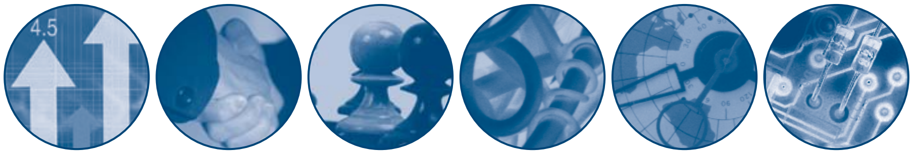

Sourcing and Vendor Relationships
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Update

Outsourcing Insights:

Managing the Relationship

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This three-part series of *Executive Updates* examines data from a recent Cutter Consortium survey of 140 organizations that have made outsourcing a part of their IT strategy.

In Part I (Vol. 5, No. 17), we observed that organizations are driven to outsource primarily for cost reduction, more so than for schedule or quality improvement. As one might expect, respondents reported that cost reductions were achieved to a greater degree. Since performance was contractually aligned toward this goal, one would anticipate results in this direction. Yet respondents still reported a fairly high level of dissatisfaction with the outcomes, as indicated by the majority (nearly 60%) seeking to switch vendors or bring work back inhouse.

We were surprised by this outcome. Given that two out of three respondents are seeking other alternatives to the outsourcing "marriage," we wanted to learn more about how client organizations choose their partners. To do so, we took a look at source selection criteria and the role of productivity metrics in evaluating potential partners. In Part I, we observed that 77% of respondents expressed dissatisfaction with their ability to acquire and use productivity measures. Ironically, Part II (Vol. 5, No. 18) reveals that nearly the same percentage describe measures as being important for evaluating and selecting suppliers.

Here in Part III, we'll explore what people are doing after a deal is signed. Clearly, many organizations are getting what they asked for but are still unhappy. They can't measure as well as they need to in order to make meaningful changes. But what happens if you switch vendors or bring the work back inhouse and still can't measure effectively? How will you know, aside from a gut feeling, whether things have improved?

AFTER THE HONEYMOON

After the contract is signed, both parties in an outsourcing arrangement enter a transition-in phase, where the outsourcer assumes responsibility for the various aspects of IT. In the case of a staff transition from the client to an outsourcing provider, a certain percentage of the client organization is retained for governance and oversight.

Figure 1 shows how respondents answered the question "What percentage of IT staff do you think should be retained after a transition to an outsourcing arrangement?"

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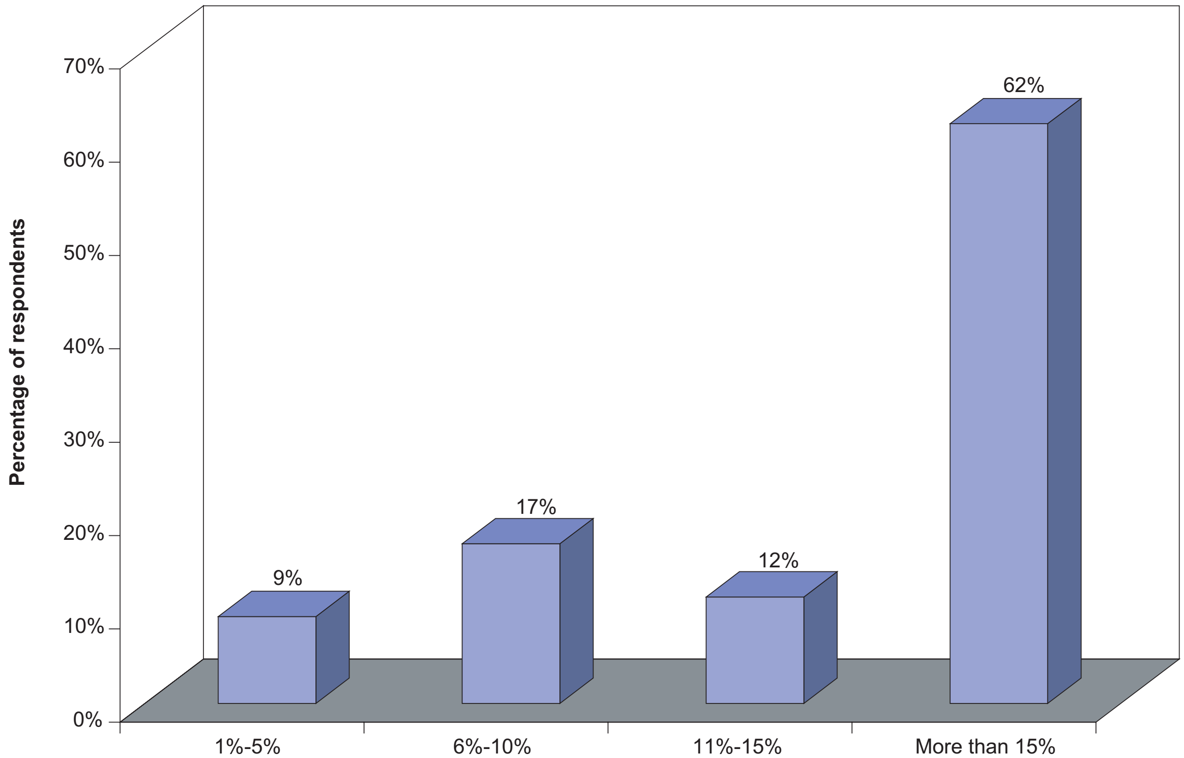

Figure 1 — What percentage of IT staff do you think should be retained after transition to an outsourcing arrangement?

A significant majority, 62% of respondents, believe that more than 15% of staff should be retained. In many large-scale staff-transition outsourcing arrangements, it's not uncommon for 1,000 or more IT staff to be involved as "in-scope." These staff members leave the employment of the client organization and transition to become the staff of the outsource provider.

As stated, our results indicate that most organizations believe that 15 out of every 100 IT staff members involved in the outsourcing arrangement should not transition to the supplier, but should stay on the client side. Oftentimes, this percentage represents business analysts with domain knowledge that is less about IT and more about the client's business. Retained staff are also responsible for governance and oversight: managing the relationship with the outsourcer and handling contractual issues across the client-supplier relationship boundary. This is no small task. In outsourcing's early years, it's fair to say that clients transitioned too many of their employees to the supplier, leaving the client shorthanded when it came to managing the relationship. Today, it seems that client organizations are trying to avoid those mistakes.

Once the transition-in phase is complete, the relationship enters the operations phase, which encompasses all the day-to-day operations specified in the statements of work. Contract governance and management procedures are in place, and reporting structures are in effect.

During this time, the outsourcer should be implementing the tools, methods, people, and processes whose goal is to bring about the productivity improvements that were promised to the client. Metrics data collection and reporting mechanisms should be in full swing. The objective of this phase of the metrics program is to populate the statistics to gauge whether service levels and productivity goals are being met. These metrics are usually gathered for the purposes of monitoring productivity on every anniversary of the contract.

MAINTAINING TRUST

The following survey question evoked some interesting responses: "After a contract is rewarded, we measure in the following manner to ensure that service levels are being met" — responses to choose from included the following:

- We retain the responsibility for metrics assessment given its importance.
- We jointly collect and analyze metrics data.
- We don't measure; we rely mostly on anecdotal evidence.
- The supplier measures, assesses, and reports to us.

As illustrated in Figure 2, the majority of respondents (44%) say they share the responsibility of collecting and analyzing metrics data with the supplier. An additional 19% state that they retain responsibility for metrics assessment given its importance. Altogether, this amounts to nearly two-thirds of respondents having an active role in measuring the results of their outsourcing relationship. In my opinion, this is crucial, since typically it's the client that is investing large sums of money in an outsourcing relationship to achieve the cost, schedule, and quality improvements that suppliers often promise.

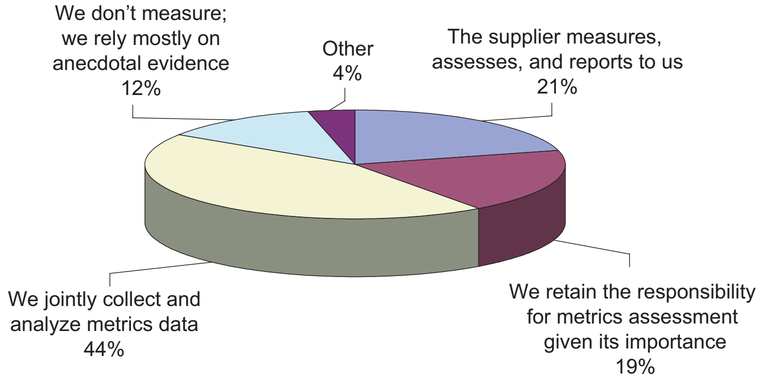

Figure 2 — After a contract is awarded, we measure in the following manner to ensure that service levels are being met:

What is shocking, however, is the fact that more than one-fifth of respondents cede responsibility for measuring supplier performance — to the supplier! In addition, 12% don't measure at all; rather, they rely on anecdotal evidence when it comes to service levels. (Anecdotal evidence to evaluate performance against a contract?!)

Allowing an outsource supplier to self-measure and self-report on its own performance can potentially create some serious problems. If results are poor, the supplier would likely try to hide this fact, especially given financial incentives and penalties that are often tied to productivity. This represents a conflict of interest.

And if the results are positive, it effectively invites the supplier to write its own bonus checks, which could also be interpreted as a conflict of interest. A client organization that does not have stakeholder participation in performance measurement, either in full or in part, can be inviting relationship conflict. Studies on IT-related litigation reveal that the typical IT organization may have as many as 50 active cases on their hands [1]. Those who either don't measure at all or allow the supplier to self-measure (not unlike the proverbial fox guarding the henhouse) are more likely the ones heading to court if the relationship falls apart. As the saying goes, without metrics, you're just someone with a different opinion — and opinions don't carry much weight in a court of law.

Without effective command of performance measures, you're also more likely to lose in a performance-related dispute. In the words of Cutter Business Technology Council Fellow Tim Lister, a professional arbitrator in IT disputes:

> Organizations that cannot or do not measure themselves in a fairly systematic way are at a huge disadvantage in litigation. If you are deficient at measurement, and the other side is on top of it, the jig is up. [1]

On the other hand, client organizations that have ownership in effective measurement and oversight are in a better position to quantify value in an outsourcing relationship. They have more access to facts in order to evaluate performance, rather than relying on judgment and opinion. Often, they seek hard answers to questions such as:

- How productive are we on our most critical projects?
- What are the findings across different areas of our business?
- Is IT applications development and maintenance productivity increasing or decreasing, and at what rate?
- Are schedules getting shorter?
- Are effort and costs decreasing?
- Is reliability improving?
- How do we compare to others in the industry?

An organization attempting to elevate its competitiveness and productivity must master not only the mechanics of acquiring measures about performance but also the ways in which management and staff act in response along with the supplier, especially if the results don't match their goals and expectations.

KEEPING YOUR PROMISES

As stated earlier, a client organization typically retains 15% or more of its IT staff for outsourcing oversight and governance. Many of these professionals are involved in business analysis, project requirements, project management, and relationship management with the supplier.

We asked respondents how they evaluate supplier estimates for projects and how they negotiate deadlines, scope, budgets, and staffing for IT projects. Figure 3 shows how respondents responded to the survey question "On application development and maintenance projects, describe how you evaluate supplier estimates." It's a fact that even the best organizations can be poor at project estimation.

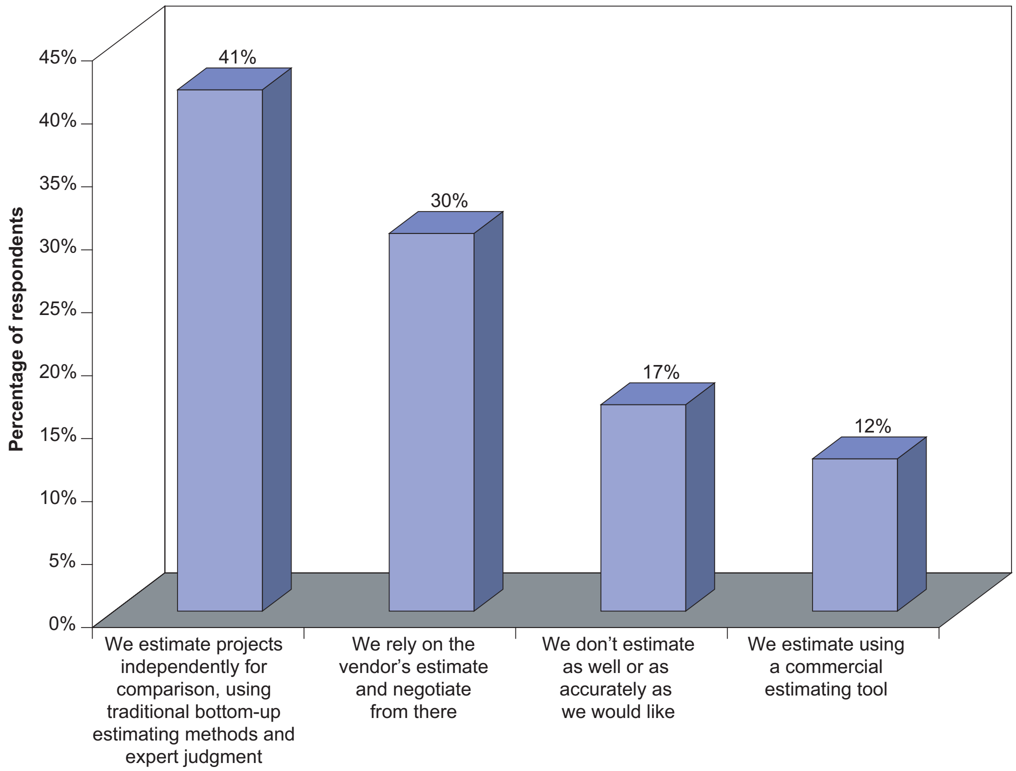

Figure 3 — On application development and maintenance projects, describe how you evaluate supplier estimates.

According to industry research, more than one-third of IT projects are cancelled. More than half overrun their budget by nearly 200%. Less than one-sixth succeed at meeting both their cost and schedule, but they do so by cutting back almost 60% of the original promised functionality — a failure by many accounts when it comes to product delivery.

Our respondents' replies seem to explain these statistics. Slightly more than 40% of the client organizations produce an independent "should cost" estimate for comparison against supplier estimates, which may themselves be inaccurate (sometimes through no fault of their own due to fuzzy requirements).

Moreover, these estimates are, for the most part, bottom-up estimates using manual techniques and gut feel couched as "expert judgment." Only about 12% use automated methods for estimation; this means that 88% do it manually, using level of effort spreadsheets that are laboriously tallied and quickly become obsolete as requirements change. Of these, 47% don't estimate at all, do it poorly, or rely on the vendor's estimate. In our view, it's no surprise that projects are cancelled, huge budget overruns are still the norm, and functionality is often scaled back. We hope that the advance of more sophisticated estimation and measurement techniques can take a bite out of these stats, as effective oversight and relationship management seem to depend upon it.

MAKING THE MARRIAGE SUCCEED

The outsourcing alliances that will succeed in today's economy are those with the best relationship management. While core competencies will differ from organization to organization, creating and maintaining trust and managing expectations must be core competencies for *every* organization.

Reliable measurement and project estimation bring speed, efficiency, and clarity to negotiating a deadline, the project scope within that deadline, or service-level agreements on IT productivity targets. Client organizations should retain responsibility for measurement and oversight to determine whether their suppliers are achieving goals, which also have to be realistic. This survey shows that we still have a ways to go.

The outsourcing alliances that succeed in relationship management will achieve more than their counterparts that are embroiled in conflict. When parties work together effectively, they achieve their goals. These survey findings should help point you in the right direction.

REFERENCE

1. DeMarco, Tom, and Tim Lister. "Both Sides Always Lose: Litigation of Software-Intensive Contracts." *CrossTalk: The Journal of Defense Software Engineering*, February 2000 (www.stsc.hill.af.mil/crosstalk/2000/02/demarco.html).

ABOUT THE AUTHOR

Michael C. Mah is a Senior Consultant with Cutter Consortium's Measurement and Benchmarking Practice and the Sourcing and Vendor Relationships Practice. He is owner/partner at QSM Associates, Inc. Mr. Mah is a recognized expert on practical applications of software metrics, project estimation/control, and IT productivity benchmarking. Over the past 10 years, he has published numerous articles on these and other management topics. His recent work merges concepts in software measurement and benchmarking with negotiation and dispute resolution techniques for IT outsourcing and relationship management.

Mr. Mah's particular interest is in people dynamics, such as the complex interactions between people, groups, divisions, and partnered companies working on the technology revolution at "Internet speed." He is also focused on the latest research and theory on negotiation, including the use of game theory, role playing, and training to increase corporate and personal effectiveness. Mr. Mah is a frequent speaker at major trade conferences, including the Cutter Consortium Summit *series,* Applications of Software Measurement/Software Management*, the* Software Engineering Process Group, Practical Software Quality Techniques*, the* Technology Partners International Outsourcing Conferences, *the* Sourcing Interests Group*, and others. Mr. Mah has a degree in engineering from Tufts University. His training on dispute resolution, mediation, and participatory processes is from the Program on Negotiation at Harvard Law School and the Radcliffe Institute for Advanced Study.*

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