

How to Manage Outsourced and Purchased Services (ICT): IT Governance Perspective

Hannes Rauhala
4-3-2008



Agenda

- My research activities
- Some basics of IT governance
- Reasons for outsourcing
- Transaction costs
- Challenges and problems
- Service Integrators (the real ones)
- Multi vendor environments
- Innovation stack

Achieving Improved Alignment between Business and IT through IT Governance and Enterprise Architecture

- What are the needed organizational capabilities for a company as it aims to reach competitive advantage through business aligned ICT?
 - What are the critical success factors of the development and change processes when a company has sufficiently aligned its ICT function with its core operations?
 - How enterprise architecture should be used to optimize the involvement of the top and business management in ICT related decision making?
 - What are the most successful organizational mechanisms and methods to increase stakeholders' involvement and understanding of ICT related business development issues?
 - **What are the characteristics of inter-firm governance and management models in the case of a successful ICT service outsourcing arrangements especially in a multi-vendor environment?**

Business challenges for IT

- Does IT proactively enable new businesses or improve business processes?
- Does the clear linkage between strategy and IT investments exist?
- Does IT provide concrete business benefits?
- Are these benefits measured, monitored and controlled in some way?
- The modeling of business processes (and operating model) to form business oriented requirements for IT systems.
- Pressure of regulations

Definitions of IT Governance

“IT governance is the responsibility of the board of directors and executive management. It is an integral part of enterprise governance and consists of the leadership and organizational structures and processes that ensure that the organization's IT sustains and extends the organization's strategies and objectives.”

IT Governance Institute: Board Briefing on IT Governance

“Enterprises design governance to compensate for the limitations of the structure. Given that organizations cannot rely on an organization chart to deliver strategy, they must identify processes and governance that transcend the organization chart.”

Weill, P., Ross, J.W. 2004. IT Governance: How Top Performers Manage IT Decision Rights for Superior Results. Harvard Business School Press.

“IT governance is the system by which the current and future use of ICT is directed and controlled. It involves evaluating and directing the plans for the use of ICT to support the organisation and monitoring this use to achieve plans. It includes the strategy and policies for using ICT within an organisation.”

AS8015, the Australian Standard for Corporate Governance of ICT

Cornerstones of the IT Governance

- Business must be the driver (or core operations in the public/non-profit organization)
- No technology because of technology (R&D is of course an exception)
- Business strategy and the IT strategy and operations have to be aligned
- Top management attention should be paid to the following issues
 - How to enable new business with IT
 - How to increase efficiency (business processes) with IT
 - How to manage major risks
- Remember the big picture – no sub-optimizing
 - Defined and deployed enterprise architecture
 - Defined and deployed decision making models (in IT related issues)
 - Defined and deployed IT management processes

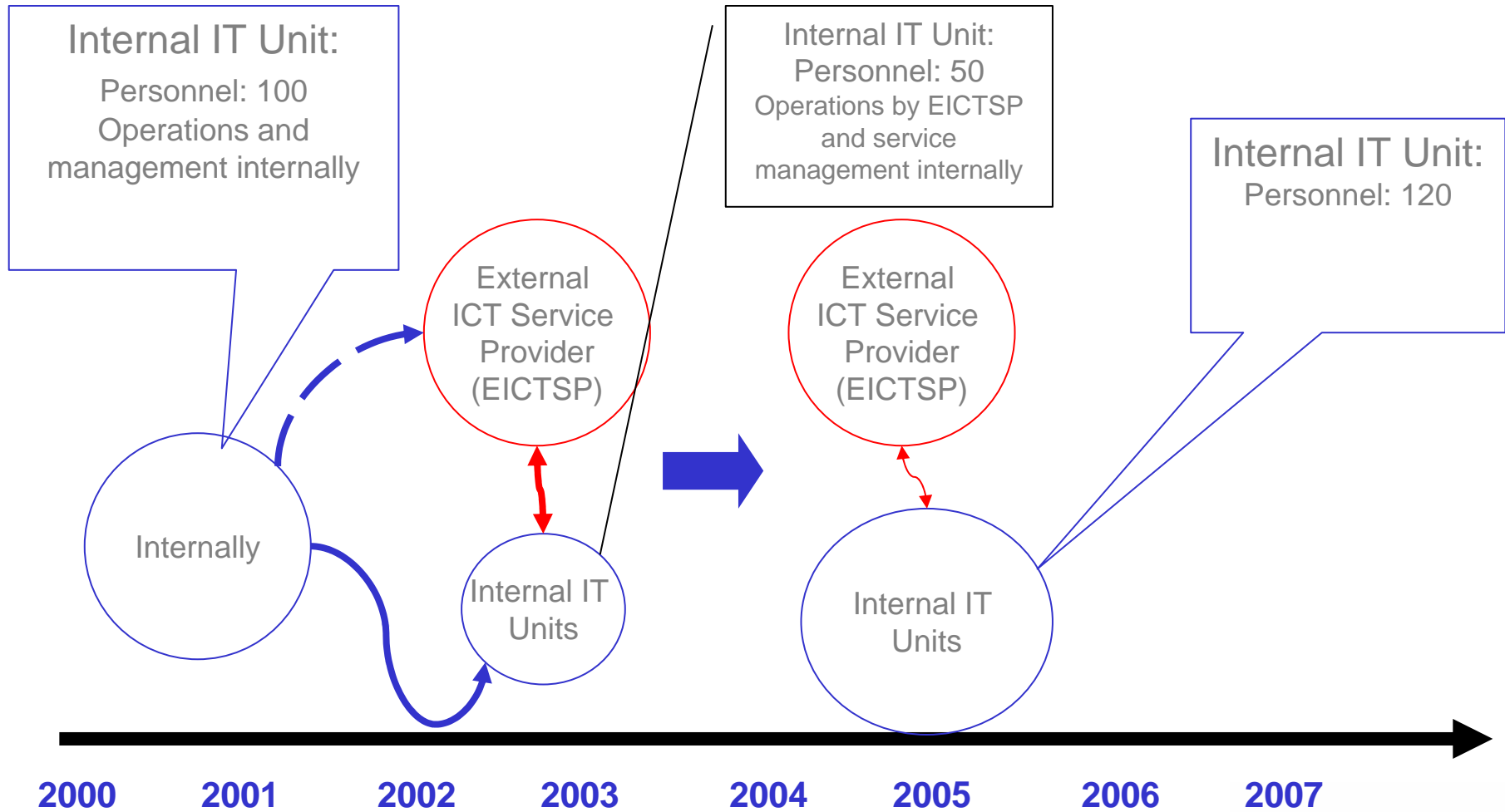
“Theory, my friend, is grey, but green is the eternal tree of life.” (Goethe, Faust)

IT Services ?

- IT Services include (for example)
 - Consulting
 - Management, IT Strategy, IT Architecture, Process, ...
 - Software
 - Software development, deployment, maintenance, operation, ...
 - Custom build, customized, COTS products, integration, ...
 - Hardware (delivery, operation, management, servicing, ...)
 - Computers, Storage, Printers, ...
 - Networking & Communication, ...
 - Low level "SW" services; hosting, email, ...
 - ...



Typical ICT Service Outsourcing Path?



Reasons for Outsourcing (1)

- Cost savings
- Cost restructuring
- Improve quality
- Knowledge
- Contract
- Operational expertise
- Staffing issues
- Capacity management

Source: Wikipedia 10.2.2008

Reasons for Outsourcing (2)

- Catalyst for change
- Reduce time to market
- Commodification
- Risk management
- Time zone
- Customer Pressure

Source: Wikipedia 10.2.2008

Transaction Costs (1)

- A transaction cost is a cost incurred in making an economic exchange
- Transaction costs can be divided into the three sub-categories:
 - **Search and information costs** are costs such as: required service or good is available on the market, who has the lowest price, etc.
 - **Bargaining costs** are the costs involved in the bargaining process, which normally end up with an agreement
 - **Policing and enforcement costs** are the costs of making sure the other party sticks to the terms of the contract, and taking appropriate action (often through the legal system) if this turns out not to be the case.

Theoretical background: : Coase R.H. 1937. The Nature of the Firm. *Economica*.

Dyer, J.H. 1997. Effective interfirm collaboration: How firms minimize transaction costs and maximize transaction value. *Strategic Management Journal*.

Dyer, J.H, Singh, H.1998. The Relational View: Cooperative strategy and sources of interorganizational competitive advantage. *Academy of Management Review*, vol. 23, no. 4.

Source for the text above: Wikipedia

Transaction Costs (2)

- The more specific the resource becomes, the lower its value is in alternative uses.
- This kind of investments in inflexible (specific) resources increase the investor's risk to face the opportunisms of the other party.
- Governance mechanisms are used to reduce these risks.
- An important objective for transactors (alliance partner) is to choose governance mechanisms and structure (safeguards) that minimize transaction costs, thereby enhancing efficiency. ..

An Example: Transition from Closed to Open Architecture

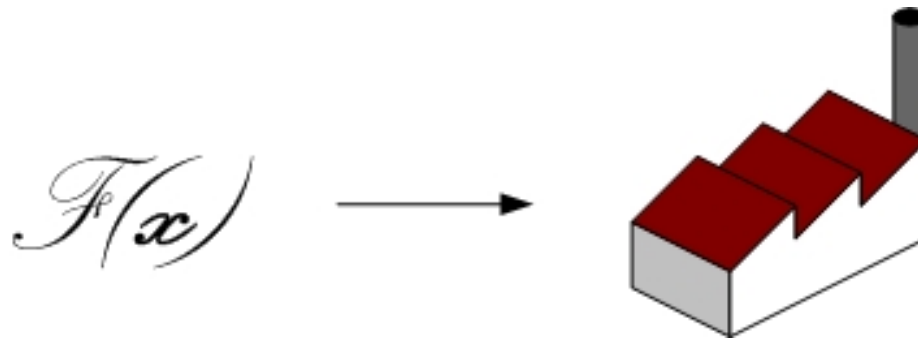
Theoretical background: : Coase R.H. 1937. The Nature of the Firm. Economica.

Dyer, J.H. 1997. Effective interfirm collaboration: How firms minimize transaction costs and maximize transaction value. Strategic Management Journal.

Dyer, J.H, Singh, H.1998. The Relational View: Cooperative strategy and sources of interorganizational competitive advantage. Academy of Management Review, vol. 23, no. 4.

About Outsourcing

- Function is being transferred from the company to a service provider
- What changes:
 - Operational level activities are transferred
 - Responsibility interfaces (processes)
 - Management model
 - Drivers (business interests)
 - Control structure
 - Development issues



Typical Problems and Challenges

- From technology execution function to manager and controller (quality, costs, effectiveness, efficiency) of the outsourced ICT services
- Competence requirements
- Pure technical transition or holistic organizational transformation?
- Change leadership
- Enabler or/and support function
- Multi vendor environment
- Interfaces: Processes, management, development

Important Issues

- Cost of management
 - Clarity of management and control model
 - Co-operation model between the customer and the service provider (vendor governance)
- Exploitation of market mechanisms
 - Business logic and controls (SLAs, OLAs, etc.)
 - Economy of scale
- Best practices

Service Science

- **Service Science, Management, and Engineering (SSME)** is a term introduced by [IBM](#) to describe Services Sciences, an interdisciplinary approach to the study, design, and implementation of services systems – complex systems in which specific arrangements of people and technologies take actions that provide value for others.
- More precisely, SSME has been defined as the application of science, management, and engineering disciplines to tasks that one organization beneficially performs for and with another.

Source: Wikipedia 10.2.2008

Essential Issues When Managing Outsourced ICT Services

- Define and manage service levels
 - Service level management framework
 - Service level agreements (SLA)
 - Service catalogue
- Support model and incident management
 - Single point of contact (SPOC) and the role of service desk
 - Escalation chain
 - Responsibility interfaces between vendors
 - High level description of the incident management process
 - Detailed control objectives of the incident management process
 - Information, communication and reporting processes
- Change management process
 - Process charts
 - Roles and responsibilities
- Problem management
 - Root cause analysis
 - Responsibility interfaces
- Responsibility interfaces
 - Process view
 - Role view
 - Stakeholder view

The Definition of the Service Integrator

“The Service Integrator is responsible for the end-to-end performance of the selected business services.

The end-to-end performance means the total performance of business service that is experienced in the users’ terminals (e.g. desktop PC, portable PC, mobile phone, PDA, etc.) and as performance of the relevant system interfaces.”

Source: Gartner

End-to-end Service Integrator Capability Requirements

- Agreements (engineering and juridical aspects)
- Integration of service chains
 - Action request systems over the whole service chain
 - End-to-end (E2E) service level management and measurement
- Change management process over the whole chain
- Business SLA have to be derive to service providers thus there is big need for
 - Service descriptions
 - SLAs
 - Management models over the organization
- How to develop whole service chain
- Information security issues within the service chain

The Innovation Stack



Source: Hamel.G. The Future of Management. Harvard Business School Press. 2007

Questions

- The most promising innovations within the context of ICT outsourcing (management, strategic, service, operational)?
- The most promising innovations within the context of service science?
- Critical success factors for outsourcing arrangements?
- Critical view of outsourcing: Why outsource anyway?