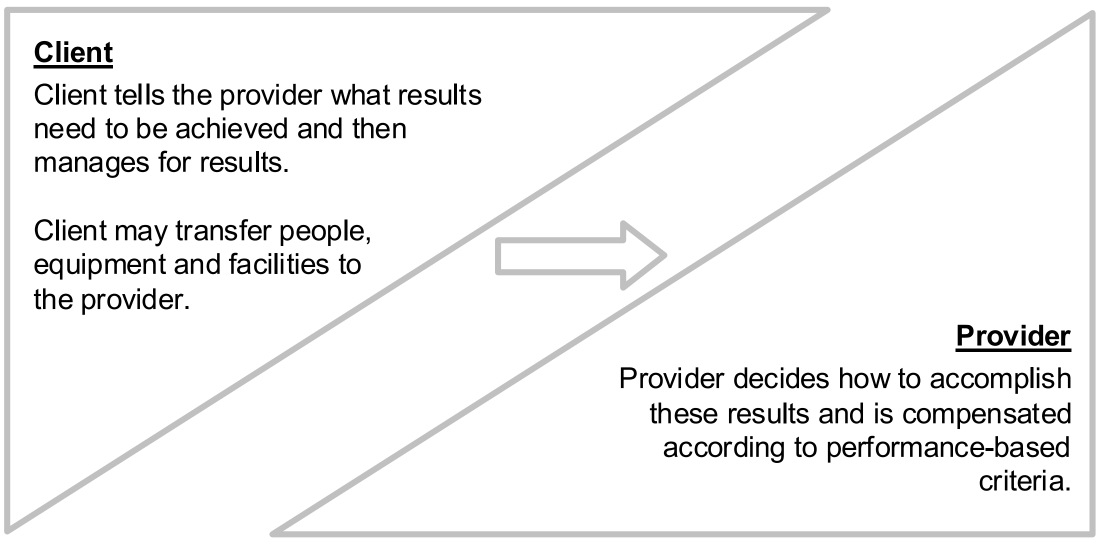
We focused on practices that were most critical, rather than the full set of practices that could be implemented. In doing so, we asked commercial firms to provide examples of how such critical practices are implemented. Our goal was to use this information to develop an evaluation framework that could provide a basis for comparison and contrast between commercial and federal (DOD and civilian) IT acquisition practices.

Our study determined that commercial firms use the term “outsourcing” to describe activities associated with acquiring IT services. Based on our research, we developed the following definition for IT outsourcing:

IT outsourcing describes the activities associated with acquiring IT services from one or more external providers. During outsourcing, a client organization transfers responsibility for one or more IT services to one or more external providers. This responsibility is executed through control and management of the processes, people, and technology associated with these services.

Objective, Scope, and Methodology (cont.)

The diagram below graphically depicts the roles of the client and provider organizations in an outsourcing relationship as described in our definition:



To identify leading commercial sector practices for IT outsourcing, we first reviewed existing research and consulted the academic and professional authorities listed below.

Existing Research

Commonwealth of Virginia
Cutter Consortium
Gartner Group, Inc.
Harvard Business School
Michael F. Corbett Associates
MITRE Corporation
Sourcing Interest Group
The Conference Board

Academic/Professional Authorities

John Halvey, International Law Firm of Milbank, Tweed, Hadley & McCloy
Mary Lacity, University of Missouri
Wendell Jones, GrayHare Partners
Outsourcing Institute
Technology Partners International

Objective, Scope, and Methodology (cont.)

We identified commercial organizations based on recognition by academic and professional authorities and publications over the past several years. We selected organizations with diverse characteristics to gain a broad perspective on how specific practices are implemented. These characteristics included business sector, geographic reach, number of employees, and annual revenues. We interviewed executives and managers at the following organizations:

Client Commercial Organizations	Provider Commercial Organizations
ALCOA	Electronic Data Systems
DuPont	Computer Sciences Corporation
ENRON Energy Services	
General Motors	
JP Morgan Chase	
Meredith	
Unisys	

Our study confirmed a number of practices that commercial organizations use in IT outsourcing. We consolidated these practices and categorized them into seven phases that were common among our case study organizations. These phases span the full range of activities that are performed during IT outsourcing.

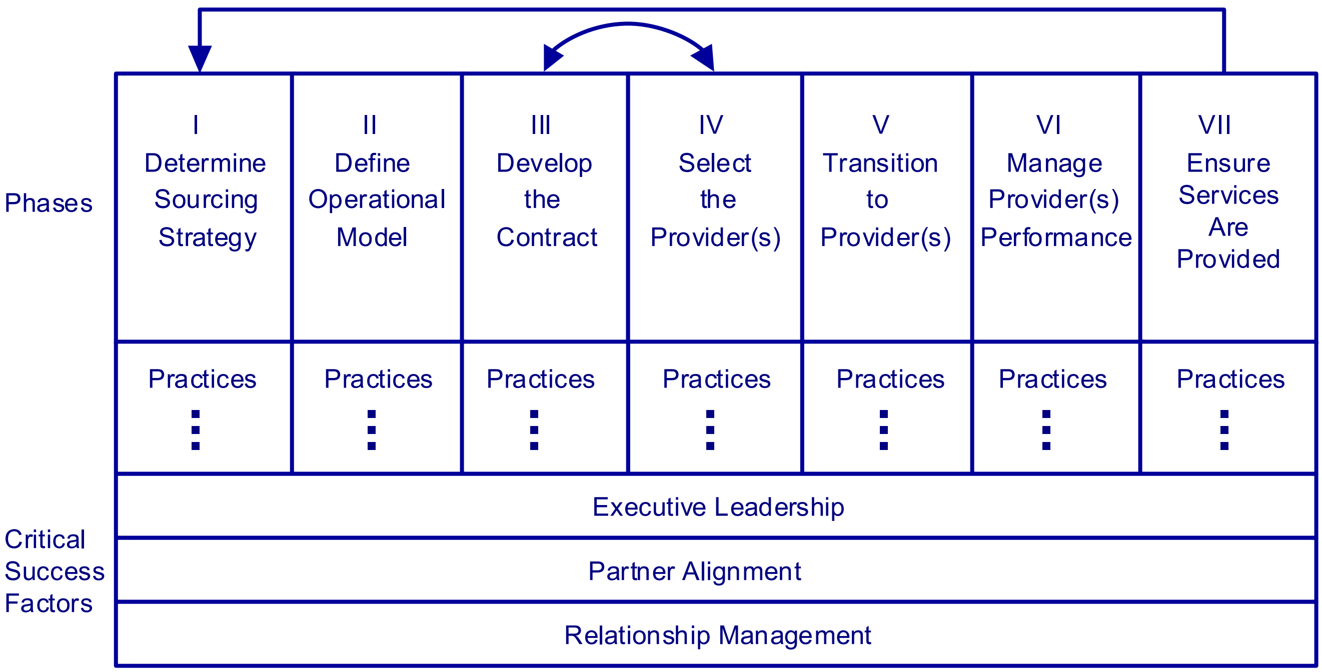
Our research also identified three factors that were critical to successful IT outsourcing. These critical success factors represent capabilities exhibited by each of the organizations we studied and impacted their ability to successfully perform the practices across multiple phases.

The relationship of phases, practices, and critical success factors forms a general IT acquisition management framework.

We obtained comments on a draft framework from leading IT acquisition experts listed earlier as well as all of the case study organizations used as examples. All endorsed the value of the framework for helping decision-makers and practitioners improve IT outsourcing results.

IT Outsourcing Framework

The framework is represented graphically below as a hierarchy of phases, practices, and critical success factors.



The framework is described in detail on the following pages. Each phase is briefly defined and described, practices are identified, and an example provided by one or more of the commercial firms we studied. Finally, each of the three critical success factors is identified and defined, followed by examples of how the critical success factors can be demonstrated.

The arrow from phase VII to phase I represents the need to reflect on lessons learned from previous phases. The arrows between phase III and IV represent the iterative nature of developing the contract and selecting the provider. While there is a logical order to the sequence of the common phases, the order of the practices within each phase does not imply any priority or sequence. Unless indicated otherwise, the practices are stated from the perspective of the client organization.

Phase I: Determine Sourcing Strategy

Definition: Client organizations determine whether internal capability or external expertise can more effectively meet IT needs.

Description: It is a fundamental premise that IT plans must align with corporate strategic plans. Close coordination will lead to more efficient and effective use of IT resources: corporate strategic objectives can be better met and investments in information technology better justified. Optimizing and baselining of internal IT processes provides an organization with the information to make a sourcing decision of whether to continue with the internal provision of IT services or changing to an outsourced arrangement with one or more external providers. When IT services are outsourced the risk of losing close alignment between corporate and IT objectives is greater than with internal IT service provision. Many firms have recognized this risk and consider its impact when making their sourcing decisions and developing strategies for its mitigation.

Practices:

- Examine how IT will support business processes when evaluating sourcing strategies.
- Use third-party assistance with experience in a variety of sourcing arrangements when formulating a sourcing strategy.
- Incorporate lessons learned from peers who have engaged in similar sourcing decisions.

Practices (cont.):

- Estimate the impact of the sourcing decision on the internal organization as well as the impact on enterprise alliances and relationships.

- Consider optimizing IT and business processes before deciding on a sourcing strategy.

- Benchmark and baseline productivity of internal services prior to making the final sourcing decision.

- Consider starting with a representative service or selective set of services to outsource; balance against economies of scale.

- Determine the business reasons for outsourcing IT. Leading organizations identified the following business reasons:

  – To expand the geographic reach of the organization without increasing internal resources for IT

  – To respond more quickly to business and industry changes by leveraging the experience of an external service provider

  – To predict operating costs better by contracting for IT services using a standard unit of measure

  – To reduce capital investments by shifting ownership of IT resources to external service provider

  – To focus internal resources on core business competencies by transferring responsibility of IT services to external provider

Practices (cont.):

- Determine the reasons for outsourcing IT that can improve the organization's ability to use and manage technology. Leading organizations identified the following technology based reasons:
  - To gain quicker access to technology skills that are in high demand
  - To acquire the flexibility to grow and shrink high-tech skills as needed
  - To gain access to enhanced hardware and software
  - To acquire the ability to refresh hardware and software as needed
  - To aggregate the demand for IT resources (e.g., skills, hardware, software, and telecommunications) from across the organization
  - To achieve a more standardized IT environment, including hardware, software, and telecommunications

Example: Determine Sourcing Strategy

In 1996 GM spun off EDS and established an outsourcing relationship with it as a separate company. GM hired a corporate CIO to set a vision, develop strategy, address issues, and manage the new relationship with EDS. As a member of GM's highest level governing board, the corporate CIO believes that he is able to elevate technology issues with business leaders and generate executive support for integrating IT into the corporate strategy. In his role since 1996, he has pursued competitive outsourcing and business-line ownership of IT initiatives. As a result, GM now outsources with multiple vendors guided by highly skilled managers. GM has also taken advantage of the tighter integration of corporate and IT strategic planning to enable its organization to provide more rapid adaptation to changing markets and to better plan for future needs.

Phase II: Define Operational Model

Definition: Client organizations formalize executive leadership, team composition, client responsibilities, and operating relationships between client and provider organizations.

Description: Critical to a successful outsourcing relationship is an operational model for guiding the structure of the contract and plans for transition. The operational model helps the organization compare its plans against the expectations that were set as the initial decision to outsource was made, and to ascertain whether these plans will enable the organization to meet those objectives. One aspect of the operational model is an explicit understanding of how the client organization plans to communicate its needs and feedback to the provider. Communication between business lines and the IT organization is always critical to the success of the IT organization. When the IT service provider is outside the client organization, as it is in the case of IT outsourcing, discontinuities between organizations are more likely and organizational processes to facilitate good communication are even more critical.

Practices:

Client executive leadership

- Establish executive leadership for IT to facilitate the outsourcing initiative.

- Continually communicate and clarify outsourcing objectives, while correcting any misinformation that affects the organization.

Practices (cont.):

Client team composition

- Establish a core group of people who will be involved in all phases of outsourcing.
- Select a person who will be involved in the negotiation of the contract to manage the outsourcing relationship. The outsourcing project manager should be on the negotiation team, though not the lead negotiator.

Client responsibilities

- Align IT and business objectives.
- Monitor and fully understanding billing statements.
- Manage provider performance, including auditing provider performance data.
- Define strategic objectives and consider the creation of a position responsible for strategic sourcing decisions.
- Create and define contract management structure with operational points of contact and managers.
- Define the role of internal IT managers and business leaders.
- Consider the number of managers needed when outsourcing to multiple providers (i.e., two or more providers do not necessarily require more managers than one provider).

Practices (cont.):

Client responsibilities (cont.)

- Ensure that the right skills are in place to support the outsourcing relationship, including those dealing with
  - contract management
  - financial management
  - IT management
  - negotiation strategies
  - teaming and interpersonal relationships
  - project management
  - relationship management

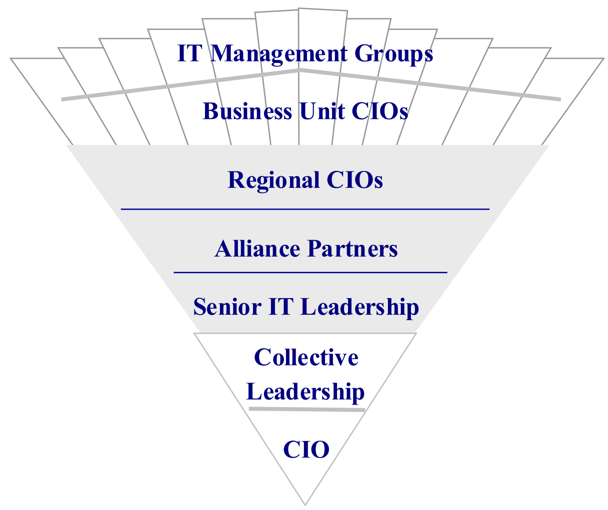
Practices (cont.):

<u>Client-provider relationship</u>

- Establish a point of contact high in the provider management structure for elevating provider performance concerns.
- Have provider establish an on-site support team to serve as liaison between client and provider.
- Train provider on client business environment and goals.
- Select or develop standard tools for managing the relationship (e.g., performance scorecards, an enterprise resources management system).
- Identify and use standard processes for managing the relationship and use consistent (though not necessarily the same) processes when dealing with multiple providers.
- Use third-party assistance to take advantage of expertise from a variety of outsourcing arrangements in defining the operational model (i.e., defining roles and responsibilities).
- Ensure the provider management team has prior experience in the client's field of business.
- Understand the organizational structure of the provider and who is empowered to make decisions.

Example: Define Operational Model

DuPont's IT management structure, illustrated at right, is intended to facilitate the alignment and integration of IT with DuPont's business units. The corporate CIO is at the head of the structure (the fan's pivot point) and receives input from a collective leadership team composed of the top 100--150 senior IT leaders from across DuPont.



The management structure also includes DuPont's two-vendor alliance members, CIOs for each of its six regions worldwide, and CIOs for each business unit. Finally, "functional" IT management groups service each business unit. This management structure is designed to build consensus by facilitating communication across the client organization and provider organizations on IT issues.

Phase III: Develop the Contract

Definition: Client organizations establish the legal terms for the IT outsourcing relationship.

Description: The contract defines the legal terms of the relationship between client and provider. It sets the expectations for service levels, delivery of essential services, continuous improvement, and is intended to protect the interests of all parties. The client protects its most critical requirements by capturing them as fundamental expectations, upon which simplified agreements are later built. While other phases in the outsourcing process describe the need for mutual trust and a close, flexible, working relationship; this phase focuses on the development of a contract that is the foundation on which that working relationship will be built. For this reason, it is critical for the client, perhaps with third party assistance, to articulate clear contract terms.

Practices:

Performance requirements and service level agreements

- Base performance requirements on business outcomes.
- Include measures that reflect end-user satisfaction as well as technical IT performance.
- Review and update performance requirements periodically.
- Require the provider to meet minimum performance in each category of service.
- Require the provider to achieve escalating performance standards at agreed-upon intervals.

Practices (cont.):

<u>Performance requirements and service level agreements (cont.)</u>

- Incorporate sufficient flexibility so that minimum acceptable performance can be adjusted as conditions change, as the provider becomes more adept at satisfying customer demands, and as improvement goals are achieved.
- Use service level agreements (SLAs) to clearly articulate all aspects of performance including management, processes, and requirements.
- Client and provider work together to define an appropriate number of SLAs and appropriate structure for each. The type of service being provided and the number of services being supplied by the provider may drive the number and structure.
- Specify circumstances under which the provider is excused from performance levels mandated by master service agreements.
- Client and provider work together to identify SLAs for which compensation is based, while additional ones may be defined to manage performance.

Practices (cont.):

Contract content

- Contract must be flexible enough to adapt to changes in the business environment (e.g., mergers/acquisitions).
- Contract should include clauses for, among other things,
  - determining pricing structures (e.g., include explicit remedies if benchmarking demonstrates that multiyear price schedules are no longer competitive)
  - performing customer satisfaction surveys and using the results to redefine performance levels
  - terminating the contract, including early termination (e.g., consider prohibiting the provider from making unusual offers to retain provider employees, while enabling the client to hire provider employees in the event of contract termination)
  - resolving disputes in a timely manner
  - taking work away, without penalty, from provider for non-performance
  - declaring a significant event that can lead to a change in the contract (e.g., volume deviation by fifteen percent (15%))
  - defining performance requirements (e.g., continuously improving performance levels)
  - conducting regularly scheduled meetings

Practices (cont.):

Contract development/ negotiation process

- Allow time to negotiate the contract (e.g., up to 12 months).
- During negotiation process, protect fundamental requirements identified in the request for proposals.
- Consider setting up a master services agreement under which all arrangements between client and provider operate.
- Include appropriate representation from each major organizational unit on contract negotiation team.
- Specify the use of volume purchases to obtain optimal discount.
- Consider performing work over the duration of the contract (e.g., incremental refresh of technology instead of a single comprehensive technology refresh).
- Negotiate contract to fill needs in most cost-effective way possible.
- Set aside funds to pay for services that may have been overlooked during contract negotiation and to resolve disputes.
- Use third-party assistance in negotiating and developing the contract.
- Conduct periodic contract modifications and renegotiations.
- Ensure continuity of contract knowledge and experience throughout the effective life of the contract.
- Sign contract after contract negotiations and final vendor selections.

Example #1: Develop the Contract

Based on its experience, Meredith Corporation offers advice to client organizations that are considering external service providers. When executing IT outsourcing contracts, Meredith highly recommends that the client hire an outside legal firm. The client should insist on terms that allow for the early termination of the contract and specify language that allows the client to immediately hire the outsourcing firm's employees in the event of contract termination.

Example #2: Develop the Contract

GM uses a master services agreement to structure arrangements with each of its primary service providers. It uses a third party to help negotiate contracts. GM identifies an initial set of metrics for all three parties to discuss and agree to, prior to executing a contract, in the service-level agreements. The metrics are reviewed monthly and updated as appropriate. Additionally, continuous improvement is built into the contract to elevate performance levels annually and for the entire term. Penalties are assessed based on failures associated with the delivery of specific services as well as certain one-time deliverables specified in the service-level agreement.

Phase IV: Select Provider(s)

Definition: Client organizations find one or more providers who can help them reach their IT outsourcing goals.

Description: Once an organization has determined the strategic goals of outsourcing its IT services, has defined the operational model for its outsourcing, and has begun to develop an understanding of the essential contractual requirements, it can then begin to identify providers that can meet its needs. It is critical that the client organization conduct market research to determine which vendors can provide services to achieve its objectives. In some cases, the field of competitors may be small. In fact, some large private-sector corporations have found that no single provider can meet all of its needs. Managing multiple vendors can be challenging for client organizations that must oversee each vendor separately as well as coordinate among vendors. An alternative approach is to develop an alliance among a group of providers, with a prime contractor and a team of support vendors.

Practices:

- Conduct research on state of the market, vendors, and technology before defining vendor selection criteria.
- Identify and evaluate various sourcing solutions (e.g., single vendor, multivendor, and alliance).
- Define a process for selecting vendors to be providers (e.g., issuing a request for proposals and prequalifying vendors).
- Define vendor selection and evaluation (acceptance) criteria at the outset (e.g., cultural fit, skill set, industry knowledge, proposed transition plan, past performance, and reputation).

Practices (cont.):

- When issuing a request for proposals, identify services with expected performance levels and define client and provider roles and responsibilities.

- Use third-party assistance with expertise in a variety of outsourcing arrangements when selecting provider(s), including developing the request for proposals.

- Conduct due diligence activities to verify vendor capabilities before signing the contract (e.g., conduct past performance and reference checks as part of the evaluation).

- Make final vendor selections after contract negotiation.

Example #1: Select the Provider(s)

JP Morgan asked three leading IT service providers in the market to identify partners for providing IT services. It chose to select a team of providers (1) because it believed that no one company could provide all services needed, and (2) to get access to the best skills as needed (i.e., JP Morgan could increase or decrease resources depending on the needs of the business). JP Morgan believed that an alliance provided access to the full breadth of expertise required and reduced risk, without having to contract separately with each provider and then coordinate among them.

Example #2: Select the Provider(s)

DuPont explored multivendor as well as single-vendor strategies for meeting its needs, before settling on a two-vendor alliance. DuPont believed that multivendor solutions required too many points of contact and difficulty in integrating multiple vendors with many in-house groups. Conversely, one provider could not provide all of the IT services DuPont required. A two-vendor alliance, in contrast, required a small increase in administration and coordination, and allowed DuPont to leverage the strengths of two providers, while fostering competition in strategic areas. In this alliance, DuPont chose to segment IT services such that one vendor has primary responsibility for infrastructure and business-specific applications, while the second has responsibility for enterprise-wide applications. New solutions or the replacement of any application solution can be bid competitively to either alliance partner or any other qualified third party.

Phase V: Transition to Provider(s)

Definition: Client organizations transfer responsibility of IT functions to one or more providers.

Description: A transition plan can help make the move from internal to external IT services a smooth and successful one. The clear definition of responsibilities and the careful consideration of employees' needs matched against the organization's needs enables both the client and provider to focus on responsibilities that they can execute successfully, and will give staff confidence in their future employment.

Practices:

- Communicate a clear transition process to all key players from both client and provider organizations.
- Clearly communicate to employees what is going to happen and when it is going to happen.
- Continue to communicate changes to employees as they occur.
- Handle resistance to change with meetings between upper management and employees.
- Shift management mindset from allocating resources to managing for results.
- Shift corporate attention from non-core business functions to core business functions.
- Establish client transition team with representatives from across the organization to facilitate the transition.

Practices (cont.):

- Place transition under single program manager.
- Create client/provider transition teams to address short-term transition tasks as required.
- Recognize that it takes time to effect transition and plan accordingly.
- Encourage transition of staff to provider, where appropriate, using bonuses, stock options, and other appropriate methods.
- Develop employee-retention programs and offer bonuses to keep key people, where appropriate.
- When consistent with organizational objectives, assist employees who do not want to transfer in finding other jobs, either within the organization or at another organization.
- Document key information to preserve organizational knowledge in the event that one or more providers change.
- Use change management strategies to help client employees deal with the transition.

Example: Transition to Provider(s)

In July 1995, JP Morgan transferred 1500 people, including existing contractors, to its new service providers. Employees were transferred to each of the provider companies based on their roles at that time, and the providers worked to make sure that comparable benefits were offered to transferred employees. Planning for the transition of the provision of technology was a joint responsibility of all the companies, but managed by JP Morgan. Building the new joint IT team was primarily JP Morgan's responsibility, with cooperation from the other providers. For example, a management committee made up of senior IT executives from JP Morgan and all provider companies was put in place to get the new arrangement up and running.

JP Morgan had planned for this by designing a new operating model that had three distinct disciplines: *Plan*, *Build*, and *Operate*. *Plan* included the overall IT Strategy and Architecture and was JP Morgan's responsibility. *Build*, which include technology product selection and roll out, was the combined responsibility of JP Morgan and the providers. *Operate* was the primary responsibility of the providers. Interfaces at each level along with new roles created on both sides to accommodate the operating model. JP Morgan believes the roles allowed for the authorization of work, decisions to be communicated, and problems to be managed. Over time, as roles and responsibilities became clear, JP Morgan's focus shifted from operating to managing. The transition plan provided for the transfer of people to the provider, as well as a framework for understanding future roles and responsibilities of the client and providers. JP Morgan is now reviewing this model since its merger with Chase Manhattan.

Phase VI: Manage Provider(s) Performance

Definition: Client organizations make sure each provider is meeting performance requirements.

Description: Frequent, clear communication between client and provider ensures that potential problems are identified and resolved before they cause disruptions. Publication of performance data creates an open atmosphere that builds confidence and enables stakeholders to review progress toward goals.

Practices:

Incentives and Penalties

- Consider incentives to motivate provider(s) to exceed performance requirements (e.g., exceed number of hardware installations).
- Use penalties to motivate provider(s) to meet performance requirements.
  - Assess penalties for failure to perform as required by individual service as well as aggregate service levels.
  - Apply penalties in the form of credit to the client.
  - Increase penalty for recurring deficient performance.
  - Hold back percentage of provider's pay for a particular service until performance requirements are met.
  - Refund the penalty if the provider returns to agreed-upon performance levels within a designated period of time.
  - Ensure the provider will cover costs, but not profit when a particular performance requirement is not met.

Practices (cont.):

Performance monitoring mechanisms

- Periodically undertake studies to assess how the provider’s performance compares with value being delivered to similar clients and the extent to which the provider's performance is improving over time (e.g., validate cost assumptions for multiyear contracts).

- Schedule periodic working-level meetings with both the end-user groups and the provider to review provider’s performance.

- Conduct executive-level oversight meetings with the provider’s senior management to review provider’s performance.

- Distribute performance data to stakeholders.

- Reserve audit rights on performance data supplied by the provider.

- Ensure that provider measures and reports on performance.

- Work with provider to redefine service levels, as appropriate.

- Sample performance data frequently enough to perform trend analysis and to permit extrapolation based upon historical data.

- Allow employees and possibly stakeholders to rate provider on a regular basis (e.g., scorecards and quarterly report cards).

Example: Manage Provider(s) Performance

GM reports weekly and monthly to business unit CIOs on the performance of its service provider. In addition, frequent meetings are held with the service provider to discuss issues, review service-levels, and conduct root cause analysis of reported problems. These meetings ensure that both companies have the same view of the quality of the service being provided, as well as a set of action items designed to improve performance when necessary. Weekly steering committee meetings are held with the program managers to address problems and perform strategic planning. Additionally, frequent interactions with end users and regular evaluation of service levels help ensure that end users understand the service level commitments versus attainment, and the provider understands end user needs.

Phase VII: Ensure Services Are Provided

Definition: Client organizations make sure that services are provided and end-user needs are met.

Description: Although the focus of outsourcing is on provider performance, client organizations remain ultimately responsible for making sure that services are provided and end-user needs met. The previous phases addressed the extensive preparation that must precede the providers' assuming responsibility for services. Much of this responsibility is defined by the terms of the contract developed in phase III, then monitored by the performance management practices described in phase VI. However, during the course of work, the client organization learns more about the capability of the provider, and opportunities to improve services thereby arise. Additionally, market conditions may change and an arrangement that was once advantageous to a client may become less so over time. Therefore, it is important for the client to monitor service levels internally as well as maintaining an external view of the performance of other providers in its industry. Periodic benchmarking allows the client to ascertain whether it is still obtaining good value from its provider.

Practices:

- Monitor the provider's work to anticipate issues for resolution.
- Conduct periodic meetings to resolve issues jointly with provider.
- Document and maintain organizational knowledge.
- Make sure provider uses the standard tools and processes defined as part of the operational model.
- Use provider performance data to continuously improve processes.
- Pursue improvement based on customer satisfaction surveys.

Practices (cont.):

- Have provider ensure that adequate and appropriate resources are available to perform services.
- Ensure that an appropriately empowered individual from the client organization oversees work.
- Set realistic time frames that are agreed to by the provider.

Example: Ensure Services Are Provided

In recent years the cost per unit of telecommunications service to major businesses has been steadily declining. For example, a major information technology company has, historically, entered into multiyear (2-3 year) contracts with its major telecommunications providers. However, telecommunications companies are commonly reluctant to commit to “forward pricing” that adequately reflects a continuing price decline 2 or 3 years into the future, in a contract in effect today. To ensure that the company pays competitive rates for service, it monitors the fees assessed by its telecommunications providers vs. the marketplace, and includes mid-term renegotiation clauses in all of its major agreements. This has led to continual refreshing of contracted rates which has allowed the company to consistently benefit from industrywide price reductions.

Critical Success Factors

Our research identified three factors that are critical to successful IT outsourcing: *executive leadership*, *partner alignment*, and *relationship management*. The organizations we studied identified certain capabilities that were essential for implementing the practices defined in the framework. We term these important capabilities critical success factors.

Executive leadership strengthens the interaction between executive management and the employees of the client organization. A strong executive commitment is intended to secure organizational buy-in from the client for the external providers. *Partner alignment* strengthens the interaction between the client and provider organization at the executive level, which ensures that the goals and objectives of these organizations support each other. *Relationship management* strengthens the interaction between the client and provider organization at the operational level. A smooth and constructive daily interaction between client and provider at the operational level is crucial to achieving the expectations of the outsourcing arrangement. The presence of these factors is essential for the successful execution of the outsourcing arrangement.

Critical Success Factor #1: *Executive Leadership*

Executive leadership is key to obtaining and maintaining organizational support for IT outsourcing. Communication begins with top-level executives and flows downward. This flow of information is initiated when the organization starts its efforts and should continue through the outsourcing process as new decisions are both considered and reached. The following activities are examples of how executive leadership can be demonstrated:

- Keep the entire organization informed throughout the outsourcing initiative.
- Conduct regular peer-to-peer meetings at each level in the organization.
- Secure key executive support before eliciting organizational support.
- Establish a communications team to promote the idea of outsourcing.

Critical Success Factor #2: *Partner Alignment*

Aligning client and provider objectives in a partnership is key to building consensus and is imperative to establishing early trust among all stakeholders. For this alignment to occur, the client and provider must work together to establish common project goals beyond the objectives stated in the request for proposals. Both sides must recognize and understand each other's underlying motives and strive to achieve established expectations. The following activities are examples of how partnership alignment can be demonstrated:

- Enlist upper-management support from both sides.
- Work with provider to determine business direction, identify available technology, and requirements for meeting end-user needs.
- Client works with provider's senior executives to develop a multiyear view for the outsourcing relationship.

Critical Success Factor #3: *Relationship Management*

Relationship management is key to ensuring daily communication and resolving issues. Relationship management goes beyond the structure of the contract. The client develops and employs standard processes to manage the relationship in areas such as resolving issues/concerns and initiating/directing work. Responsibility is executed through control and management of the processes, people, and technology associated with the IT functions. The following activities are examples of how relationship management can be demonstrated:

- Client and provider management strategies are flexible enough to adapt to business changes.
- Handle resistance to change with meetings between upper executives from both sides and lower-level client employees.
- Active lines of communication are kept open between the client and provider throughout the process.

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