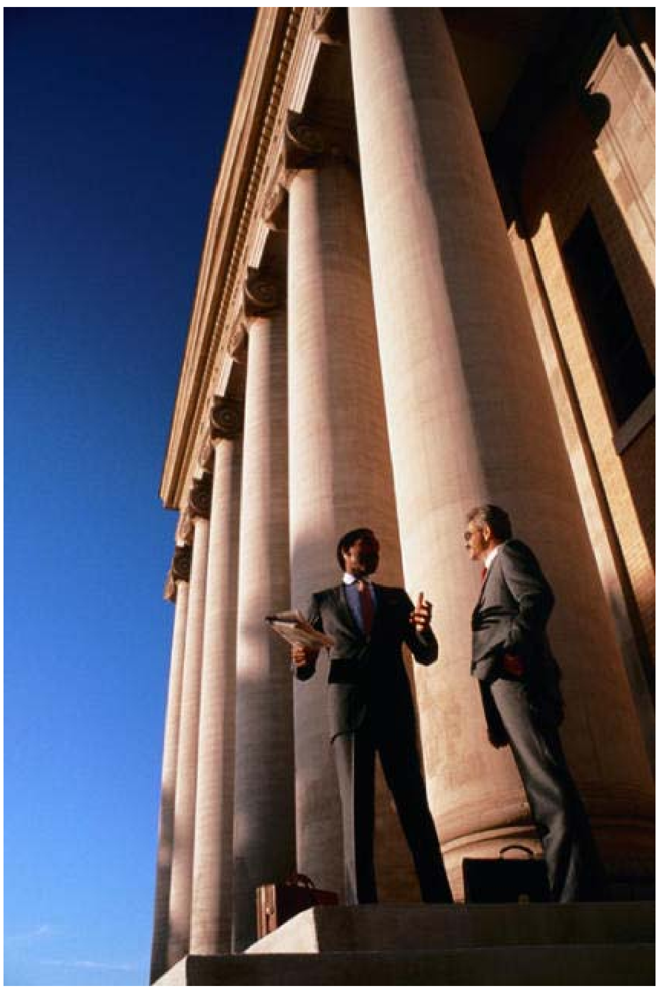
Governing Attitudes

12 Best Practices in Managing Outsourcing Relationships



White Paper

by Kathleen Goolsby

12700 Preston Rd., Suite 190, Dallas, TX 75230

Synopsis

This paper describes best practices regarding the communications methods component of a governance agreement. The structure of informal and formal communication methods employed by 63 highly successful outsourcing relationships, each nominated for the Outsourcing Journal 2002 Editor's Choice Awards, were studied for this paper. From that research, both common patterns and innovative approaches were culled to determine the 12 best practices presented in this paper.

Introduction

In any outsourcing relationship, it's important to start well, with mutual understanding and agreement as to objectives, service level performance, responsibilities and fair pricing. But long-term relationships inevitably will be affected by external situations that can cause the parties' interests to no longer be aligned and, thus, place pressure on their attitudes toward each other.

Building a governance agreement into an outsourcing contractual arrangement is a crucial component of ensuring a successful relationship over the long term. Such an agreement reflects the components of how the parties will interact and communicate at various levels of the organization, handle changing business requirements and new objectives, strategically plan for the future and continuously improve the value they wish to achieve through their relationship.

Instability or inequity and mistrust are as dangerous to an outsourcing agreement as cobra venom is to a human body. Without an effective governance module to establish how the parties will work together on an ongoing basis at a level beyond day-to-day operations and metrics, long-term success is a dicey proposition. When challenges occur, the agreement governs the parties' attitudes and reactions, preventing misaligned attitudes from governing the relationship.

Best Practice Strategies

Best Practice #1: Empowerment and Escalation

In the business process outsourcing relationship for accounting services provided by Accenture to BP, the buyer appointed one of BP's senior financial individuals as its day-to-day relationship manager. He is responsible for working through all of the operational issues that arise. He works jointly with Accenture's manager in problem solving, budgeting and performance review.

Although he reports directly to BP's vice president and CFO for downstream business, he is empowered to make decisions to work through operational issues. In fact, the degree of success in his performance is judged on using that empowerment to ensure that few problems escalate to the CFO level.

In Glasgow, Scotland, where the City Council has outsourced some of its IT processes for all of the city's schools to Mitel Networks, the council has structured its problem escalation plan on four levels. Level one takes place in the individual schools. Level two is based on geographic areas, and level three is across the entire city. The fourth level is the City Council's project director for the outsourcing and senior staff members of Mitel. The buyer's goal is to solve problems while they are still at level one; and the service provider is responsible for being responsive to problems while still at that local school level.

Best Practice #2: Peer Relationships

In long-term relationships where members of both parties' management teams have stayed in place throughout the duration of the relationship, a key component of success often cited is the development of peer friendships and in-depth understanding of one's counterpart in the other company. BP's vice president and CFO, for instance, now has a strong working relationship with his counterpart at Accenture. This peer relationship has developed over more than 10 years.

The Medicaid director for the state of Delaware, which is outsourcing its Medicaid systems and processes to EDS, meets for an informal lunch with the EDS project manager every other month. In addition, two or three times a year, the staffs of both entities in this outsourcing relationship participate in "team building" sessions. One year they deployed a buddy system process as a result of the sessions. These sessions are an effective resource for training, but they also use them for fun activities. Both companies collaborate on designing the fun activities as well as the training ideas to be used in each session to help strengthen their team approach.

In a relationship involving BP with service provider PricewaterhouseCoopers (PwC), BP's vice president of Business Unit Resources gets together with PwC's senior executive for an informal lunch or breakfast at least once a month, where they catch up on all sorts of issues.

Best Practice #3: Frequent Informal Communication

Some companies structure their outsourcing relationships around a strategy that ensures frequent informal communication on a day-to-day basis. This is most often seen in instances where the service provider's employees are located on the buyer's premises, and the buyer places emphasis on making sure the service provider's employees are treated as though they are part of the buyer company's staff. In these cases, the two parties interact often on an informal basis without scheduled meetings.

This is the case in Colombia, where BP outsources its IT processes to Getronics Colombia. In addition, BP's digital business manager (similar to an IT manager) and its service manager enjoy informal lunches with their Getronics counterparts every month. They also meet formally each month to discuss new ideas or issues that arise from time to time.

In addition to monthly operational meetings and cost savings meetings, as well as quarterly performance review committee meetings, GM Powertrain and FedEx Supply Chain Services have established a Circle of Colleagues. At these monthly meetings, all of the buyer's Powertrain employees and all of the service provider's people onsite at the buyer's premises participate. They can place any item on the agenda for discussion and also get updates on what is happening within both companies.

Best Practice #4: Establish a Special Entity

In complex relationships, especially involving very large or multinational corporations, best practice strategies usually involve the establishment of special boards or committees.

BP and Accenture, for example, formed a Joint Review Board that meets on a quarterly basis. Members from the BP team are the global CFO, the U.S. regional downstream business CFO and the day-to-day relationship manager. Accenture's team is comprised of the client partner for the downstream business, the partner responsible for the contract, and Accenture's counterpart to BP's CFO.

In their two-part agenda, the BP/Accenture Joint Review Board first reviews service level performance data over the prior quarter, discusses any problems and is updated on actions taken as a result of previous meetings. The second part of the agenda is much more strategic and involves discussions around new ideas, marketing, innovation and how they can help each other achieve goals.

GMAC, which outsources its Web portal call center and customer relationship functions to Edcor, is using the outsourced processes partially as an experiment and catalyst to change the way marketing dollars are handled on an enterprise-wide basis. To that end, they established a User Involvement Committee. Membership is comprised of partners from each of GMAC's business units. Their agenda is to ensure an enterprise-wide view in discussing new issues as they arise.

Parsons Corp., which outsources its IT to Perot Systems, established a Technology Review Board. The CFO and CTO head the group, which oversees all technology decisions for Parsons.

The BP relationship with PwC relies on a Regional Governance Board to manage all but the day-to-day business matters. The board is comprised of senior management from both organizations. It meets on a quarterly basis for decisions or issues on major systems activities. On a monthly basis, they meet to review the key performance indicators monitoring the service provider's performance. This is also the forum that discusses issues regarding the complex financial aspects of the agreement and ensures that charge-backs are going to the appropriate business units of BP's organization.

Best Practice #5: Appoint Additional Managers When Implementing New Objectives

In addition to the initial implementation and transition phases of an outsourcing relationship, some undergo additional periodic transition phases over the long term as they implement new strategic initiatives. In some instances, these additional transitions are managed by the account managers already in place.

However, if the initiative involves substantial changes, the additional workload may be too heavy to add to the day-to-day responsibilities of the account manager. The best practice is to appoint additional people to assist in managing the day-to-day challenges until the transition has been successfully achieved.

Best Practice #6: Prioritize Action Items

Where the parties are involved in numerous initiatives, or during implementation – transition phases, it is best to gain agreement on the priority of handling various projects. Even though Gung-Ho Company, for example, has ongoing conversations with its service provider, ManagedOps, the parties maintain an ongoing action-item list. Each project is rated as being top, medium or low priority. Gung-Ho also created an electronic collaborative area on its Web site and posts the action-items list in that area.

Best Practice #7: Key Strategic Issues

Upcoming challenges, internal changes and goal setting are fairly standard topics on the agenda of an outsourcing relationship's strategic review meetings. Forward-thinking companies now employ a new practice. They use these planning sessions to also review the effectiveness and strategic impact of their relationship on the buyer's organization.

Compaq is the buyer in an outsourcing relationship where its human resources (HR) processes are outsourced to Hewitt Associates. They hold monthly virtual meetings (referred to as "State of the State") between the senior managers of both entities. Both parties' teams measure satisfaction with each other. They then candidly discuss how well they are doing in each key issue category and how they can improve if something is not working well.

Continental Airlines is also outsourcing HR functions to Hewitt Associates. Together, they use strategy meetings to learn what is new in their industries. More importantly, when they review performance, they place emphasis on items that went well – and why. This approach is considered to be equal in importance with what most companies do – examine what went wrong, and why. Continental also uses these sessions to check on whether the relationship and outsourcing strategy is still achieving the goals they initially set for an initiative.

In the outsourcing arrangement between la Caixa and its IT service provider, EDS, the highest “coordinating” body among the parties is a Technology Direction Committee. It is comprised of key executives from both companies and meets monthly.

Leading global companies now use outsourcing as their primary business solutions tool. By outsourcing as many non-core processes as possible, they achieve maximum competitive advantage on an enterprise-wide basis. But this strategy requires that top executives possess a variety of negotiation and relationship management skills, as well as strategic planning expertise. Many of these companies have developed new executive roles.

Dow Chemical, which has established a new role of Strategic Supplier Manager, is one example. The key individuals in this position work with Dow’s most strategic outsourcers in developing a relationship that is very far beyond the contract operational levels of those outsourcing arrangements.

Best Practice #8: Manufacturing Processes

In an outsourcing relationship where the services involve manufacture of products, fulfillment packaging functions, or software application development, the best practice is to establish more frequent formal review meetings.

A good example of this practice is the relationship between Rational Software and its service provider, Compaq. In addition to their daily phone calls, the parties have established weekly meetings to discuss new product introduction. They also hold a middle-management review meeting every other week on a global basis, where they discuss what they are working on and a high-level view of their future goals. In addition, they hold two-day, biweekly meetings to review inventory levels and set new target goals for inventory performance.

Borland also outsources to Compaq. They do new products reviews and discuss deliverables at weekly meetings. A key component of those meetings is Borland's product managers looking to Compaq's expertise and experience in new product introduction best practices. They have also established a separate weekly meeting to review manufacturing inventory levels.

Best Practice #9: Meeting Logistics

As more and more companies employ outsourcing as their strategy to achieve globalization or centralization/streamlining of services in multinational organizations, decisions about formal meetings to review performance and discuss strategic goals must include the logistics of the meeting location.

The relationship between Rational Software and Compaq, for instance, involves services in both the U.S. and Europe. These companies decided to split their quarterly business reviews into a local or a global focus. So twice a year, the meetings focus either on business that is local to Europe or local to the U.S. and are held at a location appropriate to the geographic focus of the business being discussed. The location for the two global-focus review meetings alternates between the U.S. and Europe.

Borland, also outsourcing to Compaq, has entities in three geographic regions: Singapore, Ireland and the U.S. At quarterly review meetings, they look over the metrics and issues within each region and set joint contractual goals with Compaq for the subsequent quarter. Twice annually, Borland and Compaq review metrics and issues on a worldwide basis. Perhaps an issue is occurring in one region but not in another; or perhaps one region is experiencing a challenge that could benefit from what is being done in another. During the worldwide review meetings, they also establish an additional set of goals that are worldwide in scope.

In many instances, the service provider's operational site is located in a different city or region than the buyer's company. Where financially feasible (usually where only one or two executives are involved per company), a practice that appeals to both entities is to alternate the location of strategic planning sessions in both parties' cities. Some buyer organizations, such as Georgia Pacific Paper (which outsources its logistics functions to Transport Systems, Inc.), take a further step in relationship building by ensuring these quarterly or semi-annual meetings take place in conjunction with the buyer's other internal planning sessions so the service provider can get some exposure to upcoming plans.

Best Practice #10: Steering Committees

In high-value outsourcing relationships where a strategic objective of the parties' agreement is to find new ways to help each other grow their businesses, a best practice is to form an upper-management-level steering committee.

Alliant Energy, which has outsourced its facilities management functions to FBG Services, has established a steering team that meets on a quarterly basis. They not only determine overall guidance and budget expectations for the day-to-day operational teams, but they also focus on shaping opportunities for new business development opportunities that benefits both entities.

The steering committee for Verizon, which has outsourced its benefits process to Hewitt Associates, uses a formal agenda for the approach to its bi-weekly meetings. They also employ a methodology of "output sheets" that provide status notations of where they are on their "critical path."

Pinnacle Health System is the buyer in an outsourcing relationship with Siemens Medical Solutions. In this arrangement, the Siemens onsite relationship manager actually functions as the Pinnacle IS Director. Thinking on behalf of Pinnacle (rather than his employer, the service provider), he suggested the buyer establish an IT steering committee. He chairs the committee, which is comprised of Pinnacle's group of vice presidents. After receiving recommendations from the business units' subcommittees as to what initiatives should be included and can be supported by the buyer's annual budget, this steering committee designs an IT Tactical Plan for the priority items among those initiatives (the plan also maps to Pinnacle's strategic plan). The IT Tactical Plan is published on Pinnacle's intranet and updated quarterly. The Siemens onsite manager also presents a report card on the service provider's performance level to the steering committee on a monthly basis.

Similarly, some large buyer organizations establish an advisory board to work with the account manager and the buyer's C-level executives. The board at Parsons Corp., for instance, meets quarterly and is comprised of the president from each of the company's business units, the COO from each business unit and the business development and financial managers.

Best Practice #11: Selection of Account Managers

More and more, buyer organizations are becoming involved in the selection of which people from a service provider's company will be the key contacts for the day-to-day interaction among the parties. In five of the outsourcing relationships studied for this paper, the buyer's C-level executives were involved in the interviews of all candidates considered for the service provider's top positions in managing the relationship. This practice is especially pertinent where the service provider's manager is onsite at the buyer's premises.

An excellent example of this is Parsons Corp, which has outsourced its IT to Perot Systems. The Parsons CIO is actually a Perot executive and occupies an office next to Parsons' CFO/vice president. Because the Perot executive performing as CIO is critical to the Parsons effort and also is the person who built the service provider's IT team now resident at Parsons, the buyer's C-level executives spent a significant amount of time interviewing and getting to know the Perot executive before accepting him as the buyer's CIO. Their outsourcing agreement includes a clause stating that the Perot executive cannot be taken off the Parsons' account without the agreement of Parsons' CEO.

Best Practice #12: Corporate Media Communications

Corporate weekly bulletins or newsletters are frequently used as a means of mass communication for all employees as to what is happening in an outsourcing relationship. This practice is especially popular during the implementation and transition phases of a relationship, where employees need to be educated or reminded of upcoming changes to internal functions.

The state of Delaware, which outsources its Medicaid functions to EDS, shares its newsletter with the service provider, as well as the state's employees.

Corporate intranet Web sites also are an increasingly popular way to disseminate information to top executives as to the status of projects that are outsourced.

Summary

As outsourcing continues to evolve as the most effective strategic tool to achieve enterprise-wide value and competitive advantage, the contractual arrangements must be carefully structured to ensure deep relationships that endure over many years. A key element of that structure is establishing a strong governance module as part of the agreement.

The governance agreement in an outsourcing contract is more than a statement of how the parties desire to manage their relationship on an ongoing basis and a designation of which individuals are empowered to solve problems. In the truest sense, it may be considered a survival kit for an enduring relationship.

For More Information

For information on how Everest Group and Outsourcing Center can assist your organization with its outsourcing initiatives, please contact Marc Liebman, Vice President of Business Development, at mliebman@everestgrp.com or at 972-980-0013.