

# *Outsourcing: The 20 Steps to Success*

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*Outsourcing is here.* In ComputerWorld's March 28, 1994, edition, it listed nine "Billion Dollar Babies" - companies that had recently signed or were expected to sign billion-dollar outsourcing deals. Topping the list were Xerox Corp. with a \$4 billion plus outsourcing deal, and McDonnell Douglas and General Dynamics, with \$3 billion deals.

Outsourcing can offer definite advantages - but only if you do it right. Outsourcing is fraught with danger for the unwary executive or corporate counsel. Simply stated, it is the "make or buy" decision as applied to the information systems and technology functions of your company. The key question involved "Should your company hire its own systems staff, acquire its own facilities, develop its own systems, maintain its own hardware, develop its own documentation, contract for its own telecommunications network, etc.? Or should it contract such services to an outside specialist organization that has already achieved the economies of scale to allegedly attract the best full-time systems professionals and get the most processing power and development capabilities and tools for the least per unit cost?"

## **Pros and Cons: Which Will You Attain?**

With continued pressures to cut costs, downsize, reduce software development backlog, and re-engineer, the promises of outsourcing look very bright:

- improved service and performance;
- expert resources and staffing;
- shorter systems development cycles;
- better management control;
- elimination of personnel problems;
- stabilized or reduced costs;
- improved business focus;
- possible "tax" advantages; and even a
- Year 2000 millennium fix.

While all of these advantages are promising, the opposing realities and factors are also at work to limit and frustrate the anticipated gains:

- nickel-and-dime syndrome ("I have to charge you extra for this, and this, and that");
- contract termination problems;
- inflexible contracts that limit your ability to accomplish your stated and changing business strategies and objectives;
- loss of control over your key information resources;
- ineffective corporate or project management - they're no better than you in running a business (i.e., fighting their/our bureaucracy, turnover, etc.);
- loss of in-house expertise (including the fact that while it only takes 3-6 months to dismantle your corporate data processing department, it takes 3-4 years to rebuild it);
- conflict of interest (when push comes to shove, they make a profit by serving many customers and their own management - at times, possibly to your detriment);

With both the advantages and the dangers of an outsourcing agreement very great, it is crucial that the right

outsourcing vendor be chosen and that the relationship be managed correctly.

## So What Can You Do?

The following 20-Step Program provides you with a road map to help assure that you have:

- properly organized your team;
- achieved necessary management commitment;
- properly defined your own corporate needs, objectives, and priorities;
- identified appropriate alternatives;
- identified and evaluated your risks and benefits;
- selected the best alternative for each specified service area;
- developed and negotiated an appropriate and effective outsourcing agreement; and
- provided the mechanisms to administer, maintain, and monitor the contract and to resolve the inevitable problems.

### The 20-Step Program

1. **Organize a top management Steering Committee** to plan, monitor, and oversee the search for and transition to outsourcing. Include members from your information systems division, key user groups, and executive management including marketing and/or strategy management. It is best to factor in changing needs, markets, distribution channels from the start to help minimize surprises a few years out. Also, I believe that it is just a matter of a few years before corporate officers and directors will be sued by shareholders for losing important information resources, losing effectiveness, or leaving the company vulnerable to competition because of messing up an outsourcing deal. Thus management needs to know and be part of this process to assure due diligence is being performed and to provide appropriate stewardship up over these key corporate information assets.
2. **Identify and engage an expert team** to guide you and your organization during the outsourcing decision, selection, and contracting processes. The team should include a small group of **independent experts** with specialization in outsourcing, including: an information technology consulting professional who understands your needs and the needs of the outsourcer and who is capable to help you administer the contract over time, assure a smooth migration to the new systems, and resolve problems that will arise after the contract is signed; an **attorney** with specific contracting, business and outsourcing expertise to develop and help negotiate an outsourcing contract that is fair to all parties and provides proper incentives for both sides to perform to make the relationship work; and an **organization development/merger and acquisition professional** to help assure that the transition of staff and relationships works well. This team is also warranted and needed to make tough decisions because perceived or actual weaknesses in your current IS team may have caused the failure of IS within your company in the first place. In addition, it is wise to engage independent experts to assist your IS managers in this process as it is these latter managers themselves that will probably be most directly affected by the move to outsourcing and the resulting contract(s).
3. **Identify critical internal resources**, such as a particularly competent data processing director or chief information officer, who will stay on your company's staff internally to help manage and administer the relationship between the outsourcer and your company. Determine which staff, and software and hardware licenses and resources should/must go to the outsourcer for the relationship to be successful.
4. **Identify what is good and bad about your current installation** in terms of: service; capability; performance; uptime; costs; user satisfaction; backlog; on-time, on-target systems delivery; controls; etc. assess each strength and weakness (budget constraints; changing needs of internal users; top management commitment; resistance to change; lack of tools and human resources; staff development and ability to attract and retain quality staff; lack of methodology; hardware technology limitations;

platform limitations, etc.). Quantify and identify which items and service levels are "must haves" vs. "should haves" vs. "could haves", "now" vs. "later", etc. and which components must be improved and attained in the outsourcing arrangement. Shoot for "good enough" systems and targets that are attainable, affordable, and of necessary quality.

5. **Update the company's strategic business plan.** The outsourcing agreement will typically cover a period of 7 to 10 years. To the extent possible you must know where your company is going locally and globally in terms of products, markets, manufacturing, sources of supply, distribution arrangements, labor sources, etc., before developing a systems plan to support those directions and needs.
6. **Develop a strategic systems plan** (7 to 10 years, if possible) identifying the long-term needs of the company that dovetail into the strategic business plan. Determine the new applications that will be required (for instance, electronic data interchange, integrated manufacturing and production control using robots and automated "smart" buildings, international telecommunications networks, "intranets" etc.), which applications will be updated, which will be discontinued and when, which will be developed from modified new applications software.
7. **Identify the alternative hardware and operating systems alternatives** and determine the recommended new architecture(s) needed to develop and support the new systems plan (for instance: satellite communications, wide area networks, wireless communications, mainframe and client-server usage and inter-connect, specific operating systems, open-architecture decisions, database and programming language decisions, special development and maintenance tools, etc.)
8. **Understand your cost structure** and determine/estimate future costs to create and support the projects outlined in the strategic systems and architecture plans developed in steps 6 and 7 above, including estimates of manpower and supporting hardware and software and equipment to build, upgrade, maintain, operate, and control such systems. Recognize that over the next 5 to 10 years you must also estimate all relevant capital as well as operating costs; costs of supervising the outsourcer, likely increases in costs for salaries, benefits, service contracts, etc.; "cost of money"; interest costs; residual value of equipment and facilities; cost of transition, including personnel; cost of changes in direction and level of resources; cost of contract modification, etc. (Note: this is a most difficult task - use your expert team for guidance or confirmation here.)
9. **Identify your current and anticipated usage:** normal operations, expanded operations over time, peak periods, off-site processing, storage, archive, integrations requirements, back up and disaster recovery requirements, etc.
10. **Review the strengths and weaknesses of the outsourcing alternative.** Determine whether/how the outsourcing alternative will help your company achieve its long term goals and why that alternative is better than staying in-house or partial outsourcing or working with multiple outsourcers. Determine which applications and resources should be outsourced and which should continue with a different approach. Update this information and re-evaluate the decision throughout this entire decision-making process as new or better information is gained.
11. **Using your expert team, identify several outsourcing alternatives.** Obtain appropriate literature in a request for information from the team's preselected short list of outsourcers. Beyond all of the technical and administrative things you will need to know about your outsourcer, you will also need to know in depth: corporate history and stability; current, new and lost customers; employee numbers, turnover, and experience levels; financial stability through a review of audited financials and footnotes; technological status including methodologies, tools, platforms, expected life of existing hardware; age of current applications; their own business and systems plan; downtime statistics; results of operational and security audits; customer surveys and systems demonstrations (both are critical and must be well planned); conversion commitment success/history (a real "killer" if done incorrectly); such intangibles as responsiveness, control, competition for resources, flexibility, etc.
12. **Determine which areas of your company you would like to outsource.** Identify a phased-in approach for outsourcing services if that is the preferred method.

Services can be selected for virtually any part of your Information System areas including:

- All activities in a specified area (with only listed exceptions) vs. defined tasks
- Provision of facilities, utilities, etc.
- Equipment
- Applications software
- Systems software, tools, etc.
- Personnel
- Consulting services
- Systems integration
- Development of new programs and systems
- Data conversion
- Live system operation, management, and control
- Communications equipment, software, and interfaces
- Daily and periodic processing and reports (accuracy; timeliness; formats)
- Responsibility for troubleshooting
- Compliance with applicable laws
- Audit trails
- Pickup and delivery
- Physical security
- Data and program security
- Backup procedures for programs, data, etc.
- Disaster recovery capabilities
- Data entry
- Maintenance
- PC service
- PC installation of hardware, software, and modifications
- Help Desk

13. **Develop a rigorous request for proposal (RFP)** which has a format that forces the responding outsourcer to answer questions in a way that will allow you to compare responses from multiple outsourcers. Ask outsourcers to simplify their answers to pricing so that you can really understand what services will be included and which will be extra. Note that pricing can take on many forms, and that different services may be priced differently or in alternative combinations to your advantage: flat monthly fees; transaction volume-based fees; fees based upon a customer unit of volume (i.e., number of customers, accounts, credit cards); fees based upon CPU usage required to execute your jobs; fees based upon the number of input or output transactions or both; fees based upon the amount of disk storage or other storage requirements; programming fees - may be different from enhancements, new developments, special reports, or rush jobs; data communication line charges; disaster recovery rates; training and seminar fees; consulting fees; documentation charges; conversion fees; etc.

Identify some key clauses that you would like to see in the contract so that you may be able to win some concessions on these during the bidding phase and so that you can determine the sticking points early.

Identify Acceptance Criteria for outsourcer bids and for systems and service acceptance throughout the life of the contract: the accuracy, frequency, and timing of reports and information; response time for on-line transactions; uptime of the systems or the various components; emergency procedures in the event of downtime or other disruption of services; responsiveness of outsourcer personnel in the event of problems or errors; data archiving; access security; ease of use; unit, string, systems, and acceptance testing methodologies to be used; systems development methodologies and user participation and sign-off points; usage of data query, parameter-driven, fourth and fifth generation languages in programs; user of upper- and lower-CASE tools, client-server architecture, and object oriented approaches; etc.

14. **Invite bidders to a bidders conference** at your site and take each bidder on its own tour of your site. Have top management and the Steering Committee meet with the outsourcing representatives for at

least 45 to 60 minutes during the tour to set the tone and to demonstrate the importance and visibility of the study and resulting relationship. This can be very important if your top management must meet with the outsourcer's top management in the future.

15. **Evaluate proposals against your pre-established, and fully documented, criteria.** Identify different approaches recommended by the outsourcer and determine how they differ from your own research and preliminary conclusions. Be open to suggestions but analyze differences carefully. Follow up with outsourcers to discuss alternatives and to clarify proposals. (See [Criteria for Evaluating Outsourcers](#) below)
16. **Rank proposals so that you have a backup vendor.** This is needed in case negotiations break down with your preferred vendor. It is also required to give you the confidence to negotiate in a tough but fair manner.  
Identify absolutely necessary criteria early. No matter how well the outsourcer looks in other areas, if they don't meet the minimum "must-haves" - they should be contacted for clarification or dropped from the list. Any weighting or decision scheme that does not have this preliminary "go or no-go" decision point should be avoided.
17. **Checking references is a critical part of the evaluation and comparison of outsourcers.** Do it seriously. Visit other customers. If possible, review their contracts and the status reports on key projects. Establish a long-term communication flow. Don't underestimate the experiences of others with the outsourcer and/or assume your experience will be different.
18. **Negotiate the contract** using your expert team and using pre-determined target clauses, criteria, and escalating alternative dispute resolution (ADR) options to keep the outsourcing agreement and relationship on track.  
Consider and develop a strategy for at least each of the following contract areas: scope of responsibilities and services; third-party services; project managers; project development standards and acceptance; project timetables and milestones; progress reports and meetings; problem resolution and escalation of differences; acquisition of systems and facilities; interim acceptance testing; final acceptance testing; service warranty; proprietary rights cross indemnity; documentation; training; fees; change orders; personnel; company's proprietary rights; exceptions; physical security and backup; customer access and copying rights; termination; general provisions including taxes, insurance, most favored provisions; force majeure, severability, right to offset, transfer of software licenses; ownership of developed software; etc.; and specific concrete definitions and scenarios for those things with multiple interpretations.
19. **Monitor, manage, modify, and steer the outsourcer and the contract as required over time.** Give three-month report cards to management of the outsourcer. Update and change the contract over time to continue to assure that your needs and the, hopefully, mutual needs of the outsourcer continue to be met. This critical step is worth a whole book in itself.
20. **Be Lucky:** I learned a long time ago from a speech given by Ben Rosen, the legendary high-tech venture capitalist who invested almost first in Apple and in Compaq, and made a fortune, that you must "be lucky" in these kinds of long term relationships in uncertain times. Accordingly, after doing everything that is indicated in this article, I wish you "the best of luck!"

## Criteria for Evaluating Outsourcers

While it is beyond the scope of this article to identify a detailed checklist for evaluating outsourcers, their alternative solutions, and their contracts, I believe the following criteria can be the basis for you developing your own framework for evaluating and selecting outsourcers/outsourcing companies (including some typical questions):

1. **Commitment to Outsourcing:** outsourcing is unique and in many ways requires expertise above and beyond typical system integration services. It requires specific methods and experience.

- How long has the company been in the outsourcing business?
  - How is their company organized in terms of staffing, commitment to specific customers and industries, dedicated to solving specific problems and needs? What percent of its revenue (and profits) comes from outsourcing?
2. **A Flexible and Proven Methodology/Function:** due to the short time frame that will be available once the outsourcer takes over your IT business, there will be little time to find your way through the quicksand of technical and management issues. A flexible and proven methodology will provide your outsourcer the necessary base and the tools to create an environment that will meet your specific needs.
- Do you/they have a standard methodology? Is it fully documented? To what extent is it used?
  - Has it been used successfully in the past? Where has it proved unsuccessful? Why?
3. **A Pathway and Access to Talent:** Executive management, project management, programming and testing talent is key to any solution. The ability to bring in expertise (or at least a number of smart bodies during critical periods) will be crucial. This is especially true if you may need off-shore designers, programmers, and testers who are usually less expensive and more familiar with older technologies you may have (e.g., it is estimated the correcting millennium problems in the U.S. will cost \$1.00 - \$1.65 per line of code - but perhaps up to only half that amount in India, Ireland, and the Caribbean).
- How big is the outsourcer staff in terms of: consulting staff? Analysis staff? Design staff? Programming staff? Testing staff? Documentation staff? Implementation staff? Help desk? Knowledge in terms of mainframes, customer server, telecommunications, etc.?
  - Does the outsourcer have a relationship with off shore or domestic programming "factories"?
  - How does the outsourcer accomplish training and integration of staff?
4. **Industry Knowledge and Superiority (Intellectual Capital):** It may be critical that the outsourcer has special industry knowledge especially in regulated industries or those undergoing severe legislative changes. For other industries this may be less important. As your staff begins to become the outsourcer staff, and as you begin to lose your good industry people over time (as well as technical people) you will likely need to rely on the outsourcers knowledge of your industry more and more.
- How deep and wide is the industry knowledge and superiority of your outsourcer in terms of your current and future industry needs?
  - What connections, positions do they hold with key industry organizations?
5. **International Scope and Presence:** Your company should be looking for one outsourcer to handle current and future needs and coordinate correct problems on a global basis. This will be particularly necessary for testing interfaces on different platforms, in different languages, and between different systems world-wide.
- What experience and resources does the outsourcer have outside of the United States?
  - Where are the outsourcers' key offices located?
  - What treaties is it a member to and does it abide by?
6. **Organizational and Financial Staying Power:** Outsourcing your information processing needs, which could range from just some of your resources, all the way to your entire information technology function, is a risky business and requires a marriage between the parties. Your company must perform due diligence in selecting an outsourcer and in being sure that this outsourcer is right for you and will continue to survive. Many of the giant outsourcers have a record of lawsuits by several of their "customers" for failure to deliver working systems, systems in a timely manner, improved turnaround time, reliable databases, etc.
- A thorough examination of financial statements and financials (including 10-K's, 10-Q's, stock offerings and reports, database, and internet searches), corporate organization and strategic plans, and corporate culture and history is critical. The outsourcing business is a very tough business for the outsourcer. Make sure you know what you are getting into!
7. **Customer/Referral Base:** Because it's always easier to sell additional services to current customers

then bring on new ones, an outsourcer with a strong and diverse customer base is likely to have the inside track on new opportunities at present customers and thus also have improved "staying power" (discussed in a previous point).

Checking the references of current customers is perhaps the most serious criteria for judging outsourcers. While nobody likes to admit they selected the wrong outsourcing partner, there are ways to establish rapport quickly with your interviewee, and get that person to talk about "things" that they would do differently if they had to make the outsourcing decision, draft the outsourcing contract, or manage the outsourcing relationship differently in the future. Get this critical information, and learn from others' mistakes and adjust your thinking as necessary.

8. **Strategic Alliances:** Successful outsourcers have most likely engaged in strategic alliance and relationships with other parties (i.e., tools set providers, methodology companies/consultants, testing houses, disaster recovery companies, special "leading edge" integrators, etc.). Such alliances provide ready access to resources and tools that maybe otherwise scarce. Wouldn't you like these resources to be available to you when needed?:
  - o What relationships and strategic alliances does the outsourcer have?
  - o To what extent have these relationships and/or tools been integrated and used by the outsourcer before?
  - o To what extent might they be needed and integrated into your needs?
9. **Strong Commitment and Budget for Research and Development:** Not only will your company change over time, but the information technology industry will change. Your outsourcing needs a strong commitment and budget for R&D so that it may take advantage of new technologies as they become available and quickly determine which might be appropriate for your needs (e.g. RAID systems, ATM, HIPPI switches, Fiber Optic vs. Satellite Communications, new network architectures, new I-CASE tools [Integrated-Computer Assigned Software Engineering], etc.)
10. **Quality of the Contract:** The contract must have the appropriate clauses and incentives to continue to make the outsourcer perform and to continue to make you perform. Any clause that appears one-sided in favor of the outsourcer, should also be written with your name put in place of the outsourcer. See if that makes for a fair relationship and would be acceptable to the outsourcer. In addition, if the outsourcer gives you a contract that is "too good to be true" then it probably is! Just think about the longevity and future problems the outsourcer will have if it offers the same great advantages to hundreds of other customers. Are they good business people? Will they stay in business for long?
11. **Willingness to Negotiate:** The actual process of negotiating the contract and reaching a consensus on difficult alternatives, is a periscope into what life will be like with the outsourcer in the future as unanticipated needs come up. Let me reiterate "unanticipated needs" are a fact of life whether it be the Year 2000 bug, an unanticipated merger, or something less impactful. How your outsourcer handles the negotiations regarding its contract, and how willing they are to listen to your story and needs and modify their approach will indicate whether or not your relationship will be successful in the future.
12. **Insurance and Litigation History:** Look at your outsourcer's performance bond history and insurance policies, their criteria for selecting new customers, and their history of litigation (all litigation including wins and losses and settlements). This will tell you a lot about what mistakes the outsourcer has made and whether it has learned (or is still learning) as it continues to make its business successful.

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**Previous  
Page**