CASE STUDY 4

Global IT Outsourcing – High-Tech Manufacturer ("Client")

Challenge

Work with IT executive leaders from Corporate, US, Europe and Asia to transform the global IT operations to achieve corporate cost reduction targets and required service level objectives including realizing the following benefits from the new model:

- Reduction in labour costs with increased transition to Low Cost Geographies (LCG)
- More variable cost model
- Technology refresh and currency
- Greater responsiveness, capability, flexibility
- High grade IT processes to Capability Maturity Model Level 5

At the time, the IT department was considered a poor performer from both a cost and quality perspective with a lack of management control and visibility over critical aspects of performance. The CIO had just launched a comprehensive business transformation that included all of her team. It was a very sensitive initiative for Procurement because it involved determining their team's ongoing role in very critical aspects of supply management.

The challenge initially was overcoming the intense friction that existed between IT and Supply Chain Management that extended all the way to the senior executive ranks. To overcome this challenge I ensured I found champions within the diverse business units in IT and aligned with their own, often conflicting, objectives and priorities. The Project accomplished this by working hard to develop, implement, and sustain a more thorough and flexible approach to procuring goods and services, as well as leading an ongoing focus on supplier management after the procurements were concluded. This included comprehensive governance structures, service level agreements, regular supplier performance surveying and reviews, and transparent, scalable costing. The result was a new "partnership" between IT and Procurement with clear roles and responsibilities, a shared agenda and greater overall value for Client.

Solution

The Project started with an extensive "buy vs build" assessment to determine the most effective approach to fixing IT's problems. The Project recommended, and the senior executives agreed, that the best decision was to pursue an outsourcing strategy to ensure competitiveness in the IT services portfolio while consolidating the existing, disparate supply agreements to leverage volumes.

The scope of the IT outsourcing included:

- IT Operations - data centres, help desk, email
- Infrastructure - database administration, change management
- Application Development
    - strategic suite (SAP)
    - information management (portal, B2B, data warehousing)

This led to the Global IT Outsourcing RFP, which resulted in a selection of SUPPLIER to negotiate a 7-year contract worth $500m+ with services delivered primarily from the US, China, and India. The deal included a commitment to achieve the following business objectives:

- Customer benefits
  - Enhanced responsiveness
  - Greater breadth and depth of IT offering
  - Exploit new global IT model
- Utility computing and storage
  - A "Pay for consumption" model
  - Regular technology refresh and ongoing currency maintained
- On-demand skills and solutions
  - Variable cost model – 'burst' capacity / instant reduction
- Risk mitigation
  - SUPPLIER India has extensive experience with Low Cost Geography transition
  - Leveraging core competency and scale of skills available

The PM was also the prime for the intense negotiations that followed the RFP. For two months the negotiating team, which included Directors, Executives and other SMEs, were deployed in a hotel in daily face-to-face negotiating sessions tasked with hitting the annual, five-year budget targets that prompted the outsourcing. After a month of full-time negotiation we had made the following progress on key contract terms, crucial to the long term success of an outsourcing agreement, because of the leverage they would provide Client:

- A variable pricing structure with meaningful ARCs and RRCs. **(Good Coverage)**
- No, or low, contract minimum commitments. **(Good Coverage)**
- Liberal rights to withhold disputed charges. **(Good Coverage)**
- Unrestricted rights to use third parties. **(OPEN)**
- Partial terminations at reasonable costs. **(OPEN)**
- An effective service level management model with meaningful amounts at risk. **(OPEN)**
- Clearly defined service and financial responsibilities. **(OPEN)**

When we finally reached what seemed to be an intractable impasse on the Open Items and having exhausted every other negotiating technique to try to create forward movement, the Project recommended to the CIO that we express our disappointment to SUPPLIER's senior executive championing the negotiations and if that failed, then pull the plug on further negotiations. When the SUPPLIER SVP refused to agree on the necessary resolutions to the issues, the Client CIO formally terminated the negotiations, going so far as packing up our dedicated negotiation / war room facilities at the hotel and re-deploying the team back to their regular jobs.

This move was very risky in that if SUPPLIER still didn't concede Client would eventually have to come crawling back and compromise our negotiating position as our team and the executives knew that we had gone too far in the process to turn back. We also knew we couldn't achieve the CFO-mandated budget targets internally or with another bidder from the RFP.

Results

The risky but effective negotiation tactics I employed paid off when SUPPLIER's Canadian CEO contacted our CEO directly and made a proposal that delivered on each of the demands we had identified when we broke off negotiations. The negotiations reaped the following key financial benefits for Client:

- $60 M cash savings over 7 year term of contract (NPV $40M)
- Cost reduction of 13% on new outsourcing over first 5 years of agreement

P & L	2005	2006	2007	2008	2009	2010	2011	Total	IBM Billing
CLS Basecase	119	115	109	110	110	110	110	**783**	**84**
CLS with Low Cost Sourcing	119	110	103	103	104	104	104	**747**	**84**
CLS w/IBM *	119	106	104	100	95	93	92	**709**	**231**
Outsourcing Benefit	-	**4**	**(1)**	**3**	**9**	**11**	**12**	**38**	
EPS Impact	-	$ 0.02	$ (0.01)	$ 0.01	$ 0.04	$ 0.05	$ 0.05	$ **0.16**	
Cash Flow									
Cash from earnings	-	1	(5)	(2)	1	4	6	**5**	
Capex reduction (H/W , S/W)	6	13	14	9	4	4	4	**54**	
Net Severance Reduction	1							**1**	
Net Cash Benefit	**7**	**14**	**9**	**7**	**5**	**8**	**10**	**60**	

* Incl. transition costs of $2.7M/yr

It also brought in an innovative utility computing model that removed our IT asset liabilities from the balance sheet. The contract also featured other business benefits such as:

- Benchmarking provisions
    - Gartner, IDC, Hackett
    - Variance from benchmark target requires corrective action
    - CMM level 5 quality and productivity (KLOCs per hour) standards
- Change Management
    - All change managed through documented change requests
    - Full scope of requirements reviewed and priced
    - Approval required prior to any change or new service delivered / invoiced
- Service Level Agreement
    - Monthly performance review of metrics (Ops/Infra/ADM)
    - Performance Metrics include : Lead-time, flexibility, speed to solution delivery, Quality, OTD, KLOCs
    - Penalty for non performance up to 10% of monthly revenue
- Management system
    - Joint steering committee
    - Mutual accountability for delivery
    - Dedicated joint transition team
    - Global project executive
- Strategic alignment
    - Quarterly alignment on major initiatives / programs
    - Annual operating plan interlock / Advanced awareness in new technology roadmaps
- Other Key terms
    - Transition costs $10M capped (amortized over 51 month lease)

- Termination for convenience fee 3% of remaining contract term plus unamortized transition and we incur setup costs for resourcing
- 7 year term with evergreen annual renewal right at rate no higher than previous yea