

ALIGNMENT OF A STRATEGIC OUTSOURCING FRAMEWORK TO PRACTITIONER CASE STUDIES

Luke Ho, Informatics and Knowledge Management Group (IKM), Faculty of Computing,
Engineering & Technology (FCET), Staffordshire University, UK
luke.ho@staffs.ac.uk

Anthony Atkins, Informatics and Knowledge Management Group (IKM), Faculty of
Computing, Engineering & Technology (FCET), Staffordshire University, UK
a.s.atkins@staffs.ac.uk

Ian Prince, Informatics and Knowledge Management Group (IKM), Faculty of Computing,
Engineering & Technology (FCET), Staffordshire University, UK
i.prince@btinternet.com

Bernadette Sharp, Informatics and Knowledge Management Group (IKM), Faculty of
Computing, Engineering & Technology (FCET), Staffordshire University, UK
b.sharp@staffs.ac.uk

Abstract

In the UK, 88% of companies utilise some form of outsourcing of their Information Technology (IT) operations. The evidence from the literature indicates that approximately 50% of these outsourcing decisions results in complications and in some cases failure. There is a need for outsourcing management frameworks to provide strategic direction and guidance in the decision-making process. This paper describes the application of one such framework, known as the Holistic Approach {Business, Information, Organisation} (HABIO) framework, to two major commercial organisations indicating financial assessment, monitoring information for performance and quality of service which can be incorporated into service operations and benchmarking criteria.

Keywords: Outsourcing, Framework, Strategic Management, Performance, Benchmarking

1 INTRODUCTION

The recent myriad of outsourcing deals, such as General Electric's \$15bn multi-sourcing deal for system integration services (Thomas, 2006), indicates the rapidly increasing propensity for companies to outsource. In the UK, 88% of companies are using some degree of outsourcing in their IT operations (Cap Gemini Ernst & Young, 2003), primarily in the areas of Infrastructure Management Services (IMS). The literature indicates that as many as 50% of these negotiated deals run into difficulties, which indicates the increasing challenge to achieve successful outsourcing (Cohen and Young, 2005; Deloitte, 2005; Overby, 2006). This paper outlines the application of a strategic outsourcing framework which has been developed to incorporate a tri-perspective approach that addresses the evaluation of multiple issues such as financial costing, quality of service and performance benchmarking. The framework, known as HABIO (Holistic Approach {Business, Information, Organisation}) is based on the well-established Information Systems Strategy Triangle (Pearlson, 2001), presented in Figure 1a, which facilitates its adoption of a holistic approach (Figure 1b). The resultant framework (Ho and Atkins, 2006) is intentionally designed to be flexible because outsourcing decisions are not necessarily homogenous between companies (Dibbern et al., 2004). As illustrated in Figure 1c, the HABIO framework depicts relevant issues as "cards" which can be added or removed from each "deck" (i.e. perspective) as appropriate to the organisation under consideration.

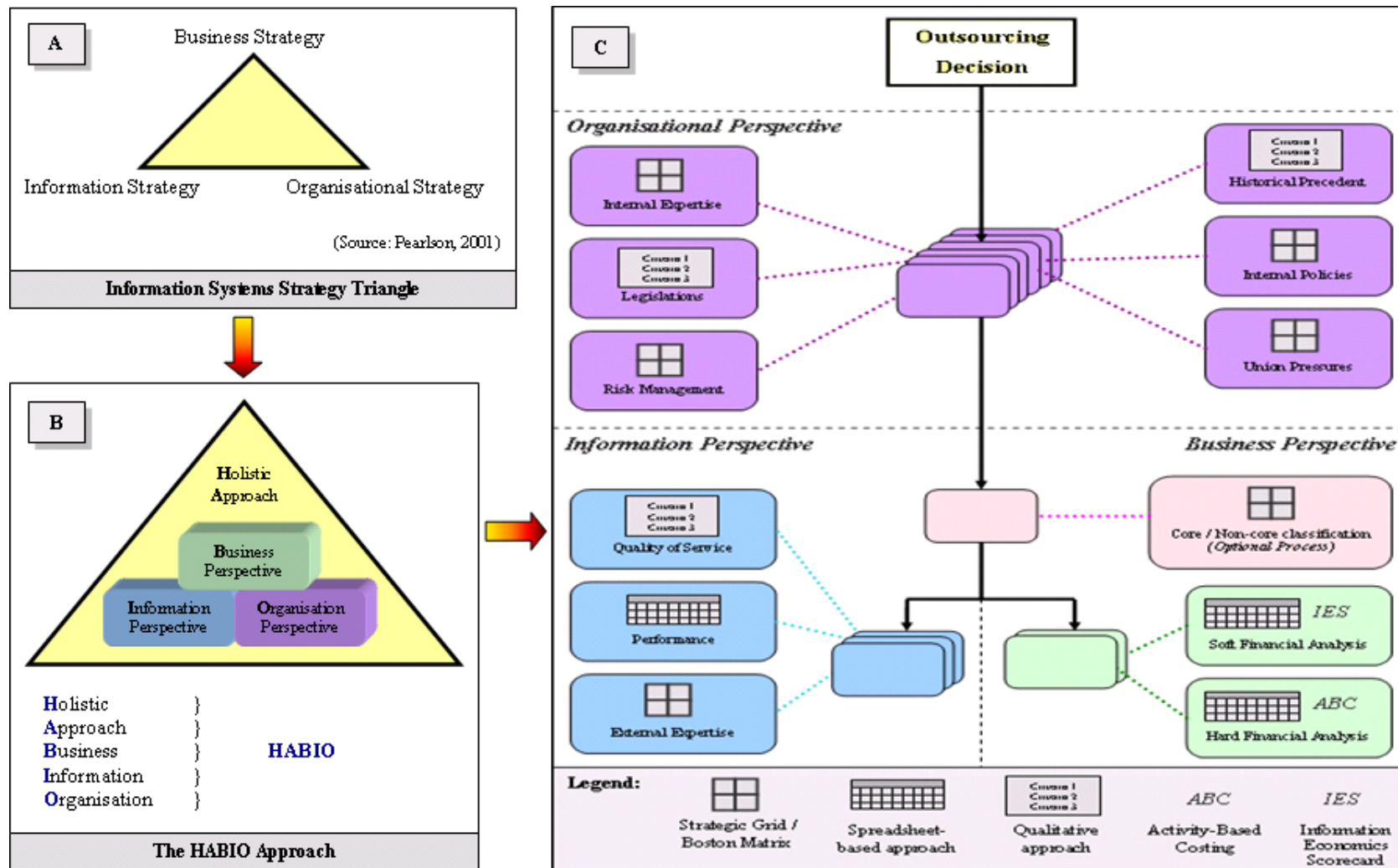


Figure 1. Development of the Holistic Approach {Business, Information, Organisation} (HABIO) Framework

2 CASE STUDY 1: UK RETAIL GROUP

Company A is a leading UK retail company with over 600 stores, dealing with a variety of products with total sales of over £3.5bn. As part of the company strategy, customers are provided with a selection of methods to place an order: through its direct retail website, one of the stores or via telephone to one of its call centres located around the UK. The Customer Services Division (CSD) is the business unit which manages all aspects of non-store contact relating to this, such as handling orders over the telephone and ringing up customers to arrange a delivery time for their items. The CSD is responsible for all of the company's call centres.

However, due to an increase in the volume of business during the months of July to December (which is considered the "peak period"), additional human resources were required to cope with the sharp rise in the number of customer calls. As the demand for such resources were only seasonal, Company A decided to outsource to an external service provider, rather than hiring new personnel whom would otherwise be underutilised during the "lull period" later. It was determined that the outsourcing arrangement would initially begin with a capacity of 25 "seats" (i.e. call centre agents), which will then be incrementally ramped up to 100 "seats" by December period. This would involve a full outsourced service, in which the service provider handles all aspects of the call centre operation, including facilities, equipment, staff, overheads and the necessary infrastructure.

This type of outsourcing was in line with their overall strategic aim of achieving higher cost efficiency throughout the organisation. At the time of evaluation, the cost basis of the company's call centre operations was approximately £30m, and through outsourcing, it sought to achieve cost savings of £2-3m in the long term. During the course of the evaluation, 4 service providers were reviewed, of which 1 was later eliminated following an initial appraisal based on client base and industry experience. The evaluation was conducted over a 3 month period which involved several management level personnel including the Strategic Development Manager who coordinated the overall decision-making process.

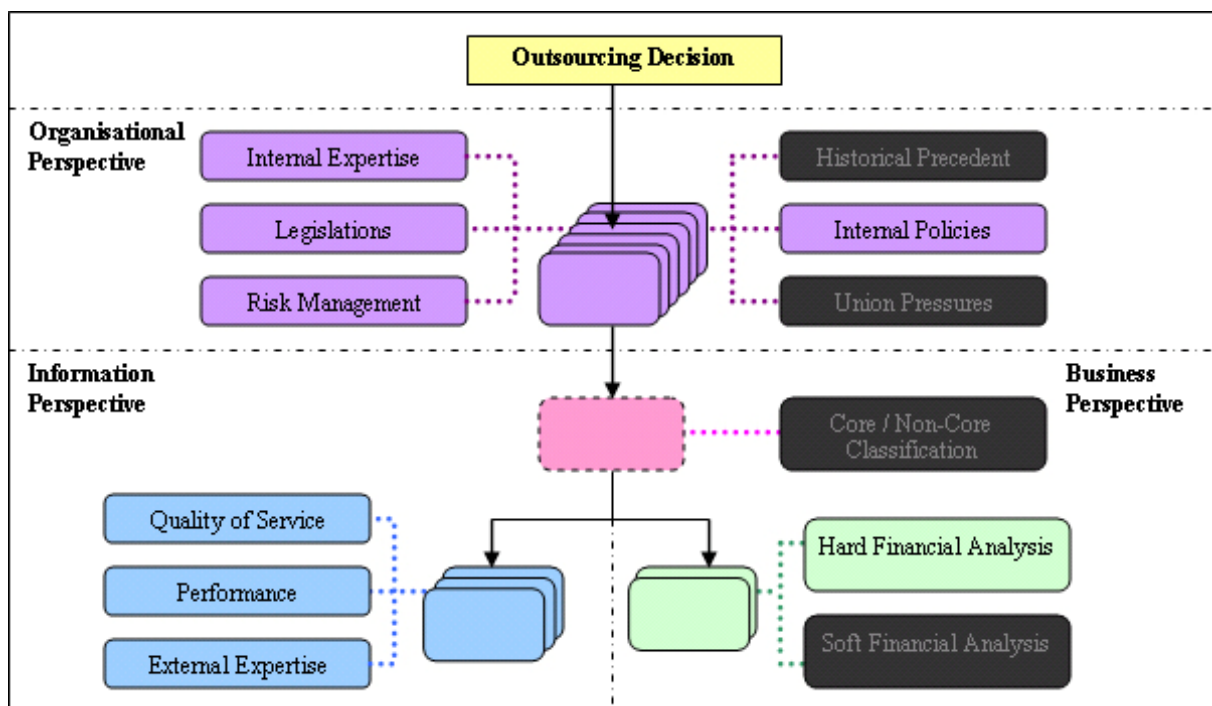


Figure 2. Mapping HABIO Framework to Company A's outsourcing decision

2.1 Organisational Perspective

- Internal Expertise

Although there was no job loss or reassignment, the company sought to ensure appropriate knowledge transfer by utilising its internal staff to train the service provider staff, thereby maintaining a certain degree of expertise within the workflow. This involved committing 10 days to train the service provider's training managers who would then train the remaining call centre agents. In order to ensure a training standard similar to its own, the company incorporated a contract clause which stated that the training managers and agents must gain accreditation acceptable to its CSD before commencement.

- Legislations

The company was primarily concerned about the impact and implications from the UK Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE), and data protection and privacy laws such as the UK Data Protection Act 1998 (DPA). As such, a contract clause was included which indemnified the company from any costs or claims arising from staff transfers relating to TUPE, while potential service providers were required to provide a detailed security response (e.g. processes, policies and procedures) which was verified by extensive on-site audits.

- Internal Policies

As outsourcing was already determined by senior management as a component of their strategic cost-efficiency drive, the decision was a top-down mandate. Hence, the focus was not whether to outsource, but rather which service provider would best enable the company to achieve its aim. Furthermore, as the scope of the outsourcing was already constrained to the call centre, there was no need to identify which function or activity to outsource.

- Risk Management

The company had reservations towards the use of offshore outsourcing (which many have utilised due to potentially higher cost savings resultant from labour cost arbitrage) due to the risk of negative publicity and loss of customer goodwill. It was also concerned about the possibility of being contractually bound into an under-performing service provision arrangement. Hence, the company specifically stated the need for a trial period (e.g. 6 months non-obligation pilot for a 24 months contract) and detailed exit clauses for various scenarios (e.g. switching service providers).

2.2 Information Perspective

- Quality of Service

Service providers were pre-assessed by their adherence to the relevant British Standards (BS) and ISO standards, as conformity to such standards provides a degree of assurance about the service provider's products and services in terms of quality and reliability, which makes it a preferred choice in vendor selection. One measure of QoS commonly utilised in call centre operations is attrition rate, i.e. the rate of labour pool shrinkage. This is perceived to be an indirect reflection of staff performance (hence service provider performance) as a high attrition rate (i.e. staff turnover) indicates low staff satisfaction and morale. Furthermore, a high attrition rate translates into a high staff refresh rate, which results in a dwindling number of experienced staff and hence poor knowledge retention. Amongst the service providers which bid, attrition rates varied between 1-24% (significantly lower than that of offshore offerings which are in the 30-50% region).

- Performance

Service provision would be measured by a set of performance metrics similar to those utilised internally, which were focused mainly on call handling time, agent utilisation and offer success rates - examples of which are shown as follows:

- 80% of customer calls to be answered within 20 seconds.
- Average customer “talk time” of 225 seconds (including 3% clerical time). This “talk time” is increased to 250 seconds from week commencing <date> until week commencing <date> inclusive.
- Agent utilisation of 91%. For avoidance of doubt, this includes contracted working time only (excluding paid and unpaid breaks, training sessions and individual coaching).
- Between 16-21% of customers placing an order to accept the offer of opening a Store Card. This range is increased to between 18-22% from week commencing <date> until week commencing <date> inclusive.
- Between 14-18% of customers placing an order to accept the offer of purchasing an extended product warranty (breakdown cover). This range is increased to between 16-20% from week commencing <date> until week commencing <date> inclusive.

- External Expertise

In this context, external expertise refers to the availability of labour during the company’s peak period between the months of July and December. While casual staff could be recruited for the months of July to September (i.e. school holiday period) to meet demands, there was a gap during the remaining months which needed to be addressed by other means. The company hence explored a number of solutions, including retraining staff from other departments to serve as call centre agents, increasing overtime pay to attract existing agents to work longer hours and outsourcing to acquire the required manpower. Outsourcing was perceived to be the best solution as it allowed for the call centre operation to be scaled up as required (i.e. ramping up to meet staffing demands) and was most in line with its strategic aim of achieving higher cost efficiency.

2.3 Business Perspective

- Hard Financial Analysis

The company was primarily concerned with tangibles (e.g. physical facilities and equipment) which it calculated using traditional costing methods such as Activity-Based Costing (ABC). This involved the determination of cost per seat which constituted the cost comparison mechanism. Cost per seat, in this instance, was determined by dividing all the costs attributable to the call centre operations and infrastructure (fixed, variable and total) by the total number of seats (i.e. number of call centre agents). In the course of determining this, the company noted the importance of including only the relevant aspects in order to establish realistic figures (e.g. outsourcing does not free up any existing floor space, hence this component was not included in the calculation). In terms of financial payment, the company elicited to implement a reward-penalty approach, which involves compensation (by means of service credits) for failure to achieve agreed service levels and bonus incentives for exceptional performance.

3 CASE STUDY 2: INTERNATIONAL BANKING INSTITUTION

Company B is a leading international banking institution with operations in over 70 countries. In order to address the needs of its wide customer base, the company offers a broad range of banking services. Private clients are provided with an all-round service (which includes account-keeping, asset management and securities investment advisory) while corporate clients are provided with the full

assortment of services of an international corporate and investment bank, such as payments processing, Mergers and Acquisitions (M&As) and support with Initial Public Offerings (IPOs).

In its drive for higher cost-efficiency and to move its staff up the value chain (i.e. to positions of more strategic value), Company B decided to evaluate the use of outsourcing, particularly Remote Infrastructure Management (RIM), which is an extension of Infrastructure Management Services (IMS). IMS refers to the day-to-day management of the Information Technology (IT) infrastructure needs of an organisation, such as managing network operations, desktop and server management (e.g. configuration, updates and maintenance), security requirements and a 24x7 technical helpdesk. RIM differs from IMS in the sense that the management of the infrastructure is conducted remotely, typically in a low-cost country, thereby allowing for labour cost arbitrage. During the course of the evaluation, 11 service providers were reviewed, of which 7 were preferred suppliers. The evaluation involved between 7-15 management level personnel (depending on phase), including several directors from its Chief Technology Offices (CTOs).

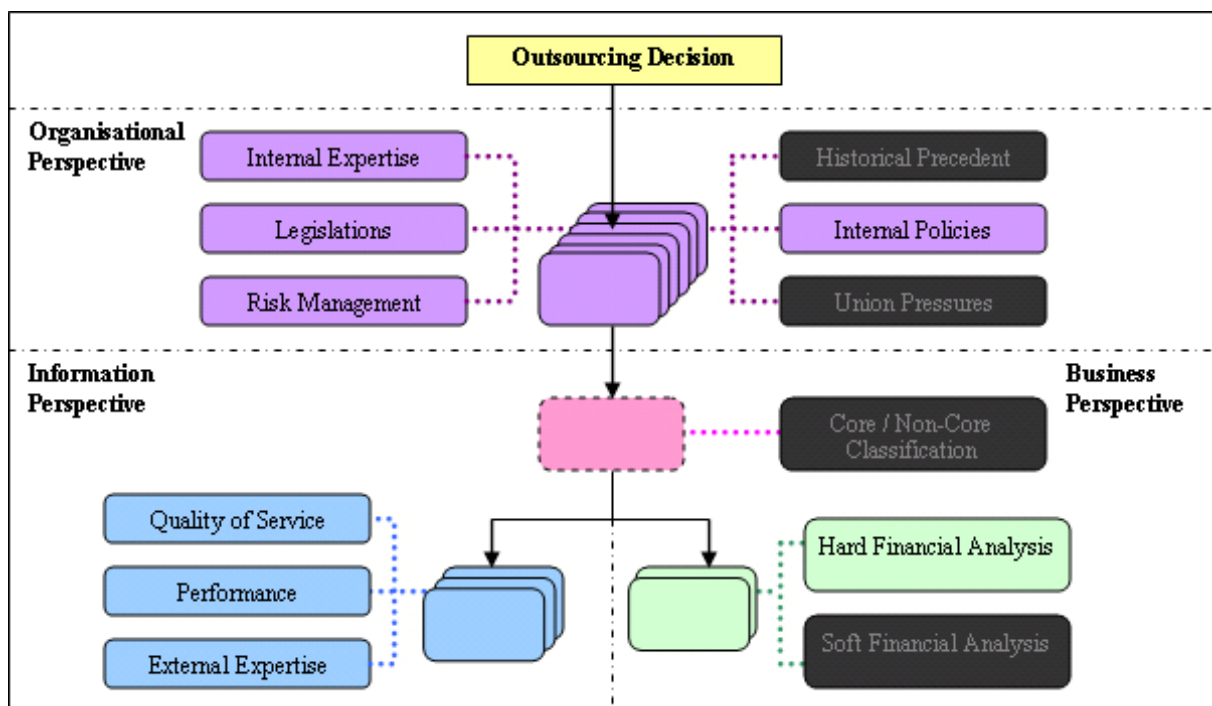


Figure 3. Mapping HABIO Framework to Company B's outsourcing decision

3.1 Organisational Perspective

- Internal Expertise

As the outsourcing arrangement involved job reassignment, the company sought to ensure appropriate knowledge transfer by the use of job shadowing, in which new staff members spent time observing current employees to gain an understanding of the knowledge and skills that are required to perform the job. This allowed for sharing of best practices between old and new staff members, which in turn facilitated the retention of tacit knowledge. This was complemented by process documentation, in which existing business procedures and practices were captured into a textual format for future reference. This information was then put forward towards the establishment of a standardised set of best practices.

- Legislations

The company was particularly concerned about the implications from the Sarbanes-Oxley Act 2002 (SOX) and the Basel II Capital Accord 2004 on outsourcing arrangements (Deshpande, 2005; Kaarst-Brown and Kelly, 2005). In order to facilitate financial reporting, it has opted to retain ownership of the software (e.g. Tivoli) and other assets related to data collection. The company was also concerned about the selected service provider's adherence to the relevant data protection and privacy laws, including the UK Data Protection Act (DPA) 1998, hence compliance to the BS7799 (Information Systems Risk Management) standard was a key differentiator in vendor selection.

- Risk Management

Risk profiling was practiced in the outsourcing decision-making process, in which the company evaluated the severity of impact if the outsourcing of an activity were to go wrong. High risk activities (e.g. customer-facing services, system architecture and data centre assets) were then kept in-house to minimise exposure, while low to moderate risk activities were considered for outsourcing. In its use of outsourcing (i.e. Remote Infrastructure Management), the company adopted a progressive approach to offshoring, in which the lowest risk activities were first moved offshore followed by increasingly riskier activities (i.e. activities with a moderate risk profile, such as overnight monitoring). This allowed the service provider time to ensure that the appropriate process and technology were in place to meet the company's requirements, and hence deliver a service which is compliant to the established performance and quality metrics. In addition, a number of safeguards were incorporated into the outsourcing arrangement to minimise the risk involved. This includes a detailed exit strategy (for instances where the outsourcing arrangement fails), flexibility in the contract (e.g. the company can ramp down outsourced staff numbers rapidly if needed) and a change management process for modifying the outsourcing scope in the event of business change.

- Internal Policies

In this instance, the outsourcing decision was a top-down mandate, as the need for outsourcing was already determined by senior management as a component of their strategic cost efficiency drive. Specifically, the Infrastructure Management Services (IMS) market was perceived by the company as sufficiently mature to support its requirements, and hence the use of Remote Infrastructure Management (RIM) was, to some extent, already decided as the way forward.

3.2 Information Perspective

- Quality of Service

The company pre-assessed service providers by their adherence to the relevant British Standards (BS), such as BS7799 and BS15000, and other standards such as Six Sigma, IT Infrastructure Library (ITIL) and Capability Maturity Model Integration (CMMi). Conformity to such standards provides a degree of assurance about the service provider's products and services in terms of quality and reliability, which makes it a preferred choice in vendor selection. In order to ensure that its Quality of Service (QoS) requirements are met, the company utilised customised Service Level Agreements (SLAs) in place of the generic templates provided by the service provider. This allowed the company to have control over the granularity at which QoS is defined, which in turn facilitated the definition of detailed QoS standards specific to its requirements.

- Performance

Service benefits were a key consideration in the company's outsourcing decision-making process. As Remote Infrastructure Management (RIM) has been indicated to alleviate problems associated with technology research, ensure appropriate staffing for Information Technology (IT) infrastructures and assist in establishing round-the-clock support availability, it was thus perceived as the best way to

leverage such benefits. Monthly service level meetings are held with the service provider, in which compliance to performance metrics is jointly reviewed and existing SLAs are reassessed for appropriateness and necessity for modifications. This provides a platform for regular communication between vendor and client, and allows for recurring problems to be flagged and escalated for attention and further remediation.

- External Expertise

In the context of the company, external expertise refers to the availability of skilled labour which was evaluated by analysing the scale and experience of potential service providers. Scale refers to the degree to which a service provider has to ramp up its staff numbers to meet to the company's requirements. A small scale service provider will need to significantly ramp up, hence is considered to have low availability, and thus a less ideal choice due to the risks involved. Experience relates to the number of currently available staff members with the specific skill sets required by the company. A service provider with limited staff numbers (i.e. skilled labour) is deemed to be lacking in experience and hence likely to be eliminated from the evaluation unless redeeming factors (e.g. low cost, preferred supplier status and good client base) are otherwise found.

3.3 Business Perspective

- Hard Financial Analysis

Cost efficiency was a component of the company's overall strategic drive and financial costing was a key consideration in its outsourcing decision-making process. The company first established a "base case" (i.e. likely in-house costs) for each activity on a Sterling rate per day basis, which was then utilised to identify the cost disparity between internal and external service providers. The analysis indicated that a potential 30-40% cost savings could be achieved. The contract incorporated severe financial penalties for instances where the service provision fails to comply with agreed standards.

4 CONCLUSIONS

This paper outlines the application of the HABIO framework to two large commercial organisations utilising outsourcing in customer service and IT infrastructure functions. The paper presents practitioner insights to the concept of mapping relevant issues to a tri-perspective approach, which has been indicated to be effective at enabling decision-makers to structure their outsourcing decision in a rigorous and repeatable manner.

The case studies suggest that the drivers behind the use of outsourcing are increasingly of a strategic rather than cost reduction nature. Despite current outsourcing being initially conditioned by the cost factor alone, companies are progressively aware of its strategic implications and hence are more inclined towards considering factors of a strategic nature (e.g. knowledge retention). Analysis of the case studies indicates that the historical precedent factor was not commonly reviewed, i.e. companies did not base their current outsourcing decisions on past outsourcing performance (contradictory to the anecdote "past perception dictates future performance"). In addition, the concept of core competency (i.e. core/non-core classification) was not explicitly addressed in the outsourcing decision, which introduces debate on its relevancy in live environments where technologies, priorities, finances and demands are more volatile (Healy and Linder, 2004).

Further work is being done on developing a web application for automated collation of quality and performance data, which will be put forward towards service compliance monitoring and the establishing of benchmarking criteria for future outsourcing evaluation and contract negotiation. An intelligent agent solution is simultaneously being developed to generate "what-if" scenarios, based on the dataset, which will facilitate the identification of future challenges and opportunities.

References

- Cap Gemini Ernst & Young. 2003. The Outsourcing Report: Making Choices - Insight into Successful Outsourcing. Available from: <<http://www.cgey.com/outsourcing/media/MakingChoices.pdf>> [Last Accessed: 05 January 2004].
- Cohen L and Young A. 2005. *Multisourcing: Moving Beyond Outsourcing to Achieve Growth And Agility*. Harvard Business School Press. ISBN: 1-59-139797-9.
- Deloitte. 2005. Calling a Change in the Outsourcing Market: The Realities for the World's Largest Organizations. Available from: <http://www.deloitte.com/dtt/cda/doc/content/us_outsourcing_callingachange.pdf> [Last Accessed: 08 January 2006].
- Dibbern J, Goles T, Hirschheim R and Jayatilaka B. 2004. Information Systems Outsourcing: A Survey and Analysis of the Literature. *The DATA BASE for Advances in Information Systems*, 35(4): 6-102.
- Deshpande D. 2005. Managed security services: an emerging solution to security. *Proceedings of the 2nd annual conference on Information security curriculum development (InfoSecCD)*. September 23-24, 2005, Kennesaw, United States of America. pp. 107-111.
- Ho L and Atkins A. 2006. Outsourcing Decision-Making: A Review of Strategic Frameworks and Proposal of a Multi-Perspective Approach, In: H.S. Kehal and V. Singh (Eds.) *Outsourcing and Offshoring in the 21st Century: A Socio-Economic Perspective*. Idea Group Inc. ISBN: 1-59-140875-X.
- Healy T.J and Linder J.C. 2004. Outsourcing in Government: The Path to Transformation. Available from: <http://www.accenture.com/xdoc/en/ideas/institute/pdf/outsourcing_in_gov.pdf> [Last Accessed: 23 June 2004].
- Kaarst-Brown M.L and Kelly S. 2005. IT Governance and Sarbanes-Oxley: The Latest Sales Pitch or Real Challenges for the IT Function?. *Proceedings of the 38th Annual Hawaii International Conference on System Sciences (HICSS'05)*. January 3-6, 2005. Big Island, Hawaii.
- Overby S. 2006. Outsourcing: Big Deals, Big Savings, Big Problems. *CIO Magazine*, February.
- Pearlson K.E. 2001. *Managing and using Information Systems: A Strategic Approach*. John Wiley & Sons Inc. ISBN: 0-47-132001-3.
- Thomas O. 2006. Broke? GM spends \$15B on tech. Available from: <http://money.cnn.com/2006/02/02/news/companies/b2_20060202_wt_gm/> [Last Accessed: 05 February 2006].