

A Strategic Guide for Local Government On:
OUTSOURCING



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ABOUT THE GUIDE

This Guide is written for local government officials interested in learning about technology outsourcing and the key steps for evaluation and implementation. It captures the collective knowledge and lessons learned of progressive cities and counties that have been using technology outsourcing to enhance their capabilities and control costs.

The experiences are intended to help other local governments to understand the drivers behind outsourcing, implementation considerations, and important steps to take. Whether the reader is a city manager, elected official or chief information officer (CIO), this Guide provides information on how to make the outsourcing decision.

The Guide's structure reflects the strategic process that smart government executives have used when embarking on a new initiative. The first half is a primer on outsourcing that offers an overview of outsourcing in the public arena and the factors that drive public organizations to outsource IT services.

The second half identifies the broad phases that jurisdictions employ for outsourcing, from evaluating what IT functions to outsource, and to creating a communication plan, to managing an effective vendor relationship and evaluating customer satisfaction. The Guide strives to provide lessons learned from those who have current experience. Although each government has its own unique situation; however, these basic phases enable local government officials to follow the road successfully paved by others.

We would also like to thank the Guide's underwriter, IBM for all of their efforts to help create the material herein.

OUTSOURCING

OUTSOURCING DEFINED

Outsourcing defies a simple definition. It is used in a variety of different ways depending on the organization and the functions outsourced. The following definitions are commonly used:

Purchasing an item or a service from an outside vendor to replace performance of the task with an organization's internal operations. The transfer of components or large segments of an organization's internal IT infrastructure, staff, processes or application to an external resource.

The transference to third parties, the performance of functions once administered in house. Outsourcing is really two types of services:

- ITO: IT outsourcing, which involves a third party who is contracted to manage a particular application, including all related servers, networks and software upgrades.
- BPO: Business process outsourcing, which features a third party that manages the entire business process, such as accounting, procurement or human resources.

Over the next five years, local governments will face unprecedented pressure to provide better services while maintaining or reducing costs. Outsourcing is one way to address this challenge. Governments outsource when they have decided that the best way to increase efficiency, improve performance and reduce cost is to privatize parts of the organization that are not inherently governmental responsibilities.

Information technology outsourcing (ITO) occurs when government entities hire external vendors to manage, maintain and/or run some portion or all of their IT infrastructure and/or applications portfolio. Business process outsourcing (BPO) is another form of outsourcing

in which a jurisdiction hands over the execution of a business process such as accounting, waste management, procurement, or human resources.

What is IT Outsourcing

ITO allows government entities to focus on their core mission, which is to serve citizens instead of managing technology. By outsourcing components of a business process to an outside vendor, management spends more time on its primary mission instead of managing the IT infrastructure.

Traditional outsourcing objectives include reducing operational costs, improving IT flexibility, focusing on core competencies, and increasing operational efficiency. By leveraging the vendor's specialized capabilities, the government organization gains access to state-of-the-art technologies without investing directly in the development or exposing itself to more risk than is necessary. Leaders who identify the need for outsourcing tend to be elected officials, city managers or financial officials. CIOs focused on transformation and modernization may also be interested in the opportunity.

The most commonly outsourced IT functions for government entities include help desk support, desktop support, wide area network (WAN)/local area network (LAN) support, data operations and maintenance of servers, application services and development, and training.

The city of Minneapolis, Minn., chose to outsource its IT infrastructure because it wanted to focus on improved service delivery, not on installing and maintaining computer hardware, software and networks. IT now focuses on applying technology to business needs instead of asset management. In addition, by outsourcing to a third-party vendor, the city gained data disaster protection and 24-hour service it previously lacked. Now the CIO can focus on new application areas that drive better constituent services, increase use of the Internet and leverage IT capabilities to better serve the city.

Outsourcing Models

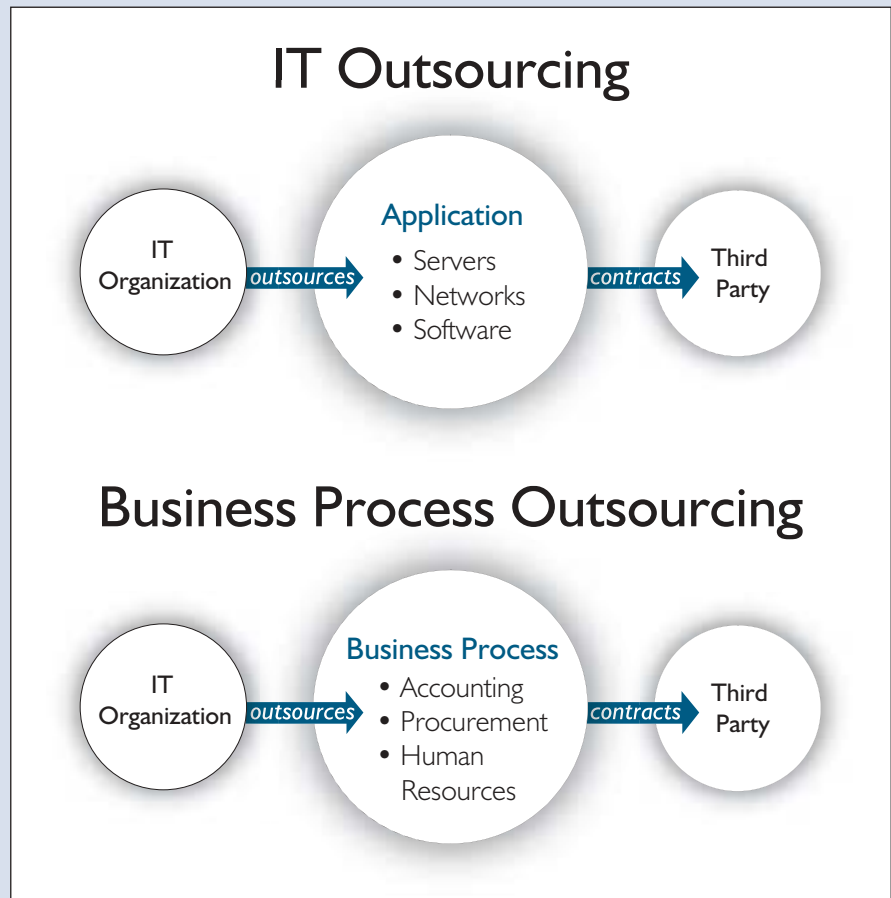
Outsourcing relationships have evolved into four typical models:

- Single Provider ITO: Outsourcing IT services to one off-site provider;
- Multiple Provider ITO: Outsourcing IT services to multiple off-site providers;
- BPO: Outsourcing business processes to an off-site provider; and
- Business Transformational Outsourcing (BTO): Transforming the organization through the outsourcer.

The first outsourcing model, Single Provider ITO provides government organizations the opportunity to outsource a component of their operations, such as help desk support, so that the organization can focus on its core competency: serving the citizens.

As technology has become more specialized, organizations have gained the opportunity to outsource multiple operations using the second model, Multiple Provider ITO. Organizations gain access to specialized IT services and can be selective in the services they choose from each vendor. For example, outsourcing to multiple providers reduces the problem of having an outsourcer that provides excellent desktop support, but below-average application development services. However, organizations must consider the tradeoffs of specialized service with the additional complexity of managing multiple vendors and integrating their activities. Larger vendors typically perform all of those services or subcontract if appropriate.

Minneapolis turned to the Multiple Provider ITO model when it outsourced its help desk support, application management and data center network support to take advantage of different providers offering specialized services. In fact, the city divided the Request for Proposal (RFP) into three parts – each part for



the specialized service needed. Dissatisfaction prompted the move. Users were satisfied with desktop support from the previous ITO, but not with its application development services.

As government becomes more results oriented, process outsourcing is likely to become increasingly prevalent. Some of the more feasible candidates for BPO in the government include fleet management, payroll, bill collection, and check processing.

And, finally, beyond the BPO model is the BTO model, which focuses on organizational transformation. The BTO model is gaining sig-

nificant traction in the private sector. The transformational approach involves taking different departments, such as the finance or human resources groups, and using IT to transform and reengineer related business processes. With more stakeholders involved, change is more rapid and effective throughout the enterprise.

Key Reasons Why Jurisdictions Outsource

A confluence of events is driving local governments to consider new ways of managing and administering technology. Faced with budget challenges, an aging workforce, skills shortages, and a dated technology infrastructure, governments are increasingly considering technology outsourcing as a vehicle to address these issues.

Governments have used outsourcing for years. From recycling to garbage waste collection to IT services, well-managed outsourcing programs help government reduce costs and increase effectiveness. Today, government organizations are outsourcing IT services for a multitude of reasons, including:

- Increasing focus on core competencies;
- Containing costs/saving money;
- Increasing specialized skills to improve IT flexibility;
- Obtaining predictability/reliability;
- Improving service and operational efficiency; and
- Eliminating out-of-control functions or unnecessary resources.

Focus on Core Competencies

Outsourcing allows government organizations to focus on their core mission. After interviewing city and county officials across the nation, outsourcing played a significant and positive role in enabling organizations to focus on mission-critical activities for their constituents and deliver higher overall value and service levels. By outsourcing IT services, the agency focuses on its core mission – improving service to its citizens, not worrying about the LAN or staffing a help desk.

Minneapolis expects outsourcing to save the city \$20 million over seven years, the length of the outsourcing contract. The contract centers on infrastructure management, including servers housed at the vendor's data center. However, the city focused on strategic rea-

sons, not just cost reasons, for outsourcing. By outsourcing, the city is able to improve IT services, increase backup and reliability of systems, and the IT organization is able to focus attention on using technology to improve services rather than the technology itself.

Containing Costs

Along with enabling governments to concentrate focus on their core competencies, outsourcing helps organizations contain costs. In fact, government leaders cite cost containment (particularly during periods of increasing demand for IT services), as opposed to cost reduction, to be a key driver. Most leaders realize that savings is a long-term result and understand that outsourcing limits the costs to a set amount, so jurisdictions gain control over operating costs.

In some cases, governments are in need of aggressive modernization of hardware, software and mission-critical applications. This can often lead to short-term needs to significantly increase investment in IT. The expertise of high-quality firms will help organizations invest efficiently and target spending where it will have the greatest impact and the strongest business case.

The city of Fort Wayne, Ind., moved to outsourcing to gain control over costs. Its outsourcer provides a fixed-cost to run the equipment on site allowing the city to dispose of managing IT functions and better focus on the real issue at hand – improving customer service to its citizens.

Increasing Specialized Skills

Top-quality vendors provide access to a wider and deeper set of skills and services. Governments can also reduce overall IT risk by using suppliers with a reputation for delivering first-rate services and capabilities.

The most common IT specialized skills and services that local governments need include:

- Help Desk Support
- Desktop Support
- Maintenance/Repair
- Data Operations (Servers)
- Server Maintenance
- WAN/LAN Services
- Training
- Application Services and Development
- Consulting and Reengineering

The city of Minneapolis looked for an outsourcer who could provide a data center to house its servers in the state. The vendor has a nearby data center with back-up capabilities and redundancy – technology components the city lacked. In addition, the vendor houses other clients' data, which proved to the city that the vendor had the specialized skills and experience required for housing the city's server environment.

Montgomery County, Md., generally manages its own operations and infrastructure, but relies on vendors for specialized skills and expertise.

Obtaining Predictability/Reliability

Predictability of cost and service is another driver. Many contracts use a fixed-price contract in which the outsourcer provides negotiated-levels of service for a fixed price. Risk of out-of-control costs or unforeseen charges because of technology changes are reduced.

Reliability is crucial for local governments to ensure that citizens and public servants receive the services they need. By outsourcing specific functions, local governments gain access to high-performing infrastructures. For example, by outsourcing application development, local government entities can work with a vendor to prioritize appropriate technology investments.

In some cases, outsourcers bear the risk of ensuring that the technology itself is reliable. For example, the city of Minneapolis sold its assets to the vendor. The outsourcer now owns all of the PCs and is responsible for upgrading the Microsoft software and refreshing systems to maintain reliability. None of the risk of upgrading the PCs and ensuring reliability falls on the city anymore, since the outsourcer owns all of the assets.

The city of Chicago, Ill., on the other hand, continues to own the assets. The city bears the burden and risk of upgrading equipment while the vendor manages the assets. Half of the PCs still run on Windows 98 because the hardware does not support newer operating systems. The burden of improving the technology falls on the city to obtain more reliable systems.

Improving Service by Increasing Operational Efficiency

Over the next five years, local governments will face unprecedented pressures to provide better services while maintaining or reducing costs. Improving service to the end users is another driver of organizations considering outsourcing. For example, outsourcing help desk functions to a vendor who specializes in help desk support can improve the quality of services to the end user. Having specialized in that industry, the outsourcer uses industry best practices to ensure call waiting is minimized and issues are resolved quickly.

An outsourcer may bring leading-edge technology to allow for quick look-up features, storage and retrieval of data, and top-of-the-line customer relations management. This expertise provides the government with the opportunity to provide the total positive customer experience.

A byproduct of outsourcing to improve service

is improved business. All local government participants in a recent meeting to discuss outsourcing, indicated that they had used their outsourcing engagements to standardize business processes and technology, which increases efficiency. For example, prior to outsourcing, the IT environment in the city of Minneapolis was decentralized. Outsourcing helped centralize its IT infrastructure. For example, the CIO consolidated operating systems by standardizing on Microsoft.

For San Diego County, Calif., outsourcing brought consolidation and standardization. The deputy CIO said that outsourcing provided upgraded technology, a reliable infrastructure and a dependable support team.

Eliminating Out-of-Control Services or Unnecessary Resources

Outsourcing can be used to impose discipline on "out-of-control" functions. However, the manager is still responsible for the outsourced function. But, if the function is difficult to manage because of inefficient processes or misunderstood requirements, outsourcing the inefficient process will most likely not fix it. The organization needs to understand its own processes in order to communicate them to the outsourcer. In many cases, a quality-outsourcing firm brings expertise to bear on this problem as well.

Managing Government Concerns about Outsourcing

While local governments are realizing the benefits of outsourcing, important considerations keep organizations from quickly opting in. Worry over eliminating jobs, the desire to avoid costly moves and the fear of losing control of data are all frequently cited concerns. As discussed below, government organizations that have outsourced have had to address these same considerations.

Worrying Over Eliminating Jobs

One of the reasons organizations opt to outsource is to contain unwanted costs. One of the reasons not to outsource is the fear of eliminating jobs – positions that provide value to the organization. One way to retain jobs while transitioning to outsourcing is to re-deploy employees to other companies, transfer them to the outsourcer or free them up to focus on other needed functions within the organization.

To ensure employees' jobs are not eliminated when outsourcing, the organization can require the outsourcer to hire government employees as part of the contract. The city of Minneapolis required the outsourcer to hire its government employees for three years with full salary, benefits and tenure when the city outsourced its IT infrastructure. For the employees not transitioned to the vendor, the city reallocated them to other government areas.

The Fear of Incurring High Costs

Fear of high costs keeps some organizations from moving to outsourcing. The opposite is generally the reality. Investing the time to analyze the business and technical environment and build a case for change provides insight into whether outsourcing may or may not be the best alternative for the organization. The CIO in the city of Minneapolis had to demonstrate cost savings in its business case to the city council and mayor. The outsourced services

could not increase costs over performing the services in house.

Many agencies have found that even if the cost is the same as running the function in house, the ability to fix future outlays has value. For the city of Indianapolis and Marion County, Ind., outsourcing is used to contain costs. Cost containment stabilizes technology costs, which otherwise could spiral out of control. For example, if desktop management is outsourced, the contract specifies a time period and a finite cost for the service. Outsourcing provided the city of Chicago's CIO a fixed, predictable cost over a period of five years. Predictability is welcome by CIOs, CFOs and other city or county executives.

The Concern of Losing Control of Data

Another reason jurisdictions avoid outsourcing is because they don't want to move the public information and data off site. Visiting other cities helps in finding out what other cities are outsourcing. In addition, a clear understanding of laws and regulations helps to make informed decisions about data management.

Outsourcing firms are generally able to offer the best rates when they manage customer data at their city's data centers. These centers may run the operations of hundreds of other customers and offer both economies of scale and leading-edge skills. Some cities are reluctant to give up control and prefer that an outsourcer continue to manage operations in the cities' facilities.

Other governments are comfortable with the secure and reliable environments of high-quality vendors. As a result, they take advantage of cost savings by allowing their data to be managed at vendor facilities. In either case, vendors should be able to describe and demon-

strate the skills and processes used to assure data security, including the use of offshore resources used by themselves or their subcontractors.

The city of Minneapolis would only outsource its data to a vendor located in the same state. While the city lost some ability to "touch" the data, the vendor provided back-up capabilities and redundancy – capabilities that did not exist before and significantly increased data integrity and public safety.

What Functions Should Not Be Outsourced

Not all IT functions should be outsourced. Early adopters of outsourcing indicate that certain functions need to remain in house to maintain control of the knowledge, such as project management and business knowledge.

Project management is a crucial operational function that evaluates risk, change management issues and schedules that drive the cost and success of projects. The government agency needs to be in control to ensure end users are satisfied and results are achieved.

Business knowledge needs to remain in house as well. Business knowledge includes strategic planning, architecture and standards. Allowing the vendor to hold this information leaves the government agency vulnerable to not being able to manage the IT operations in the future because the knowledge goes with the vendor.

The county of San Diego uses its County Technology Office (CTO) to manage the strategic planning of IT with the individual departments. The CTO is also responsible for managing the contractor performance. Since all IT services have been outsourced in San Diego, the county utilizes the project management office concept to manage large developmental projects with the vendor teams performing the work.

PHASES OF IMPLEMENTATION

Throughout all phases, both public- and private-sectors leaders who participated in the recent outsourcing meeting found that building and maintaining a collaborative environment between the government and vendor was the largest factor for long-term success.

Given that organizations vary in size, functional departments, business processes, organizational hierarchies, systems architecture, and applications and more, the following phases provide leaders with a roadmap to a successful outsourcing implementation.

Implementation consists of four key stages, Launch, Mobilization, Implementation/Transition, and Operations.

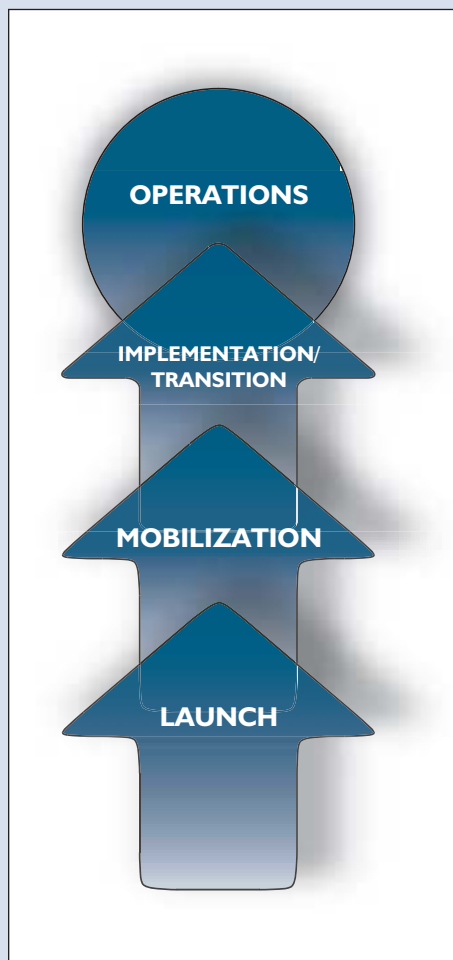
The Launch phase focuses on evaluating whether an organization should outsource. If the organization decides to move forward, this phase also includes building the right teams, creating communication and project management plans, analyzing the system environment, and developing and distributing an RFP.

The second phase, Mobilization, is when the teams develop the contract scope, service level agreements (SLAs), and the statement of work (SOW) to guide the project to achieve stated goals and results.

In the Implementation/Transition phase, organizations transition the operations to the outsourcer while focusing on knowledge transfer, managing the vendor relationship and managing the project to customer satisfaction.

Finally, the last phase, Operations, sets the stage for maintenance and support to ensure outsourcing will be sustained in the future through disaster recovery and disentanglement. This phase also looks at how to evaluate the process to ensure the end user is satisfied with the results.

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LAUNCH

In the Launch phase, leaders should conduct a feasibility study to ensure outsourcing is right for the organization. Organizations examine internal operations to see what functions should be turned over to an outside vendor. Usually the functions or processes to outsource are areas where the organization can cut or contain costs, gain increased skills or knowledge, supplement core competencies, find predictability or better reliability, improve service to citizens, or eliminate functions or resources that are hard to manage.

If the analysis shows that outsourcing provides benefits, the goal of this phase is to build functional teams, develop a communication and project management plan, analyze the system environment to prepare for outsourcing, and develop and distribute an RFP to find the right outsourcing vendors.

Investigating Feasibility

The first step in investigating whether outsourcing is the answer to the organization's needs is to evaluate the tasks and processes that are being performed within an organization to analyze the costs and value proposition of those tasks. Cost reduction is usually what convinces elected officials and local government executives to outsource. A business case enables government leaders to compare the costs of outsourcing with the costs of performing the services in house. The business case should also include an evaluation of the risks and benefits of moving forward with one alternative over another.

One recommendation is to visit other governments using outsourcing, which helps to visualize the results. Seeing how other organizations have implemented outsourcing helps leaders understand the impact within their own jurisdictions and how it can help to increase efficiency and employee and constituent satisfaction.

Building a Business Case

A thorough business case outlining costs, benefits and risks must be made for outsourcing. The first step in evaluating whether outsourcing is the right decision is to complete a cost analysis. The total cost of performing the activity in house should be compared to the projected cost of outsourcing the activity. The business case should include both quantitative and qualitative benefits and their impact.

Full-time employee costs are usually the greatest cost factor of performing the activity in house. Other significant in-house costs to consider include software and equipment acquisition, maintenance and modernization, application design development and implementation, and backup and recovery. Management time, training, recruitment, turnover, and facility and supply costs may also be significant bottom-line contributors.

Outsourcing costs include time for putting the outsourcing proposal together, annual outsourcing fees – including anticipated future pricing adjustments, training of the outsourcer on business processes of the organization, and any additional ongoing costs, such as project management time to manage the relationship between the outsourcer and the organization.

After completing the cost analysis, the business case examines the benefits. This step is the value proposition. The business case compares alternative courses of action. The negative impact of not outsourcing should be considered. For instance, the risk of not moving forward could lead to lost data from failed backups or reduced productivity because of using older technology.

The major consideration in developing a needs analysis is that the results need to satisfy four objectives, at a minimum:

- Show how outsourcing reduces costs.
- Demonstrate how outsourcing adds value.
- Educate elected officials on the performance impact.
- Provide enough evidence to gain support and buy-in.

Outsourcing benefits include access to top-of-the-line technology and resources that can improve delivery of mission-critical issues. Other key benefits include controlled costs, reduced risk of system downtime and overall increased efficiency.

In Minneapolis, IT outsourcing is expected to cut operating costs by \$20 million over seven years. Two million dollars of that is related to avoiding lease space for the data center. Another major area of savings is in technology refreshment. The city was spending 60 percent of its budget and management time just on infrastructure operations, including its laptops,

desktops, databases, servers, and networks. Outsourcing drove savings in all of these areas in addition to providing 24-hour help desk and a back-up system that the city previously lacked.

Many local governments use a consultant to lend expertise to the analysis. Local governments who obtained buy-in from elected officials and other city or county executives found that consultants help to provide both project-level experience and credibility to convince the leaders to move forward.

Creating Teams

ROLE OF THE CIO

The role of the CIO is very important in outsourcing arrangements. Half of CIOs come from a technical background; the other half sport non-technical credentials. With reference to outsourcing, the role of the CIO is seen more as a business function than a technology function. Using the assistance of their technology managers, the CIOs need to be able to manage in a matrixed environment, articulate the government's business challenges and issues and understand the solution strategy that the vendor is proposing. In addition, the CIO needs to be able to manage to business results and sell changes to diverse stakeholders, from citizens and employees to elected officials.

As the organization moves forward with outsourcing, the next step is to create the planning and implementation teams. This step differs for jurisdictions depending on the number of functions to outsource, they might include: procurement, employee relations, and other business functional areas.

Effective team dynamics play a large role in the success of any large initiative. Not only is managing the teams important, but managing the flow of communication between the teams is equally as important. Team members should include:

- **Champion:** An elected official or executive who galvanizes and evangelizes the project. The champion provides leadership and advocacy for the project.
- **Steering Committee:** Policy stakeholder group that helps resolve issues and risks. The steering committee varies for each jurisdiction, but usually includes sponsorship from the functional business executives, such as human resources, finance and IT. The team meets monthly with the project manager (PM) and provides updates and decisions. This group should review high-level progress and critical risks, and help resolve any issues.
- **CIO:** The executive most focused on how technology can meet business needs. The CIO acts more like a contracting manager and relationship builder. In this role, the CIO looks at outsourcing as a business function that adds value to the operations. (See "Role of the CIO" sidebar.)
- **PM:** Assists the CIO in managing the outsourcing contract, change control, SLAs, and the relationship with the outsourcing vendor. The PM coordinates agency resources and work involved with the outsourcer, focusing on project activities, issues, risks, quality, budget, and its team members.

- **Outsourcer's PM:** Assists the organization's PM and CIO in managing the contract relationship and out-of-scope changes, along with its team members.

Generally, organizations should have an RFP team that includes a technologist to determine the requirements, human resources to cover labor relations concerns, and finance and business leaders for fiscal concerns. Following the development and distribution of the RFP, the RFP team may become the evaluation team to appraise the vendors' qualifications before selecting the final company.

Union involvement is a critical element to consider. It is critical to obtain the support of any employee relations organization or unions. It is advised that employee relations be involved from the beginning. In this way, they can best understand the impact to their members and be allowed to provide input to the RFP and vendor negotiations.

Developing a Communication Plan

A communication plan, both internal and external, is vital for success and should be used and updated throughout the process. Communication must begin at the onset and is a three-way line of extension; the lines of communication should extend all the way down to the employees, all the way up to the elected officials and executive members, and all the way out to the citizens. (See “Communication Vehicles to Use” sidebar.)

Topics to discuss include:

- **People:** Outsourcing is often a people issue. Rumors and informal communications will begin as soon as the project is initiated. Employees will have significant concern about their careers and employment and should be told that retaining jobs is a top priority. Union concerns need to be met, as well, since they view outsourcing as a reduction in resources. Once the transition to outsourcing begins, it is important for managers to communicate the vision and business goals to educate and evangelize benefits to the organization.
- **Outreach:** Public hearings should be held so that the citizens are aware of the outsourcing project and its opportunity and value to the community. This will allow leaders to address concerns. Minneapolis' CIO focused on educating as many stakeholders as possible to gain acceptance for outsourcing. The CIO developed a communication plan, held public hearings, educated the council members, and built a business case to sell the idea successfully.
- **Government – Vendor Communications:** Throughout all phases, the organization and vendor should build a positive relationship. Both should share their views on the scope of the contract and how performance will be measured. The city of Chicago's CIO looked at the vendor-government relationship as a marriage.

Both the vendor and government entity needed to view the relationship as a long-term partnership.

- **Implementation:** Outsourcing is about change and the way the organizations manage change. Communication is required to introduce new processes and procedures. The organization's and the outsourcer's employees should be educated on how the outsourcing activity will proceed and how the relationship will have a positive impact on their area of responsibility.
- **Expectations:** As expectations for services, transition and management processes are established, these should be communicated to employees, executives and citizens. For example, outsourced help-desk functions bring efficiency to end users, increased customer service and extended hours of service.



COMMUNICATION VEHICLES TO USE

Communication is important for buy-in and managing expectations. Communication should begin at the onset of the outsourcing project and continue throughout the life of the contract for maximum effect. Some communication vehicles for information dissemination include:

- End-user surveys to citizens and city/county officials to see how satisfied they are with the services.
- Newsletters to provide a consistent message to the organization's and vendor's employees to promote teamwork, describe department's business operations or answer questions.
- E-mail blasts to discuss benefits of the outsourced services and more.
- Monthly or quarterly reviews with the vendor to look at level of performance.
- Web site to publish dashboard on performance metrics.
- Brown-bag lunches to facilitate information discussions about the outsourcing relationship.

Creating a Project Management Plan

Project management begins early and should be retained in house because it's the function that oversees resources, schedules, risk management, and budget control in the interest of the organization.

The city of Chicago retains the project management of the outsourcing arrangement. The PM drives innovation, flexibility with contract issues, and most importantly, the relationship between the organization and the vendor. The deputy director of the city of Indianapolis and Marion County believes that strong project management should remain in house so that the knowledge is retained in the event of termination of the contract.

The plan should address the issues of roles, responsibilities, processes, issue, and risk escalation, conflict resolution, maintenance, schedules, scope management, and change and resource management. The plan should focus on vendor relationship management. Mutual trust is key, and recognition of the importance of communication through regularly scheduled meetings and meaningful reporting mechanisms.

Analyzing the System Environment

The next step and a key element of the project management plan is to analyze the system environment to prepare for transitioning the functions and processes to the outsourcer. The business processes that will be outsourced should be analyzed to assure the processes are efficient or to identify efficiencies to be gained.

In addition, along with streamlining the processes, the inventory of assets involved in the outsourcing agreement should be completed. The contract, SOW and SLAs reflect an accurate account of the system environment and project scope. Minneapolis' CIO believes in allowing enough time for due diligence to develop an accurate inventory, improve the RFP process and allow the vendors to develop a greater understanding of the scope of the project.

Outsourcing requires an examination of internal processes, which usually leads to improving processes. The true value that outsourcing brings is the opportunity for an organization to become more efficient and effective, and reduce or maintain costs. It forces organizations to answer difficult questions, such as:

- What are the primary objectives of the department or organization?
- What processes are in place to support those objectives?
- Who is involved in implementing these processes?
- Are there multiple functions involved in the process?
- How can performance be improved in the process?

By finding the answers, organizations document the current processes, find areas that need improvement and enable the outsourcers to focus on the new improved processes.

RFP and Vendor Selection

The RFP should be tailored to each organization's unique business processes and system's environment. A third-party consultant can help to develop the RFP, assist in evaluation of responses, select the vendor, and negotiate the final contract. Since a strong working relationship between the government and vendor is required, cities should avoid over-reliance on third-party advisors.

One way to streamline the RFP process and improve vendor selection is to provide as much information as possible concerning the scope and expectation of the project. The better those vendors understand the environment, the less risk is assumed. Vendors generally build cost for risk into their proposals. Therefore, a thorough understanding by the vendor will ultimately reduce cost. Three of the most important points to cover in the RFP include:

- Detailed SOW that is required and description of IT system environment;
- Service levels expected and performance measurements that will be incorporated; and
- Proposed terms and conditions expected to be met.

The Indianapolis/Marion County RFP included the organization's vision and strategy; IT strategic initiatives; an overview of the agency; the agency's outsourcing goals and scope; and SOWs for all of the business groups (data center, network, help desk, distributed computing, and application services), including their related service environments, service requirements, roles and responsibilities, and service level expectations.

Considerations during this step include:

- Hiring a consultant to help analyze system environments and business processes.
- Talking to vendors to see if there is interest in responding to the RFP.
- Holding a vendor conference to answer questions.
- Inspecting references and qualifications. A financial background check will help to ensure that the company is viable over the long run. Both the county of San Diego and the city of Minneapolis evaluated the financial background of the companies to verify their long-term stability. Previous local government experience is a positive sign that the vendor will bring value to the project.
- Focusing on the quality of the vendors before reviewing the costs to keep the choices subjective. The city of Minneapolis narrowed the choice down to two vendors and then capped the cost of the project at a specific amount so that cost was removed from the issue. The two vendors then compromised on certain areas within their proposals to meet the requirement.
- After narrowing the choice down to a select number of vendors, visiting the vendors' sites to view facilities and experience the culture. The city of Minneapolis' CIO visited the vendors in their locations and looked at their facilities before negotiations began.

MOBILIZATION PHASE

The Mobilization phase is where the organizations assemble and prepare for the outsourcing to take place. With the vendor chosen, the contract, SOWs and SLAs should be finalized

and communicated. All parties in the transaction have legitimate interests to protect; however, establishing an effective long-term relationship is critical.

Developing the Contract

The contract is a tool that can evolve through the negotiating process. The contract needs to outline the agreement between the two parties on scope, performance and pricing. The contract references the SOW.

Public entities have historically preferred fixed-price arrangements for long-term outsourcing contracts. More recently, government finance and IT organizations have been considering the benefits of having part of the contract be variably priced – where charges are based on usage. This may result in lower total cost and has the benefit of providing greater flexibility than pure fixed-price contracts.

Other governments have utilized gain sharing in which the vendor has an incentive to deliver savings to the city and receive some of the benefits. The city of Indianapolis and Marion County incorporated “gain sharing” into the contract to motivate and reward vendor innovation. The contract states that “any change initiated by provider resulting in the savings or improved services benefiting city/county entitles provider to earn an account credit equal to a percentage, not to exceed 25 percent of the actual savings or demonstrated value in improved services for a period of 12 months, after which all further savings or enhanced value shall be realized by city/county.”

The contract also needs to cover how to handle changes. The contract should be flexible enough to allow for continuous improvement in technology and business processes. For Indianapolis and Marion County, the outsourcing contract established almost a decade ago has 80 amendments, providing an example of showing how contracts are likely to evolve over time.

Creating Service Level Agreements

SLAs outline specific quality expectations the outsourcer must meet and range from overall success criteria to day-to-day operations. Performance management ensures that the vendor is providing the service expectations set out in the agreement. By meeting the service level performance metrics, the vendor is providing value to the organization. (See “Examples of Service Level Agreements” sidebar on p.17.)

The SLAs should be small in number and easy to understand, define which metrics should be measured, and identify who is responsible for quality. Governments should also consider the true service level requirements for various components of government to avoid unnecessarily

high costs. Indianapolis and Marion County reduced the number of SLAs from 60 to nine to simplify and focus on key metrics and processes.

Minneapolis put SLAs and penalty arrangements in place for its contract; however, the CIO stresses that the contract is only the starting point in the outsourcing arrangement. The CIO believes that it “all comes down to people. Working together is like a marriage.” The vendor has to blend into the culture and understand how the city operates and realize that if the IT systems fail, the impact will be huge.

Using penalties versus rewards is a factor organizations struggle with when setting up contracts with vendors. During our study on

outsourcing, several government organizations felt that penalties are required to keep the vendor performing; however, organizations rarely enforce them. Organizations should carefully balance the costs and benefits of including harsh penalties in contracts. Overly strict penalties will deter high-quality vendors – even as governments consider penalties to be a last resort.


The city of Chicago focuses on the relationship as a long-term partnership. The city does not believe that the vendor should look at the small details. If the vendor runs the outsourcing project right and it’s running well (as measured through customer satisfaction), then the government is satisfied with vendor performance.

The city also incorporates awards into the contract to help provide incentives for the vendor to exceed performance levels.

Indianapolis and Marion County analyze the SLA monthly. If the vendor falls below the metric established in the contract for two consecutive months, the vendor is penalized. This process enables the vendor and organization to monitor performance and right the problems before they become an issue.

Governments use rewards as useful incentives to provide long-term benefits. In the private sector, businesses reward their employees who are managing the outsourcing contract. Tools such as goal-aligned bonus packages, reward them for company success and partner success. In addition, a bonus is provided for effectively responding to change.

Indianapolis and Marion County incorporated "gain sharing" into their contract to motivate and reward vendor innovation. The contract states that "any change initiated by provider resulting in the savings or improved services benefiting city/county entitles provider to earn an account credit equal to a percentage, not to exceed 25 percent of the actual savings or demonstrated value in improved services for a period of 12 months, after which all further savings or enhanced value shall be realized by city/county."

 EXAMPLES OF SERVICE LEVEL AGREEMENTS			
NAME OF SLA	DEFINITION	MEASUREMENT PERIOD	PERFORMANCE TARGET
Data Center Services:			
System Availability	Percentage of time the systems are available for use during scheduled uptime	Monthly	99.9%
Online Transaction Response Time	Length of time for online systems to process request and return data to end-user's screen	Monthly	95% within 2 seconds 99% within 5 seconds
Backup Completion	Percentage of time that backups must be completed successfully. Backups must be verified and re-run if not successful	Monthly	99%
Local Area Network:			
Transaction Response Time	Length of time host systems and networks transmit and process request and return data to end-user's screen	Monthly	95% within 5 seconds 99% within 10 seconds
Help Desk:			
Call Waiting	Length of time for caller to reach a live human voice	Monthly	90% within 90 seconds 99% within 180 seconds
First Call Resolution	All calls resolved during initial call to Customer Support Services	Monthly	49%
Password Resets	Length of time between password reset request and completion	Monthly	95% within 30 seconds 99% within 60 seconds

Formulating the Statement of Work

Part of the overall contract, along with SLAs, is the SOW. The SOW details the work to be performed and describes the scope of the project. Organizations participating in a recent outsourcing study indicated that the SOW should clearly articulate which services are in or out of the scope of the contract and how changes will be made to those services. The SOW provides a baseline in which to manage the project. SOWs will vary considerably across projects, but should at a minimum contain:

- Complete listing of services and tasks
- Service levels
- Deliverables
- Other key expectations

IMPLEMENTATION PHASE

Once the vendor has been selected and the contract, SLAs and SOW are complete, the Implementation or Transition phase begins. At this point, operations of various IT services will be transitioned to the vendor. While the business relationship is established during RFP and contract negotiation, this is the phase where a true partnership needs to be built between the outsourcer and the government agency.

Important issues to consider during this phase include enabling knowledge transfer through training, establishing relationships and managing the outsourcing process to customer satisfaction.

Enabling Knowledge Transfer

The contract, SLAs and SOWs help set project expectations and manage performance; however, a transfer of knowledge between the organization and the vendor is critical for the outsourcing partnership to succeed.

The organization and vendor need to cross train each other; the organization's employees should learn the outsourcing operations; and the outsourcer's employees should learn the organization's business processes. Cross training enables team members to develop ideas for innovation and change, identify risks, discuss issues and help with the overall management of the outsourcing process. Minneapolis' CIO believes training is a must for outsourced personnel in order to learn how the city runs its business.

Managing the Vendor Relationship

Active relationship management is critical to ensuring that government objectives are met. According to the CIO of Minneapolis, the working relationship between the government entity and the vendor is like a marriage and management is the key to success. Some organizational leaders state they spend more than 95 percent of their time on relationship building.

Although scope of work, service levels and penalty arrangements are defined in the contract, participants in the study indicated that in reality the organization's managers rarely enforced the penalties. Further, changes in requirements and technology are inevitable. It is common when unexpected developments occur for the vendor to look toward the SOW and the organization will focus on the SLAs. By being flexible on both sides, the organization and the vendor can deal with issues in an open and non-adversarial way. In fact, if the relation-

ship focuses purely on meeting SLAs, there's a problem in trust. If trust is lacking, the relationship will have trouble succeeding.

For the city of Minneapolis, vendor creativity was a plus. For example, the vendor leveraged the contract with the city when additional mainframe capacity was required for new projects. The vendor used the financing provided in the contract for a set number of servers to fund the acquisition of the mainframe. The city believes that the vendor should be able to maximize its profit, as long as it works within the constraints of a price ceiling.

The vendor needs to understand the organization's needs as they evolve in order to offer new technology or modifications to existing processes because the organization's business needs are likely to change throughout the life of the contract. Organizations should be cau-

tious not to unreasonably constrain vendor profits or the relationship will inherently sour.

The vendor and government customer must look at the relationship as a long-term partnership where the focus is on the outcome, not the tasks. Building the relationship right from the start involves a process of continual improvement that is bolstered by performance measures and end-user satisfaction metrics.

Managing Customer Satisfaction

END-USER SURVEYS

For Indianapolis and Marion County, an end-user customer satisfaction survey was conducted semi-annually. The outsourcer's customers were the city and county's employees who used the outsourcer's services. The city and county outsourced an extensive list of IT services, including help-desk support, IT services, network support, and more. Using a rating scale from one to five, with five being the highest possible rating, the city and county used the survey to ensure that the vendor was providing its customer satisfactory services.

The survey asked the end-user to rate the outsourcer on help-desk support, IT services, network and systems stability, and availability and usefulness of the government's enterprise PC applications.

In addition, the survey provided the opportunity for the end user to rate the outsourcer's availability and average time to repair computing hardware and enterprise PC applications.

Other questions focused on rating the outsourcer's:

- Understanding of the department's technology needs, value of the services provided, and overall satisfaction in areas of communications and responsiveness, commitments in meeting project deliverables, problem-solving, business consultant services, application development/maintenance and support services, network support services, and production services (reports, batch jobs, etc.).
- Attitude and demeanor, such as how respectful the outsourcer's employees are, whether they deliver what they promise, and if they're friendly and enjoyable to work with.
- General quality of services. For example, if the vendor maintains high standards of quality services, successfully meets employee's needs, provides a simple process for employees to get information or help when needed, and has an effective process for employees to make suggestions or escalate issues.

Finally, the survey asked open-ended questions, including:

- What do you consider to be the vendor's strengths and/or weaknesses?
- Have there been any services/technical support that your department has requested, but was not provided? If so, please explain.
- What additional services and/or technologies would you like the vendor to provide for your department?
- What other comments would you like to make to the organization or vendor about your IT needs?

Most organizations outsource to increase services to their citizens, while enabling them to focus on core competencies. The questions often asked are, "Is the outsourcing improving customer satisfaction? Are we doing a good job? How do we capture it?"

The city of Chicago retooled its contract after the first year to better focus on customer satisfaction. A baseline survey showed that only 50 percent of employees were satisfied with the current services. After increasing focus on satisfaction, the percentage of satisfied employees rose to nearly 70 percent.

The city uses its customer satisfaction-driven SLAs to improve customer service. Weekly program management meetings focus on the dissatisfaction factors articulated in the survey. By following up on the root cause for dissatisfaction, the city and vendor are able to improve customer service.

Indianapolis and Marion County included verbiage in a new contract to ensure the vendor performs end-user satisfaction surveys at a minimum of once a year and within 180 days after the commencement date of the contract. The surveys must cover a representative and statistically significant sample of end users along with a separate sample of senior city/county management.

The city and county will help the vendor to identify the appropriate sample of end users, distribute the surveys, and encourage participation in order to obtain meaningful results. (See "End-User Surveys" sidebar.)

Operations and Contract

The final phase includes ongoing operations and the contract. In addition, if an outsourcer must discontinue operations or a disaster occurs, this phase looks at how to ensure government operations continue.

Contract changes are a natural result of long-term business agreements. Government requirements may change or evolve and the services required of the vendor may expand. Contract changes should be a natural extension of a well-managed relationship between a government and its outsourcing partner. The contract should address the process for project change, but good project management and communications will be critical for effective execution of long-term contract change.

As discussed earlier, Indianapolis amended its contract 80 times in 10 years. Outsourcing relationships and IT requirements naturally evolve over time, so flexibility is critical.

There may be unfortunate circumstances when the jurisdiction must terminate the contractual relationship, such as when the outsourcer consistently fails to maintain agreed-to service levels or adequately support the functions being outsourced. Organizations should include a “Termination Clause” in the contract.

Indianapolis and Marion County added disentanglement obligations to their contract after the last outsourcing engagement ended in a difficult and costly affair incurring unforeseen transition and legal expenses. Their contract now requires the outsourcer to provide the following disentanglement requirements:

- Complete transition of terminated services to the government organization or to a replacement vendor designated by the government organization without any interruption of services or impact on the services.

- Full cooperation with the government organization to complete the disentanglement.
- All information provided to the organization pertaining to the outsourced contract. For example, interface specifications and data conversion.
- All work managed by the outsourcer, whether completed or partially completed, along with documentation of work in process and other measures to assure an orderly transition occurs.
- All disentanglement services provided for the transition with costs specified.
- All asset transfers and other obligations provided to the satisfaction of the organization for the vendor’s obligation to be deemed completed.


Finally, contracts should address disaster recovery. Without an effective backup and recovery plan, core city services may be at risk. The contract should consider disaster recovery situations and remediation plans to ensure continued support of operations. The plans should include how the vendor will ensure:

- Continuing availability and integrity of the outsourced services and/or systems;
- Regular testing and updating of a disaster-recovery plan.
- Availability of alternate site facilities.


In addition, the government and the vendor should update and test all disaster-recovery procedures at least once a year.


CRITICAL SUCCESS FACTORS

What makes outsourcing a success? What makes it fail? The following critical success factors from those who have previously been involved in outsourcing should provide insight into how to successfully weave a little magic into outsourcing programs.


 **Develop a Strategic Plan for Outsourcing:** One of the first tasks to accomplish when deciding to outsource is to work through the strategic planning process and develop a clear vision, goals and measurable performance objectives. The vision statement steers the project to the end expected result, and the goals define the expected objectives to be accomplished to obtain the result. Performance objectives and measures provide city managers with the tools to both track overall effectiveness and demonstrate the results of the initiative.


The vision and goals should provide a commitment to adopting best practices to be communicated to policy makers, staff, citizens, and the vendor. It also assures buy-in to embrace the resulting strategies and action plan.


 **Conduct Site Visits to Other Entities that Outsourced:** The public sector is different than the private sector in that the governments are willing to share information. In the private sector, information is viewed as a competitive advantage. Site visits provide an opportunity to see firsthand how another city or county manages its outsourcing operation. Visits also offer the chance to hear lessons learned. In addition, if elected officials or executives are unsure as to whether outsourcing is the right direction to take, site visits help leaders visualize how the process can be accomplished within their own jurisdiction, and how it can help their organization increase efficiency and customer satisfaction.


 **Identify Clear Scope and Inventory:** Scope expansion, which happens when there are out-of-scope tasks or uncounted inventory, should be avoided. Scope change is defined as


any activity that modifies the deliverables, cost or schedule of a project. Change management is clearly a vehicle to allow for managing changes in the scope because of unforeseen issues or tasks, but it adds additional costs to the pre-defined budget. If scope is clearly defined in the beginning, costs can be maintained. A detailed SOW can help identify the scope of the project. The SOW establishes a baseline of services to be delivered. It should be sufficiently detailed to allow the organization and vendor to assess if a change is an additional request not included in the originally defined scope.

 **Maintain Business Knowledge In House:** Strategic, contract and project management, and related business knowledge should remain with the government party so that operations are controlled in the best interest of the citizens. Most importantly by maintaining business knowledge in house, the organization protects itself if the vendor discontinues services. The agency can continue the services or transition the services to another vendor ensuring critical government systems continue to function. Retaining the management of the critical elements keeps the project under the organization's control.


 **Develop and Follow a Communication Plan Throughout the Process of Outsourcing:** The key phrase is "throughout the process." Communicating at the end does not work. Informal communications will begin as soon as the outsourcing plan is initiated. The most important element in the communication plan should be people-focused to reduce resistance to change. Most employees will be worried about change and how the change will affect their jobs. This can lower morale and reduce productivity. A communication plan is helpful to iron out the details ahead of time. Considerations should include: message, audience, schedule for communication, and communication vehicles to use. (See "Communication Vehicles to Use" sidebar on p.13.)

 **Create a Relationship with the Vendor:** Successful leaders of outsourcing engagements say over and over that the relationship between the vendor and the outsourcer is one of the most important elements in ensuring that the government achieves its performance objectives. Both parties need to be flexible when changes occur in technology and processes and both need to trust the other for maximum results. Although the two parties have differing objectives, both need to look at the relationship as long term. The vendor must understand that the government's needs evolve throughout the life of the contract, and the vendor should be prepared to react quickly to those needs. The government, on the other hand, should realize the contract should be flexible enough to allow the vendor to be creative in how it responds to necessary changes.

 **Use SLAs, Penalties and Rewards:** Usually government organizations include SLAs in contracts along with penalties to ensure quality service from the vendor; however, most organizations never refer to the SLAs once the contract begins. If a vendor's performance is continually lacking, invoking penalties may help to turn the performance around. However, most organizations stated that they prefer to manage the vendor relationship through a flexible arrangement of give and take. As a result, in designing RFPs and contracts, governments must balance the desire to zealously protect their interests against the costs of unnecessarily high service levels and the risk of "scaring off" high-quality vendors with overly difficult terms and conditions. Rewarding effective performance is a win-win solution for both vendors and governments.

 **Cross-Train Employees:** Training is crucial to ensuring smooth operations. Not only does the organization need to learn the outsourcer's operations, but also the outsourcer needs to understand the organization's business processes. The two parties will be working together over a long period of time,

so both should be comfortable with the technology and business operations involved for the best results. In addition, by understanding each other's business operations, employees from both sides can offer innovative ideas in technological improvements and process efficiencies over the life of the contract.

 **Maintain Executive Support and Customer Focus:** For the project to succeed, support at all levels of the organization is critical. From the constitutional offices, the executive level, the employees and citizens, communicate what the project is about, who it will affect, how long it will take, and what benefits will be realized. Executive support is critical to illustrate to stakeholders that the project will move forward with complete support. In addition, the executives become the champions of the project evangelizing the benefits that will be realized.

Deciding to move to outsourcing is a customer-focused move from the start. One way to evaluate if the outsourcing is meeting the needs of the customer is to conduct customer satisfaction evaluations, not only of the end user, but also of the government leaders. Expectation management is important so as not to over-promise early improvement as transition is under way. ■

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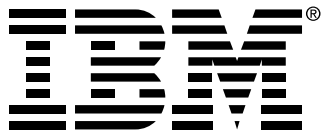
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