Number 09-04

The Swingtide CIO Monograph Series

Bringing Governance Upstream: The T-Minus Deal Approach

SWINGTIDE

It is an industry truism that good governance is critical for successful outsourcing.

Unfortunately, it is just as uncontroversial to state that, in fact, few existing deals are well governed. How can this be if outsourcing governance structures and processes are so well understood and documented, reside in almost every outsourcing contract and are an inevitable part of the "kit" of every outsourcing advisory firm?

We believe that there's an important cause for the prevailing situation that, despite everything that's written and understood about the concept, governance is often ineffective.

In our view, a significant source of this ineffectiveness is that governance processes are not established early enough in the lifecycle of the outsourcing relationship. The normal pattern of events is that the kick-off of the outsourcing governance function is viewed as a post-contract activity. This pattern aggravates the existing problem of hand-offs that already afflicts outsourcing deals between the end of negotiations and the beginning of transition.

Instead of viewing governance as entirely a post-contract activity, we believe there are tremendous short- and long-term benefits to implementing a "T-Minus Deal" approach, by which you move governance oversight up in the process to cover the very earliest deal-forming and relationship-forming activities.

Of course, no advisor would ever suggest you wait until after the contract is signed to design the governance processes. Governance design and planning prior to contract signature is in everybody's playbook. The difference between the normal set of recommendations and the approach discussed here is that, in addition to the early planning, designing and staffing of the processes in preparation for the long period of post-contract "steady state" operations, a T-Minus Deal approach also designs and implements governance processes for the management of the pre-contract activities themselves.

HOW GOVERNANCE IS CURRENTLY NORMALLY IMPLEMENTED

When we use the term governance in this paper, we mean the set of roles and functions that comprise the essential ongoing administrative oversight and management of the outsourcing relationship. These roles and functions optimally enable the performance of the underlying service and help assure that the customer's anticipated value is received over the term in business conditions that are certain to change.

Our starting place for further discussion is to identify some key common ideas about governance that we affirm and some common governance practices that we reject.

Part 1: Ideas that we affirm

The fundamental attributes and functions of good governance processes (and some fundamentals of the soundness of the underlying deal) are:

Attributes of successful outsourcing governance:

1. Both parties need to be engaged in the process, and the function needs to be adequately resourced (with the appropriate skills)
2. There needs to be documentation of clear roles and responsibilities, clear expectations and commitments
3. Reward and penalty structures are established in the contract that appropriately incent performance and are resistant to being "gamed" by suppliers
4. Performance is monitored, tracked and reported; issues are quickly and effectively resolved
5. Processes are flexible and adaptable to inevitable changes in business strategy, and to changes in the technology environment

Activities essential for successful outsourcing governance:

- ◊ Business case management: (updating and adjusting the documented financial rationale for the deal based on inevitable changes over the term)
- ◊ Monitoring operations/Review of supplier performance reporting
- ◊ Customer satisfaction monitoring and reporting
- ◊ Issues management/Escalation
- ◊ Communications
- ◊ Contract modification
- ◊ SLA monitoring and adjustment to match the current business priorities
- ◊ Relationship roadmap/end of term options/restarting the sourcing cycle
- ◊ Innovation management

So far, so good….

Part 2: Practices that we reject:

All of the above is well enough understood. But to truly know the good, you must also have an appreciation for the bad. So to clarify our starting point, we also need to briefly state some of the problems with governance as it is commonly implemented:

◊ **The "Customers Pays, Supplier Performs" model of the outsourcing relationship:** As the complexity of services, the financial magnitude of the commitment and the duration of the contract (and consequent need for midterm adjustments in the alignment between customer and service provider) increases, the further away you have to move from the mere "Customer Pays, Provider Performs" dynamic. Any experienced outsourcing manager will confirm that the active engagement of both parties is critical to the success of the relationship. In spite of this, governance processes, as often implemented, tend to have a narrow focus of unilaterally squeezing the suppliers without acknowledging the critical role that customers play in relationship maintenance.

  There are two main problems with this kind of purely procurement-driven approach to governance.

  First, it tends to focus on "prevailing" over suppliers. This has the effect of harming post-contract management because, for the relationship to be in balance, customers always need to be measuring how well they are performing their responsibilities under the deal, too. This can be done in a number of ways, both objective and subjective (See our "Outsourcing Health Check" white paper for details) through customer responsibility matrices, surveys, etc.

  Second, procurement-driven approaches also insist on maintaining an excessively protective distance from the supplier (more than the proverbial prudent "arm's length") until the moment the contract is signed. This has the effect of harming the chances of establishing functional intimacy through early oversight and management of those pre-contract relationship-forming activities. We believe that this early oversight and management critically positions the parties to manage the deal better once it has been signed.

◊ **Governance consists solely of moving the knobs and levers on the existing agreement:** A focus on managing to the particulars of the agreement is necessary and inevitable. But if you can think back to the time before you outsourced, you know that your charter to be a good steward for the shareholders of your company went far beyond just dialing internal service delivery up or down or solving urgent IT Operations performance problems. You also had to look at consumption/demand management and at ongoing alignment with business value.

  The deal is a tool to meet your business strategy. Exclusive focus on the particulars of the deal without seeing how the agreement fits into your broader mission for the company and how it can be used to deliver evolving business value (a value that is never described within the four corners of the contract) is too narrow a focus and will result in you not being able to fully optimize the deal.

- **"Don't worry, your contract has a sweep clause"**: Unfortunately, this is a direct quote from an individual at a highly regarded outsourcing advisory firm. The notion they were trying to convey was that specificity in an agreement is not all that important because of the existence of clauses (called "sweep clauses") which act as catch-alls when it is impossible or impractical to describe everything done by internal service delivery today. A fair example of such a clause is:

  > Tasks and responsibilities that are reasonably required for the proper performance and provision of the Services and that are inherent and ancillary to the Services are deemed included in the Services in addition to those expressly set forth in the SOW.

  Used correctly, there's absolutely nothing wrong with these clauses. In fact, in order to contract for extremely complex services, they have become essential. But it is foolish to believe that they relieve you of the responsibility of articulating supplier service obligations as clearly and carefully as possible. During the days when I wrote IT contracts, my test for a clear provision was "How will this language support us in the event of a dispute." It's easy to see how a supplier relationship can be poisoned over disagreements about what was meant by "the activities reasonably required for the proper performance and provision of the Services." Foolish reliance on sweep clauses sets you up for a governance disaster.

- **You have to do it all yourself**: After an outsourcing relationship is implemented, companies often find themselves without the skills to manage a third-party relationship of this complexity. To take a single prominent example: It's been estimated that 80% of outsourcing bills contain errors. Clearly a supplier is not incented to find the mistakes that result in overbilling. The persons in your company who normally administer bills for simple IT services (e.g., server maintenance) are often overmatched when it comes to the demands of validating an outsourcing bill under a consumption based agreement that may contain 50 or more different resource units with complex, many-layered technical definitions, and each of which could vary based on actual volumes.

  To correctly audit and administer these complex bills you would need a multi-domains team with technical, contractual, sourcing, and financial/administrative skills. You need to be able to approach these problems creatively and understand that there are alternatives to trying to laboriously build an internal team out of persons all of whom have "day jobs" at your company. There are companies who have developed service offerings to solve this skills mismatch problem at a fraction of the amount of the potential overpayments under these agreements. Since value leakage from poor governance can be as high as 20%, this service, called Outsourcing Bill Audit Service (or OBAS) can be eminently worthwhile.

- **Governance Team Enters as Deal Team Exits**: As they pass each other, they silently hand off the documents. One of the worst implementation problems currently crippling outsourcing governance is the idea that governance begins only after the confetti from the signing celebration is swept up. Out go the sexy and dynamic deal makers and in come the maintenance staff to sift their way through the documents, dimly looking through the artifacts for clues on how this massive deal is going to work.

This is a problem on both the provider and the customer side. Provider pursuit teams are incented to seal the deal, even if the delivery team frankly can't deliver what was sold. Customer governance teams are handed the results of months of work, with little hope of understanding what the deal framers intended because the deal framers scatter after the deal is signed. Furthermore, the essential involvement of hard-to-book executives on governance steering committees often means that critical initial meetings to kick off the process are delayed for months. There is no surer way to make governance fail than to first start it after the deal is signed.

BRINGING GOVERNANCE UPSTREAM

How far upstream is “upstream”?

People have gotten used to thinking that the relationship really starts only after the contract is signed, or worse, after the switch is flipped and service is cutover (in contract terms, the Services Commencement Date…often months after the actual contract effective date). But by thinking of the starting point of the relationship in that artificial way, we have cut off an important part of the whole process from the same kind of beneficial oversight and management that we all recognize needs to be provided for the ongoing relationship. As a result we start too late.

If you conceive of governance (as we did above) as the essential ongoing administrative oversight and management of the outsourcing relationship, then you have to look at the place where the relationship meaningfully begins, namely downselect. Unless negotiations are aborted, the downselected provider is your partner.

We think that a number of the above key maladies (the practices we rejected) are addressed by bringing governance upstream in the sourcing cycle, and that the benefits of this approach, once understood, are impossible to ignore.

WHAT TO DO AND HOW TO DO IT

Obviously, some governance processes can only relate to an executed contract. The processes we are discussing in this paper are preliminary processes appropriate for the stage of the relationship and the joint activities that occur prior to contract signature.

T-minus governance designs and staffs the processes for the post-contract operational state, but also implements governance processes over pre-contract activities.

Preliminary governance processes should be implemented to oversee, document, track and manage the following key pre-contract activities:

1. Final solutioning with the downselected supplier(s)
2. Staffing the governance function with the actual individuals who will manage the operations with decision-making authority
3. Contract negotiations
4. Customer operational baselining (measurement and documentation of current internal service delivery SLAs as prudent preparation for Transition)
5. Business case development
6. Any outstanding due diligence
7. Structuring of the post-deal governance functions/processes themselves
8. Managing the “cutover” from current service delivery to new contract

All eight itemized pre-contract activities benefit from oversight and management.

The chart below clarifies how the ground for normal post-contract governance functions is prepared by having a team (representing both the client and the provider) that is assigned to perform related pre-contract activities:

Team Member	Functional Need	Pre-Contract Role/Function	Post-Contract Role/Function
Project Manager	Tracking and escalating	Creation of Pre-Contract Project Plan: Tracking, reporting and escalating issues with progress of all pre-contract activities against agreed timelines; creation of client/supplier team interface detail and contact lists.	Tracking, reporting and escalating on progress of all post-contract activities
	Hand Off from Pre to Post Contract	Assurance of involvement of the Supplier Delivery Team during negotiations; assurance of the involvement of all client post-contract governance team in the deal finalization, as appropriate;	Brief go-forward function until all Pre-Contract issues are closed and all governance functions have owners among the go-forward governance management team
Relationship Executive	Relationship Management	Relationship Management: Executive Oversight of pre-contract issues	Relationship Management: Executive Oversight of ongoing supplier performance
	Escalation	Escalation Point for Pre-contract issues	Escalation Point for ongoing performance issues
	Business Case and Business Alignment	Assurance that original deal design is responsive to current corporate objectives; Review and coordination of approval of original business case with CEO	Ongoing Management of Alignment and review of Business Case Management Review/Benefits Realization Processes
	Technology Roadmap	Overview and concurrence with initial Technology Roadmap	Subsumed in Relationship Management
Contracts/Sourcing	Contract Management	Contract Negotiation	Contract Administration
	Due Diligence	Coordinate completion of due diligence with Operations and implement results in contract documents	No go-forward function
	Business Case and Business Alignment	Responsible to implement original deal design and its responsiveness to current corporate objectives	Subsumed in Contract Administration
	Communications	Assist in design of contract education	Assist in delivery of contract education
IT Operations/Systems Architecture	Performance Monitoring	Operational Set up	Subsumed in Performance Monitoring
	Hand Off from Pre to Post Contract	Intense Interface with Supplier Delivery Team during pre-contract phases, as required	Brief go-forward function until all Pre-Contract issues are closed and all governance functions have owners among the go-forward governance management team
	Due Diligence	Final due diligence after down select	No go-forward function
	Transition Management	Client operational baselining: Participation in review and development of final Transition Plans	Implementation of Transition Plans; SLA monitoring during transition (before formal SLAs become effective)
	Transformation Management	Design of Transformation Plan	Management of Transformation Plan
	Performance Monitoring	Participant in design of Performance Monitoring processes; Review and Assurance that supplier can measure what they have committed to measure	Performance Monitoring
	Technology Roadmap	Review and participation in development of Technology Roadmap; Scheduling Technology Briefings	Technology Roadmap monitoring; Review Technology Briefings
	Procedure Management	Policy and procedures manual: Riding herd over design and drafting	Managing completion of manual and ongoing modification
Business Liaison	Alignment	Establishment of customer representation (Business Unit representation) throughout solutioning and negotiations	CRM
Financial	Business Case Management	Develop Business Case	Manage Business Case: Forecasting, budget support, controls, benefits realization
	Demand Management	Design of Demand Management Process and Communication	Demand Management
Communications	Communications	Preparing the organization for change (e.g., supporting business case buy-in, etc.); creating communications plan; assist in design of contract education.	Ongoing communication of changes
Governance for governance	Managing client performance	Development of client obligations matrix and calendar for tracking	Managing client's performance of its own obligations

The above chart shows the logical continuity of activity from pre- to post-contract stages of governance. While the content of many of the activities themselves is often not new, the formal oversight and management of these activities is. It's part of a smoothly ramping up of the governance processes and the early creation of a culture of governance within the customer organization.

KEY NEW ACTIVITIES AND ROLES

In addition to simply moving the processes upstream, however, there are a number of new roles and new pre-contract activities that are worth noting and emphasizing further.

Early Appointments/New Roles:

It is important to fill these roles with the actual individuals who will have responsibility for the ongoing function. This will enable the development and validation of the right chemistry of the collective team in time to make changes, if needed, as part of the formulation of the final relationship.

- ◊ Project manager to track all the pre-contract activities
- ◊ Communications resource to develop the communication plan and to prepare the organization for change
- ◊ Customer Liaison function to assure appropriate participation of business in framing the deal, not just after it's signed
- ◊ Demand Management role for Finance Team. Fosters stewardship orientation and business case enforcement; prevents internal customers from treating the outsourcing deal as a buffet of services
- ◊ "Governance for Governance" role that tracks customer's performance of its contractual obligations and the effectiveness of customer's management of supplier

New Activities:

- ◊ All major pre-contract activities are managed like a project
- ◊ Handoff management: assuring the involvement of the supplier delivery team to validate the solution and begin to form the "face-off" relationships with the internal IT Tower Leads
- ◊ Negotiations progress tracked and issues escalated
- ◊ Development of contract training jointly by sourcing and communications groups
- ◊ Measurement and documentation of current service delivery performance to support "No worse than" performance of supplier during Transition (and Transformation)
- ◊ Focus on Transition and all other required transformation or changes to the current state as a key to successful outsourcing
- ◊ Validation of supplier's ability to monitor performance as contracted (yes, deals have been signed where they couldn't)
- ◊ Validation of the supplier team's ability and authority to effect change and assert control over the specific deal
- ◊ Design of reports concurrent with the design of the deal, not as an afterthought

New Benefits:

- Provides prudent oversight of all the post-downselect activities
- Makes for more orderly contract negotiations. It lessens the chance that important deal principles are missed. It increases the chances that important deal principles gain traction as they are embedded in post-contract governance tracking, communication and management activities
- Structures a more intimate involvement of supplier delivery team in the negotiations
- Validates the chemistry of the collective team and enables a functioning team on the effective date
- Creates an audit trail on customer’s pre-deal internal service delivery to more accurately track the changes resulting from the transition from internal to external service delivery
- Minimizes the normal disconnects between the supplier pursuit team and the supplier delivery team that occurs between pre- and post-contract phases
- Sends signal to supplier on how important deal management is to customer
- Establishes a culture of governance between the customer and the supplier before the service cutover
- Helps the customer understand the importance of the process to the relationship and to avoid the trap of underestimating how to resource the function
- Helps prepare both parties to embed business case maintenance into the formal post-deal relationship management

SUMMARY

We believe that one of the reasons for the common ineffectiveness of outsourcing governance is that the roots of the process are not established early enough.

Even before the deal is signed the critical role of governance must be introduced, firmly established, and piloted. Effective governance must start from the very beginning of any mutually beneficial strategic partnership. Often, people recognize the necessity of these preliminary activities but don’t manage them to completion with the same diligence that they would bring to managing even a minor project. In outsourcing, the stakes are simply too high not to take these steps to ensure the success of your deal.

If you are interested in discussing the concepts in this white paper or obtaining assistance in performing a health check for your deal, contact:

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