

# **The IT Outsourcing Spiral**

*A Model for Successful IT Outsourcing*



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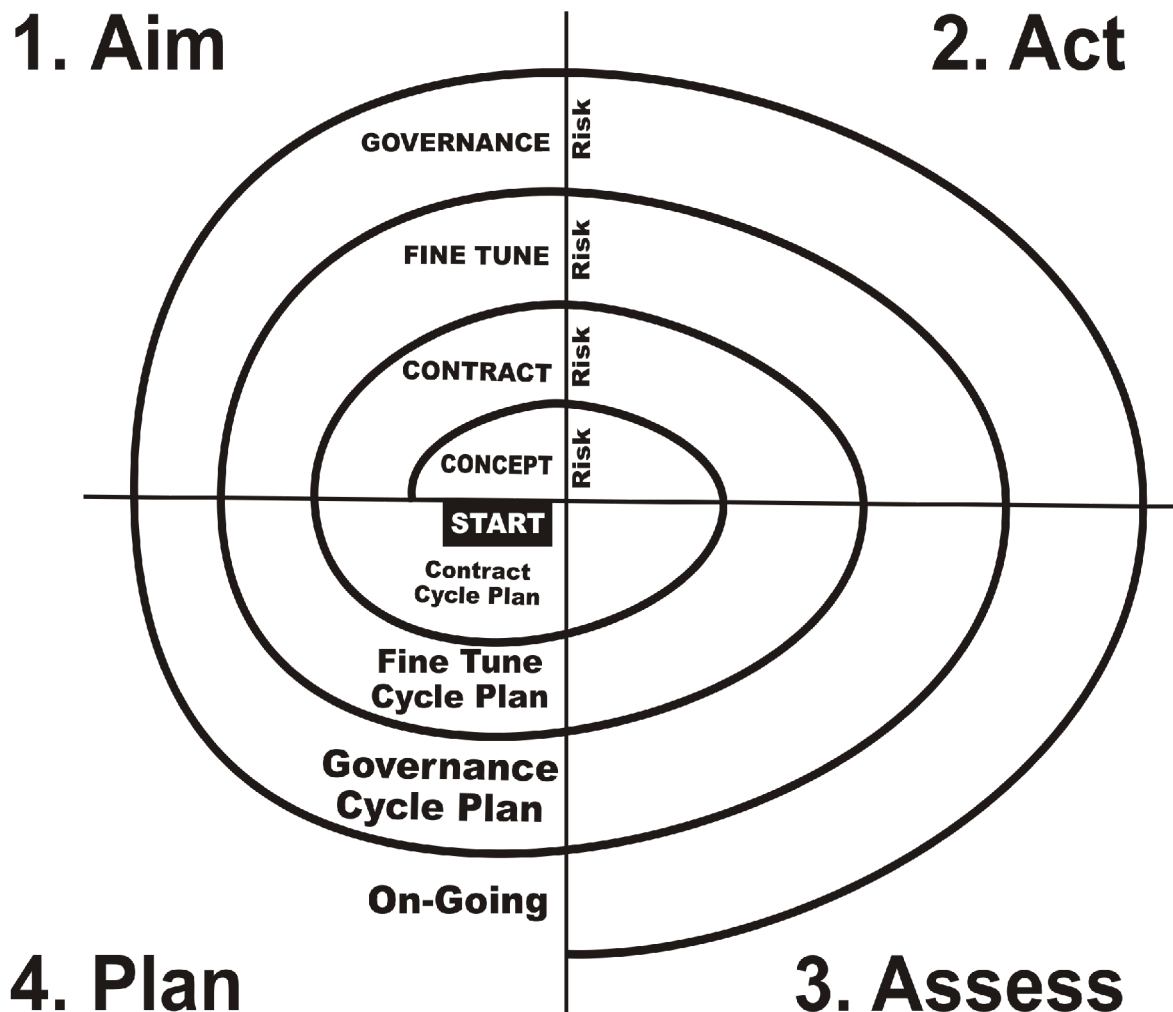
# The IT Outsourcing Spiral

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## Introduction

Some organizations are very happy with IT outsourcing – their vendors delivered everything they expected, and more. Others are not – they haven't gotten what they wanted and the gaps can be painful.

Nothing will guarantee IT outsourcing success. But in the 15+ years that IT outsourcing has been widely practiced, we have learned what to seek and what to avoid. That understanding is captured in *The Outsourcing Spiral*. It's an approach that warrants serious consideration by any organization with outsourcing questions or concerns.



Adoped from Boehm's Spiral Model

## IT Outsourcing Cycles

1. **Concept** – Develop and test the outsourcing concept. What must the vendor provide in order to justify outsourcing. What's the vendor's “unobtainium”? End state: Answer to the question of whether outsourcing is potentially attractive.
2. **Contract** – Vendors respond to an RFP that focuses on the concept that has been identified in the first cycle. The resulting contract focuses attention on the concept, and provides appropriate mechanisms to drive towards success while managing risks. End state: A signed contract that covers all important aspects of the relationship.
3. **Fine Tune** – The transition is an obvious hurdle which must be followed by establishing the right ongoing measurements. And there needs to be a thorough contract review within 6 to 12 months. End state: Measurements in place and operating. Contract adjusted to reflect actual experience.
4. **Governance** – Successful outsourcing relationships require active and continuous management by the customer. Measurements must be actively reviewed. Connections between vendor and customer must span the entire chain of command. End state: Stable, managed, productive relationship.

## **The Opportunity**

IT outsourcing has become an opportunity that responsible managers can no longer ignore. Under the right conditions, outsourcing can reduce costs, improve service, and provide continuing access to state-of-the-art technology. The outsourcing vendor takes over responsibility for a bundle of IT services, which could include anything from desktop support, to network support, to applications maintenance, to applications development.

The vendor can bring to the table specialized and current knowledge, a pool of trained and motivated people, economies of scale, and sourcing in economically attractive locations. Reported benefits from the right outsourcing arrangements have seen cost reductions of 20% to 50%, dramatic improvements in service levels, significant reduction in compliance costs, and improved business benefits through use of best practices and optimal technology.

## **The Challenge**

Success is possible with IT outsourcing. But success is not guaranteed – there have been some spectacular outsourcing failures. Initial costs may be attractive, but those costs can rise, often dramatically. Promised and contracted service levels can be ideal, but actual delivery may fall far short of the initial promises. Or the business can change enough that the ideal day-one arrangement becomes a straight-jacket frustrating all efforts to effectively respond to changing business conditions.

We have designed a process to identify real outsourcing opportunities and then translate those opportunities into successful, properly governed outsourcing arrangements. Our process doesn't guarantee that an outsourcing contract will be signed – outsourcing isn't right for all conditions and all organizations. Clients should follow a spiral approach, driving each cycle by an assessment of risk and an understanding of the targeted end-state.

## **Win-Win**

Too many organizations believe they will be able to triumph over their outsourcing vendors. It's a belief that has little grounding in reality. Outsourcing vendors specialize in writing contracts that will maintain the vendor's profit margin under almost all conditions. It's rare to find outsourcing contracts where the client organization is the clear winner. And such contracts can prove singularly unrewarding for the client organization.

The best people from the vendor's organization will run from any contract that doesn't give them the opportunity to be winners. If the contract is a losing proposition for the vendor, only the weakest people from the vendor's organization will accept work under the contract. An “A” team may come in on day-one, but soon discovers there is no way they will meet their targets. They're soon replaced by a “C” team, with a predictably unhappy client organization.

In order for outsourcing to be successful, the vendor must be able to add something that would be very difficult for the client to obtain on its own. It's this “unobtainium” from the vendor that makes outsourcing a success. The client needs to be vitally concerned about “unobtainium”. It's what will make or break the arrangement. Step one for the client is to identify the “unobtainium” necessary for the contract to make sense for them and for any outsourcing vendor they may select.

## Spiral Model

It's long been recognized that there is an Uncertainty Principle<sup>ii</sup> for systems – installing a system will change the requirements for that system. This Uncertainty Principle is what makes a waterfall approach to development so difficult, and lies at the heart of why the new Agile approach has such a great appeal. In response to the problems with waterfall development, Barry Boehm developed a Spiral Model<sup>iii</sup>, initially for development, that has been subsequently applied to acquisition.

Boehm's Spiral Model has been mandated for all US DoD systems development and acquisition projects. In his words,

“The spiral development model is a *risk driven process model* generator that is used to guide ... engineering of software-intensive systems. It has two distinguishing features. One is a *cyclic* approach. ... The other is a set of *anchor point milestones* for ensuring ... feasible and ... satisfactory ... solutions.”

The first outsourcing spiral identifies win-win conditions – what “unobtainium” does the vendor need to bring to the table. The second cycle runs through to a signed outsourcing contract. The third takes the process through to the necessary fine tuning 6 to 12 months into the contract. The fourth cycle establishes a continuing governance model. The first cycle may take only a few weeks. The second will require a number of months. The third and fourth cycles can take 12 or more months.

## Failure

Almost all clients recognize that they need to set aside several months in order to properly complete the second (Contract) cycle. Many clients recognize that they will need to fine tune the contract 6 to 12 months out – execute a Fine Tune cycle.

There is much less recognition of the need for the first (Concept) or fourth (Govern) cycle. Failure to identify the win-win conditions (Concept cycle “unobtainium”) leads to frustrated clients – they can't understand why their vendor isn't delivering what they expected. It doesn't really matter that what they expected was/is unrealistic. That's what they heard the vendor's sales team promise.

A failure to follow-through on governance will typically result in the vendor slacking off – the client isn't paying attention, even when the vendor speaks up. One common result is that the initial “A” team is replaced by a “B” team, and eventually by a “C” team. At some point, the client is will become unhappy with the level and quality of service being provided. Outsourcing has become a whirlpool, sucking all benefits beneath the surface.



## The Concept Cycle

### Aim

The process begins because someone believes that IT outsourcing may be a promising opportunity for the organization. This may be nothing more than a due diligence argument where senior management feels that it needs to ask the outsourcing question, but has reached no conclusions. On the other hand, it could arise because senior management has been convinced that outsourcing is the most effective and efficient way to deal with (some of) the opportunities and challenges facing IT.

The first step is to determine objectives, alternatives, and constraints. What are the range of IT activities that should be considered as outsourcing candidates? Is it Application Development; Application Maintenance; Data Centre; End-User Computing; Business Continuity; Disaster Recovery; IT Security; Voice Network; Data Network; ... or what? What range of alternatives should be considered? Could the current people form an insourcing centre that signs a “contract” with the organization? What about new outsourcing management, locally or remotely? What are the constraints, if any, under which this study is to be conducted? Must it be done in secret? Are there core competencies which must not be considered as outsourcing candidates?

### Risks

Outsourcing is always “sensitive” – people's jobs are at risk. The organization needs to think carefully about whether this first cycle should be kept confidential. In practical terms, it will be very difficult to keep a study conducted by local people confidential. There is a clear risk that the wrong information will become the subject of hot local gossip. Unless the organization takes aggressive steps to keep the work confidential, a commitment should be made to open communication with the people who may be impacted by any conclusions reached.

There is a present and a future risk that either opportunities will be overlooked or that unrealistic benefits will be expected from outsourcing. The present risk is that the organization will move towards an incorrect outsourcing contract, given current needs and current market offerings. There's also a risk that a good current outsourcing contract will turn into a bad future outsourcing contract – outsourcing contracts can last a number of years and conditions change.

In all of this, there is a risk that outsourcing vendor hype will be taken as the real benefits that outsourcing can deliver. The reality is that any outsourcing vendor must take profit off the table. If they cannot put compensating “unobtainium” on the table, then it's not going to be a very satisfying deal for the organization. The “unobtainium” could take a number of different forms – ability to meet compliance requirements; economies of scale; lower cost sources of supply; access to a pool of highly skilled professionals; etc. The right “unobtainium” is needed on day one of any outsourcing contract, and the right “unobtainium” needs to be there as the relationship evolves.

### Act

The organization needs to talk to the market. One mechanism, assuming the organization has decided to go public with the study, is to issue an RFI. The organization describes the benefits it is seeking from IT outsourcing. It asks prospective outsourcing vendors whether they can deliver those, or similar, benefits, and whether the vendor has a verifiable track record of delivering such benefits. That can lead to

the kind of information needed to plan the next cycle, but it does assume that the study is being made public.

In the case of confidential studies, most organizations deal through an arms length advisor – often a specialized consultant or lawyer. The advisor probes the market. The advisor scans the current, published outsourcing research. The advisor keeps going out to the market until enough information has been obtained. This action step will take anywhere from a few weeks to a few months. One of the advantages of using a knowledgeable advisor is that he or she will come equipped with a wealth of relevant information. But it's important to recognize that it will take time to determine if the right “unobtainium” can be found, and to verify that vendors are actually delivering that “unobtainium” at an attractive price.

### **Assess**

Does it appear that IT outsourcing will provide attractive net benefits to the organization? Is the organization justified in going through all the time, trouble, and expense of trying to sign an IT outsourcing contract? This requires a careful balancing of possible benefits against potential risks. As a natural part of answering these basic outsourcing questions, the organization will also identify issues that need to be addressed in subsequent work.

### **Plan**

To proceed, the organization will have to assign resources to carry out the next cycle. This Contract cycle can be a very labour intensive effort. It takes time to qualify vendors, to develop a detailed list of requirements and concerns, to verify claims made in vendor proposals, to negotiate an acceptable contract, and to manage communication with the people who may be affected. Resources must be dedicated to this work. The overall plan for the Contract cycle must be developed.

## **The Contract Cycle**

### **Aim**

In order to begin this cycle, the Concept cycle must have concluded there is a reasonable chance that a satisfactory outsourcing contract can be signed. The target for the Contract cycle is to either sign an IT satisfactory outsourcing contract or to conclude that such a contract is not possible, at least not now. The nature of the target contract will significantly determine the complexity of this cycle. If the goal is an almost commodity like IT service offering, this can be a relatively simple cycle. In complex cases, there may be a separate RFI cycle, followed by a master contract cycle, followed by the first actual contract cycle(s).

### **Risks**

The goal is to obtain a contract, at an acceptable cost, that leads to desirable service and financial consequences, today and into the future. The risks are several ... It might take too long or cost too much to obtain an acceptable contract. Or the contract may lead to undesirable service delivery today or in the future. Or it may lead to undesirable financial consequences today or in the future. There are also important risks connected with the (mis-)information that can spread through the jungle grapevine (office gossip).

Identifying potential risks is a key responsibility of advisors – legal, technical and management. Client organizations should recognize that outsourcing vendors have a full range of experienced advisors to help them minimize risk (and maximize gain). That's certainly true with respect to the formal contracting part of this cycle. Establishing and maintaining open communications to the people who may be affected by this contract is also critically important. The key people could “walk” if they don't feel they are being treated properly. It's happened in the past; it will happen in the future. The right communications can significantly reduce the risk.

### **Act**

The required acts are relatively easy to describe. A critical first step is to establish contact with those candidate vendors who should be considered. This could require a very public RFI process, followed by a screening to develop a short-list of the most attractive vendors. At the other extreme, a recognized outsourcing expert might be able to just write down the short-list of vendors to consider, given the concept developed in the previous cycle.

From the short-listed vendors, an offer is desired. The vendors will need to understand the concept, the constraints on how they may respond and what they can propose. For a significant outsourcing contract, a significant amount of information needs to flow out to potential vendors. This could involve multiple meetings, many documents, and several months of work on the part of the organization seeking offers and the vendors developing those offers.

Depending on the nature of the offers submitted, there may be a need for a meaningful effort to verify or test the offers. Are the vendor claims supported by evidence from their customers? Does the vendor really have the “bench” capabilities claimed in their offer? Is the vendor's track record really as successful as they claim? How many core competencies does each vendor have to support and discharge the work they are proposing to undertake?

A very short list of zero, one, or maybe two of the most attractive vendors (offers) must be identified. It is with these vendors that draft contracts will be developed. It is possible to simultaneously negotiate with two prospective vendors, but the process will be “delicate” and may seriously distort the relationship that can be developed with the vendor that is ultimately selected.

Actual contract negotiation will take time. Both sides in the negotiation, often through their council, will seek to maximize gain while minimizing risk. It can be important to have an intermediary present who is free to propose alternatives that balance the concerns of the two parties. The ideal outcome would be a contract that never needs to be consulted, but would be dead-on if it ever did need to be referenced. The contract needs to express in clear terms the shared understanding of what is offered and what is required for success.

### **Assess**

The assessment step is really the process of determining what will be required to translate the contract into successful, on-going practice. This could be relatively simple if it only involves a new application or service with new people. If it requires that people or assets move from one organization to another, and possibly from one location to another, then the translation process could take a considerable length of time and demand a considerable amount of attention. An important part of that assessment will be to identify the risks, and to identify the steps that can or should be taken to mitigate those risks.

### **Plan**

The next cycle is called Fine Tune, but a large part of the effort will be devoted to the work of translating the contract (the concept) into successful, on-going practice. It's always important to plan on the effort required to fine tune what is installed. And it's important to recognize this need to fine tune in the contract. In a simple case, installation/translation may take only a few months, and can be followed by fine tuning in 6 to 8 months. In more complex cases, installation may proceed in waves lasting over several years. The fine tuning in such a more complex case could also proceed in waves, and time and effort should be reserved to fine tune all waves.

## **The Fine Tune Cycle**

### **Aim**

The goal is to install the service (translate the contract into practice), and to Fine Tune the service in the light of the organization's actual experience with the service. For a simple service, this can be relatively simple. For a complex service, this could extend over multiple waves and last several years.

### **Risks**

There's a risk that not enough time and effort will be spend fine tuning the service to meet the organization's actual and on-going needs. A new service can look great on paper, but the practical reality may require real changes. The contract needs to recognize this, and the time and effort required needs to be put aside. There is also a risk to too much tinkering with the new service. It's important for a new service to bed down in the organization. Constant tinkering can frustrate this process. The right balance must be struck.

And throughout the transition, people must be dealt with in an open and supportive way. There is always a risk that the best people will just walk away if they don't feel that their interests and concerns are being appropriately addressed. In part, this needs open and regular communications. In part, this requires that the transition be structured to recognize people's concerns. Paying attention to these concerns can pay large dividends. The outsourcer should be sensitive to these risks, but the client also has a responsibility in this area.

### **Act**

Most of the “work” in this cycle will be to effect the transition. This could require nothing more than turning on a new service and bedding it within the client organization. It might, on the other hand, require the transfer of people and assets in multiple locations, with both people and things being physically moved, possibly to different countries. In general, it's not a good idea to plan on a transition that takes more than one year. Too much can change outside the outsourcing arrangement if the transition takes too long.

Throughout the transition, both client and outsourcer should be fine tuning the work being done, the measurements that are being made, and the on-going relationships that are used to guide, direct, and control the outsourced service. It's important in this cycle that the changes be documented. At a minimum, it should be possible to compare what was anticipated in the contract with what has been found important in practice. It can also be useful to document changes that are seen as desirable, but which the contract will not support (or tolerate).

### **Assess**

The assessment process needs to step back from day-to-day operating details and examine whether the anticipated benefits are being achieved. The concept identified a potential win-win opportunity. This may have been modified in the contract. But there should have been clear opportunities for both client and outsourcer to win under the arrangement. If it's not happening, this needs to be fixed. Failure to realized expected benefits can give rise to a need for a new cycle that openly examines what would be required to fix the problem.

It may not seem important for the client organization to concern itself with questions about whether the outsourcer is achieving its expected benefits. Appearances, in this case, are deceptive. A “bad” deal for the outsourcer will result in only the weakest people from the outsourcer being willing to accept work on the contract. The best people are used to winning, and they all have career options. They will walk unless given an opportunity that gives them a fair shot at winning. A deal that's bad for the outsourcer will result in only “C” team members being willing to work on the contract. And that's going to be bad for the client.

## **Plan**

Assuming there is no need for an extra corrective cycle, all that remains is to bed an appropriate governance arrangement in the client organization. What happens too often is that planned connections, especially at senior levels, get postponed, ... and eventually are canceled. It's not just meeting once at the beginning of the relationship, but meeting regularly throughout the life of the contract. The Governance cycle needs to last long enough to insure that planned meetings happen as planned, and continue to happen.

## **The Governance Cycle**

### **Aim**

The aim is simple: To have in place and operating a governance process that insures maximum benefit is delivered at an acceptable level of risk. The previous cycle will have bedded down the service and tuned it to fit current needs. It should be working well, at the end of the Fine Tune cycle. Keeping it working well requires constant attention. Appropriate processes must be in place to deliver that constant attention.

### **Risks**

One of the more important risks is that the organization will not want to take the time to properly manage the outsourcing contract. As a rule of thumb, an organization will need to spend 5% of their outsourcing dollars managing the outsourcing contract. Failure to do so will lead to a need to spend 10% of those outsourcing dollars to correct the inevitable problems.

There is a natural tendency, once the contract has been signed and the service turned on, to heave a sigh of relief, in effect saying “Great, now someone else is looking after our IT problems!” Alas, it doesn't quite work that way. There's a considerable amount of truth in the observation that clients get the outsourcer they demand. Inevitably, attention goes to those clients who ask/demand attention.

### **Act**

The challenge is to make sure that the right connections are made linking all levels of the client and outsourcing organizations. And it needs to go beyond holding initial kick-off meetings. Regular meeting with meaningful agendas need to happen at all levels. The senior people may only meet once every quarter. At operational levels, it may be useful to have a quick standing-room-only daily meeting, just to make sure nothing falls between the cracks. This cycle needs to run at least 12 months and may need to run 24 months – that would increase the chances that annual meetings happen as planned.

### **Assess**

At some point, the entire process will repeat. A new concept will be identified. That will lead to a new contract, new fine tuning, and new governance. The assessment part of this cycle should identify the point at which the whole process should repeat.

## **Exception I**

One important exception to this approach is when there already is an outsourcing contract in place, but it's not meeting the needs of the client organization. There are two possible extremes under that circumstance. The “easy” case is where a bit more management attention will tune the contract enough that it can be made to meet the needs, at an acceptable cost. Often, a benchmark study will result in a 5% to 10% price reduction. And sometimes that's all it takes to turn around a troubled outsourcing contract.

The other extreme is where the contract has to be torn up and replaced by a new contract in order to meet the organization's needs, at acceptable costs. It's almost certain that both sides of an outsourcing contract will have violated some of the necessary terms and conditions in the contract. With effort, the client organization will be able to document the vendor's failure to meet all of those necessary terms and conditions. Clear reasons can be established to justify tearing up the contract.

But something will be required to replace the flawed outsourcing contract. In effect, one or more alternative concepts are required. With a careful enough examination of alternative concepts, the organization may decide that the original contract really isn't so bad. Or they may discover a new concept that seems to be viable and appears to deliver everything the organization needs, at an attractive price.

What should happen in the case of a troubled outsourcing contract is that the concept cycle is extended. That is used to determine attractive, or acceptable, alternative paths forward. The subsequent cycles are all present, but need to be adjusted to fit the new circumstances.

## **Exception II**

Another important exception is when outsourcing is considered with a view to effecting a major change in the structure, composition, or orientation of the IT department. The concept is simple – the outsourcer has the flexibility and the resources to drive organizational change in ways that would be very difficult for the client. This approach has been successfully used by a number of organizations in the private as well as the public sector.

If that is really the driving concept, then it would be natural to plan an end to the outsourcing contract after the desired change has been achieved. Post-change, the outsourcer is not expected to provide any advantages that would not also be available to the client. Post-change, all that would happen is that the outsourcer would add its profit margin to the cost of the services covered by the contract. Under these conditions, it's more than reasonable to plan on an exit.

The contract is developed to cover a limited period of time, with clear transition back planned from inception. The Fine Tune cycle becomes an exercise in tuning the structure, composition, or orientation of the IT department. And the Governance cycle becomes an exiting exercise under which the outsourcer hands back the IT department, now transformed in ways desired by the client.

## **Other Exceptions**

There are an almost endless number of outsourcing “deal” variations. Sometimes outsourcing is undertaken to achieve the immediate financial relief that comes from asset transfer. Sometimes outsourcing is a real partnership opportunity where both parties actively seek new business for their new partnership. These and other variations can be approached using the IT Outsourcing Spiral.

- i I first heard the term “unobtainium” from a star salesman. He used it to describe what a salesman needs to put on the table in order to close the sale. That was more than a decade ago. It applies in any sales situation. It applies with particular force in outsourcing. The outsourcing vendor must add something that the client would find very difficult to obtain on its own, else all that will happen is the price will have to go up to cover the outsourcer's profit margin.
- ii This is a take-off on Heisenberg's Uncertainty Principle from Physics. Heisenberg recognized that determining the position of an atomic particle would change the particle's momentum, and determining its momentum would change its position. The act of measurement changed that which was being measured. With systems, the installation of a system changes the requirements for the system. My first published reference to the principle was in “Modest Software Tools”, *Information Strategy*, Volume 14, Issue #3, Spring, 1998.
- iii Barry Boehm's Spiral Model was first published in "A Spiral Model of Software Development and Enhancement", *ACM SIGSOFT Software Engineering Notes*, August 1986. The 2000 Software Engineering Institute workshop on the Spiral Model [Spiral Development: Experience, Principles, and Refinements (Spiral Development Workshop February 9, 2000) - CMU/SEI-2000-SR-008] is an excellent reference that brings the model up to date.