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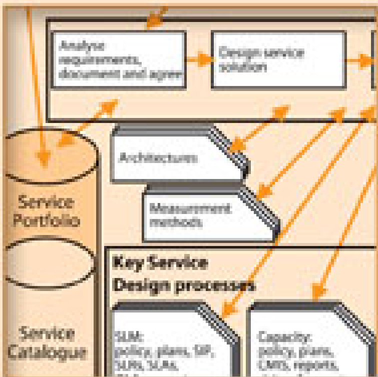
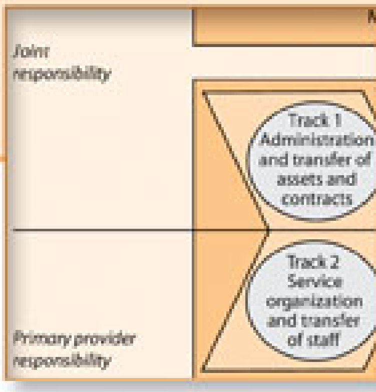
A MANAGEMENT GUIDE

IT Outsourcing Part 2:
Managing the Sourcing Contract





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Part 2: Managing the Sourcing Contract
A Management Guide

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IT Outsourcing

Part 2: Managing the Sourcing Contract

A Management Guide

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CHAPTER 1

Introduction

This book describes the processes for managing the contract for outsourced IT services. It is the sequel to *IT Outsourcing Part 1: Contracting the Partner*, which describes the processes of selecting a suitable IT partner to outsource the services and developing a contract. We assume that readers of this book will be familiar with the topics discussed in *IT Outsourcing Part 1*, which include:

- the business case for outsourcing
- developing a Request for Proposals (the requirements for the service itself, transition, governance, human resources (HR), finance and legal aspects)
- the criteria for selecting a suitable partner.

IT Outsourcing Part 2: Managing the Sourcing Contract (this book) covers all the processes for managing the contract, from the transition phase through to normal operational service and contract termination.

1.1 What is contract management?

Contract management is the process for ensuring that the service provider delivers the required services during the contract period. It provides the interface between customer and provider, so that business requirements are clearly understood, services are delivered to the agreed quality and cost, and risks are managed effectively.

The contract management process is made up of three components:

- service delivery management, which ensures that the services meet the performance requirements set out in the contract (managing contract fulfilment and obligations)
- relationship management, which ensures that the interface between the customer and service provider is clearly defined and communications are effective, and includes accountability for the commercial and contractual relationship
- contract administration, which handles the routine tasks such as payment of invoices and production of management reports for the organization's supplier management function or equivalent corporate overview of supplier relationships.

The process of contract termination also has to be managed.

A governance framework defines the roles, responsibilities and reporting arrangements for managing the contract.

1.2 Why is contract management important?

For most organizations, IT services are critically important to the business. Effective contract management ensures that service delivery runs smoothly, with no surprises, and benefits are realized as set out in the business case, through development of a good working relationship and clear understanding on both sides of what is required.

Unfortunately, experience has shown that customer organizations often lose interest once the contract has been signed. They are actively engaged during the acquisition process, but fail to see the importance of continuing that engagement; providers frequently lose interest too, after they have secured the contract for new work. As this book will demonstrate, it is essential for both parties to take an active interest in contract management right from the start, during contract development, to the end of the contract term and handover to a new provider.

1.3 New approaches

The IT services industry is increasingly moving away from adversarial 'them-and-us' relationships in which there is little trust and respect for each other, to partnering arrangements where both parties recognise a mutual dependence and aim to work together for shared benefit. The extent to which the parties are willing (and able) to work as partners will vary, but usually includes a shared approach to risk management and some form of open-book accounting in which the costs are visible to both parties. The working relationship is critically important to the success of a partnering contract. (Chapter 5 discusses relationship management in some detail.)

1.4 Critical success factors

Surveys of successful (and unsuccessful) IT sourcing contracts consistently point to the same set of factors for success:

- thorough preparation during the Request for Proposals (RFP) stages, with a clear understanding of the business case for outsourcing, the service requirements and the type of service provider who would best meet the business need
- good contract development as the foundation for contract management, which covers every aspect of operational service – such as service quality, performance measurement and communications

- an appropriate governance framework, which ensures that everyone knows their role and responsibilities in the contract
- appropriate control and intervention mechanisms in place
- the right individuals in key roles, with appropriate authority and likely to be able to work together effectively
- access to external expert advice when required, especially if the organization is new to outsourcing
- continuity of people involved in the contract, right from the early stages of the RFP through transition to everyday operational service
- effective relationship management, with mutual respect and good communications, where neither party seeks to gain an advantage over the other
- a collaborative customer-driven business attitude based on mutual trust and understanding
- flexibility in day-to-day administration of the contract, with willingness for a 'win-win' approach when problems arise.

1.5 The common pitfalls

The common pitfalls in contract management can be traced to two major themes: contract preparation and 'people' issues.

Poor contract preparation means that the everyday aspects of the contract have not been considered in enough detail. Areas that are critically important (but often skimped because they do not seem especially important at the time) are:

- the governance framework – lack of clarity about roles, responsibilities and the interfaces between the service management processes of both the customer and the provider
- no clear understanding of how performance will be measured, including appropriate Key Performance Indicators (KPIs)
- not addressing the risks in transition and operational service – what those risks mean to the business, how they will be managed and who will be responsible for managing each risk.

The 'people' issues are concerned with:

- identifying the wrong individuals for key contract management roles (both the customer and the service provider) with mismatched skills and personal styles that are incompatible with the aims of the contract – leading to personality clashes and disputes

- frequent change of staff, resulting in loss of continuity and lost knowledge about the purpose of the contract
- insufficient staff and/or inadequate skills for contract management.

1.6 Structure of this guide

This book is structured as follows:

- *Chapter 1: Introduction* (this chapter) sets the scene for contract management
- *Chapter 2: Principles* discusses the factors for success and outlines the relationships with service management processes, including ITIL™[1]
- *Chapter 3: Foundations* describes how the components of contract management are developed and put in place from the earliest stages of the RFP, through to transition and everyday operational service
- *Chapter 4: Roles and responsibilities: the governance framework* describes the formal roles and reporting arrangements for contract management – the demand and supply organizations
- *Chapter 5: Managing the relationship* discusses the 'soft' or informal aspects of contract management through the working relationship
- *Chapter 6: Managing service delivery* (performance) explains how services are delivered and performance of the service is measured and managed
- *Chapter 7: Risks in an IT outsourced service* describes typical risks (business, service and external environment)
- *Chapter 8: Managing improvements and changes* deals with requirements for continuous improvements and changes to the business need, including contract termination
- *Chapter 9: Contract administration and tools* describes the day-to-day procedures for contract management and the tools to help, together with the interface to the Supplier Management process.

1 ITIL: IT Infrastructure Library

CHAPTER 2

Principles

This chapter discusses the factors that influence successful contract management, the resources that will be required and the relationships with service management processes, including ITIL.

Managing an outsourced IT service contract is about achieving common understanding between the customer and the IT partner, delivering results and managing expectations.

There will be relationships to manage and service quality to monitor, as well as getting value for money and (ideally) ongoing improvements to the service. You may have to manage more than one partner, possibly with complex interdependencies of providers and infrastructure.

2.1 Objectives of managing IT service contracts

The objectives of managing IT service contracts are to:

- influence, as far as is practicable, the RFP process, to end up with a service that is manageable in its scope, boundaries and performance metrics and is in line with the outsourcing goals
- similarly, influence the selection of an IT partner who can do the job well and who the organization can work with
- manage the delivery of the service through the life of the contract, within agreed parameters of benefit, cost and risk
- monitor, influence and control the performance of the service and contract
- ensure that the service adapts appropriately to the changing needs of the business and/or technology advances
- prepare for smooth handover to a new provider at the end of the contract period or termination of the contract.

2.2 What does success look like?

A contract is working well if:

- the contractual business case has been met
- the customer obtains the service they want at the agreed price

- the service provider is making a reasonable profit
- both parties are meeting their contractual obligations
- changes are managed smoothly
- there is a 'win-win' approach that is mutual
- disputes or issues are resolved promptly and fairly, to both parties' satisfaction
- there are no surprises.

The customer organization and its end-users (including its own customers) want the agreed service, no more and no less. They are not interested in problems or excuses if service delivery falls below expectation; nor do they want service credits as compensation for poor service.

Successful service providers are well aware of this. However, there may be times when their own suppliers fail in spite of their best efforts, so it is important to create a culture of shared responsibility rather than blame if things go wrong somewhere in the supply chain.

Delen, in his research of 2005, reinforces the points above. He defines success in this way: 'Both the customer and the provider derive so many benefits that they want to continue to work together.' Table 2.1 shows Delen's critical success factors that can be instrumental in ensuring a good collaboration based on mutual trust.

Success factor	Indicators
Systematic approach to the outsourcing process	A specific plan to be used in planning the outsourcing: – identifiable phases in the sourcing lifecycle – activities translated into man-hours – a clear division of responsibilities
Positive business case for the customer	No core competencies are outsourced Tangible and intangible benefits laid out in advance Advantages weighed against costs and risks
Positive business case for the service provider	Insourced processes are the provider's core competencies Tangible and intangible benefits laid out in advance Benefits weighed against costs and risks
Decoupling of processes	Mapping the processes and IT resources at the level of marketable sourcing units: large-scale service packages of interest to the provider; For each marketable sourcing unit: – products and services (input and output) – resource allocation – results in measurable terms (service levels) – management and reporting methods

Success factor	Indicators
Professional customer role – clearly defined interface between the business and the service provider	Aligned business and IT strategy A sourcing strategy as part of the IT strategy Clear demarcation between the customer's responsibilities and the provider's responsibilities An appointed demand manager resolving operational problems independently together with the provider's service manager Reporting and communication structures designed at strategic, tactical and operational level Conflicts with provider are handled through appropriate escalation mechanisms With multiple sourcing: sufficient IT expertise for the differentiation of roles and responsibilities
Sourcing knowledge	Sufficient knowledge, experience and competencies of both the customer and the provider, such as on: – project management – financial management – HR management – IT law – employment law – IT knowledge – ITIL – ISPL[2]

Table 2.1 Critical success factors in outsourcing (Delen, 2005)

Successful contract management is influenced by:

- the contract developed during the process of sourcing the IT partner
- the type of relationship established in this process.

Successful contract development ensures that all the detailed points about how the parties will work together have been examined in depth and resolved. Successful relationships are formed during this stage, when the parties begin to negotiate.

Important factors for success are:

- whether the same people are involved in the sourcing process and subsequent contract management; and whether they are the right people
- the negotiating style adopted in the sourcing process, which will be reflected in contract management – a 'give-and-take' style will result in a 'win-win' contract; a confrontational style will result in a 'them-and-us' contract, with a high likelihood of disputes
- the cultural fit – whether the culture of the two organizations is compatible
- a contract where neither party feels disadvantaged
- the KPIs and service level agreements (SLAs).

2 Information Service Procurement Library

2.3 What makes a good contract?

A good contract ensures that you, as the customer, get the service you need - delivering the business case for the outsource; at the same time, you want everything to go smoothly, with no surprises. One of the best ways to assess whether a contract is likely to be successful is by trying to visualize how it would work in practice. During the RFP process, these are the main things to visualize:

- the service specification – can you see this working in your organization? Would it deliver what you need, at an affordable price?
- the service risks – what would be the impact of handing over responsibility to a service provider?
- the provider marketplace – could your organization work with a company like Provider A or Provider B? Would your cultures be compatible?
- the contract terms and conditions – how well would these work in practice once the service is up and running?
- performance measures – what are the important aspects of performance and how would you measure and influence it?

When formalizing the contract, the points below are typically found in a good contract:

- plain language throughout that is easy to understand – no jargon
- the scope of the work is set out clearly and precisely
- the roles, responsibilities, obligations and expectations of the parties to the contract are clearly defined
- performance measures and targets are reasonable and have been agreed by both parties
- change control procedures are clearly defined
- payment terms and conditions are clearly set out
- dispute resolution procedures and remedies for poor performance are defined
- agreed contract exit criteria and procedure.

2.4 What makes a good relationship?

The first consideration is the type of relationship that is appropriate for your specific contract. For the purposes of this book, a *partnering* arrangement is a close commercial relationship where both parties agree to work together for mutual benefit, typically sharing the benefits and the risks; it is not the same as a legal entity where two or more individuals trade as a partnership. A *traditional* arrangement is based on simply providing a service for an agreed price, with no requirement for working together. Table 2.2 sets out the factors that indicate whether an IT services contract is suitable for a partnering arrangement or might be more appropriately managed in a different way.

Factor	Suitable for partnering	More suitable for traditional arrangements
Strategic importance	Business critical	Support service
Benefits sought	Business value	Cost savings
Requirement focus	Outcome based	Resources based
Purchasing approach	Long-term arrangement	Standalone transactions
Agreement type	Shared benefits	Fixed charging
Type of relationship	Trust	Formal
Likelihood of change	Liable to change/uncertain	Unlikely to change/stable
Definition/measurement	Difficult to define/measure	Easy to define/measure

Table 2.2 Factors affecting suitability of a partnering arrangement

You should consider partnering if your organization needs:

- business change, especially where the future is uncertain
- innovation in service delivery (such as providing services online)
- joint customer/provider teams, involving specialist skills or scarce resources
- outsourcing of business processes or services, perhaps to allow staff to concentrate on core areas
- a service where there are few providers in the marketplace and their offering is scarce or unique.

Partnering is unlikely to be appropriate for:

- short term requirements, because there will not be enough time for the provider to recover their initial investment costs
- contracts where the customer requires substantial control over the specification and service delivery, because there will be no opportunity for the provider to propose new ways of doing things
- contracts where there is little or no scope for continuous improvement.

If the contract is suitable for a partnership, 'cultural fit' will be especially important. 'Culture' is often described as 'the way we work round here'; 'cultural fit' is the degree to which the organizations' different cultures are compatible, although not necessarily with the same values. Your concern will be to assess how well the two organizations will work together before committing to a contract. Some indicators include:

- asking potential partners to describe their organization's values and culture in their proposals, with examples of how this works in practice
- monitoring the working relationship during the RFP process, checking back how well it matches the provider's description of their culture

- defining the characteristics of the type of culture and behaviors that you see as a good match for your organization – such as openness, willingness to share ideas; adaptability; responsiveness; a proactive approach; constructive questioning.

Be aware that the success or otherwise of the working relationship will depend a great deal on the personalities of individuals working together. It will be vital to choose the right individuals to match your desired culture and behaviors.

2.5 What are the contract risks?

The main risks in an outsourced IT services contract are:

- service failure, where the service is not accepted by the customer because the provider does not deliver to the required quality or on time
- reputational damage, where the provider's activities reflect badly on the customer's business (such as illegal, dangerous or unethical behavior)
- additional cost, more than expected (often associated with unexpected changes to the requirement)
- technical failure (too risky/unproven) and technology becoming outdated.

The type of IT outsource influences the extent to which your organization is exposed to risk. For example, an IT service to develop business-critical applications would be high risk compared with a service to process routine transactions, where the same tasks are repeated at regular intervals with a predictable workload and low levels of complexity.

Risk is discussed in more detail in Chapter 7.

2.6 What contract management resources will you need?

The costs of contract management resources will usually be in the range of 4 to 8 percent of the contracted value (Gianotten and Wijers, 2005, and Barthelemy, 2001). If offshoring, the percentages might be as much as 10 to 11 percent (Overby, 2003).

Under-resourcing of contract management is a common cause of contract failure; under-qualified staff, or staff with inadequate experience, is another major concern. The UK's National Audit Office, in its 2008 report *Central Government's management of service contracts*, found that most government departments in its survey allowed for around 2 percent of the contract value. All respondents felt that their contract management teams were overstretched and many had inadequate skills.

For an adequately resourced contract management team, the exact percentage of resource costs will depend on:

- the complexity of the contract
- the proportion of IT services remaining with the customer organization
- the maturity of the demand organization as a customer, based on a capability maturity index (costs will reduce as maturity increases)
- the maturity of the service provider organization
- the skills and experience of available contract management staff
- the scale of the outsource (costs will reduce as the scale increases).

For smaller contracts, a single individual could take responsibility for managing the contract. A team might be more appropriate for larger contracts; the size of the team may need to change over the life of the contract, depending on how much it is expected to change. The early stages are usually more resource-intensive than later on.

The extent to which the contract management team will need to change is influenced by the complexity of the service and whether a transition period is required:

- if the service is simple and straightforward, you may only need a short transition period or none. The service can start as soon as the contract is awarded; there will be little change over the life of the contract
- more complex services are likely to need a transition period and the way in which the contract is managed will change once the transition is complete
- if the service is very complex, with long periods of development and transition, the approach to contract management will change over the life of the contract.

Depending on the type of service, you may need to:

- retain specialists such as IT domain architects
- create new roles (such as contract managers)
- place more emphasis on existing roles (such as business information managers).

Importantly, your organization must retain 'professional customer' expertise. This enables you to maintain good up-to-date understanding of both the business and technical aspects of the outsourced services, which is essential for effective contract management.

Roles and responsibilities are described in detail in Chapter 4.

2.7 Relationships to service management processes

ITIL provides a good example of the required relationships between contract management and service management (Figure 2.1 shows ITIL Service Design processes), but the same principles apply irrespective of which service management process framework and guidance/standards have been adopted. ISO/IEC is an important international standard for contract management, specifically developed for IT service management.

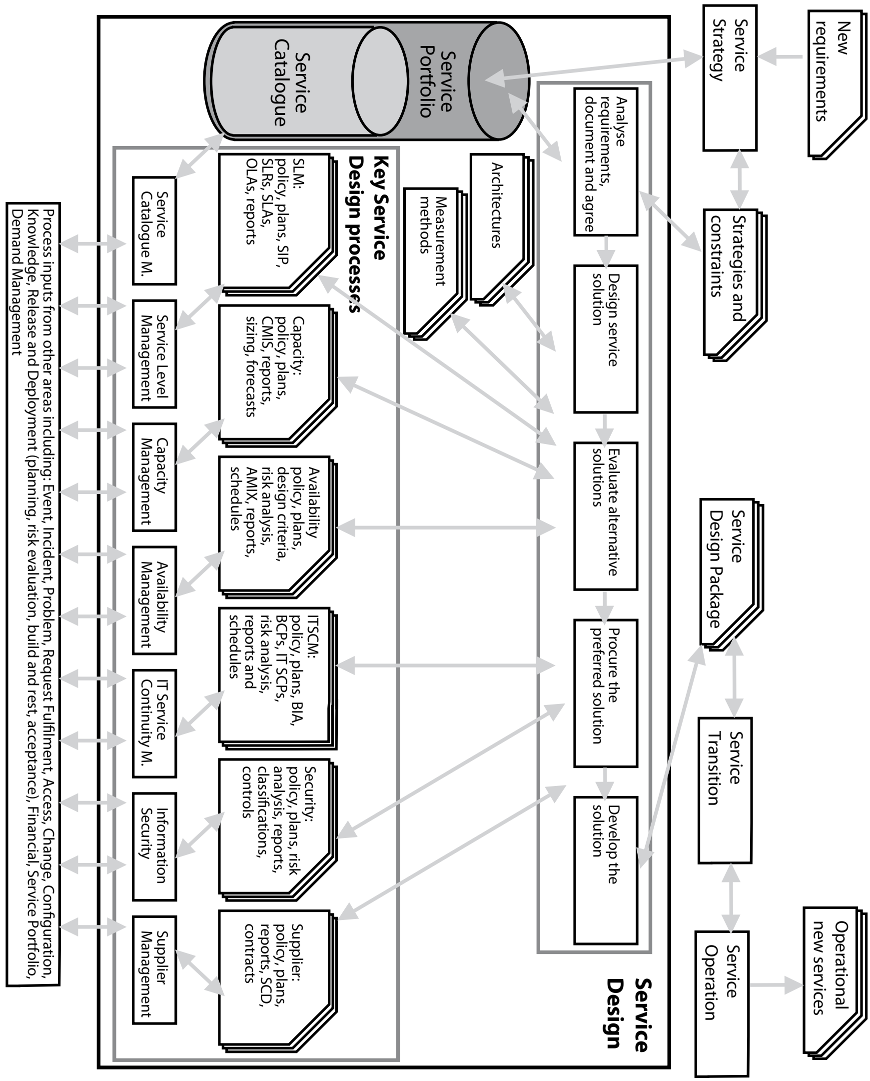

Figure 2.1 ITIL Service Design processes

Contract management interfaces with Service Design process elements, as described in ITIL Version 3.

The ITIL processes and interfaces are:

- Service Catalogue Management: the Service Catalogue describes a customer-facing view of IT service provision. Contract management interfaces with Service Catalogue Management via the demand and supply organization (see Chapter 4), to ensure that the Service Catalogue is accurate and up to date
- Service Level Management: this process ensures that the services delivered to the customer comply with the Service Level Agreement (SLA) defined in the contract. Contract management interfaces with Service Level Management, again, via the demand and supply organization and through performance reviews of the services
- Capacity Management: this process provides the focal point for balancing demands on capacity with acceptable levels of resources. Contract management interfaces indirectly with Capacity Management via the demand and supply organization
- IT Service Continuity: this process aims to support business continuity by ensuring that normal services are resumed as quickly as possible if disrupted. Contract management interfaces directly with IT Service Continuity through ensuring that the customer and IT services partner work closely together to develop and maintain plans for IT service continuity
- Information Security Management: information security protects the interests of the people in the business who rely on information and its secure delivery. Contract management interfaces directly with this process; as with IT Service Continuity, the customer and IT services partner work together to comply with the customer's IT security policy
- Supplier Management: this process manages all of the service provider's suppliers and their services, with an overview of their contracts, their performance and value for money. For the customer, a similar process is used to manage all its key service providers. Contract management interfaces directly with Supplier Management via contract administration, which is described in detail in Chapter 9.

CHAPTER 3

Foundations

The foundations of contract management are laid during the RFP process, when key decisions are made about the service that is required, how its performance will be managed and the type of service provider that would be most suitable. This chapter takes a step-by-step approach to the task of defining how the contract will be managed.

The key considerations are:
- how the contract is developed, making sure that the business case objectives are always in mind
- the type of relationship that is established between the customer and potential providers (the way in which the RFP is written, the style of 'due diligence', contract negotiations) – for example, an adversarial position or mutual cooperation, which will be reflected in the style of operational contract management
- the extent to which the same people are involved in developing and managing the contract.

3.1 The business case

In this early stage the customer has identified a business need for outsourcing an IT service. The reasons for doing so will usually be one or more of the following:
- IT is not the core business of the customer organization
- wanting to reduce costs
- wanting to improve the quality of service
- requiring specialist skills
- wanting to transfer the risks of changing business needs, operation or technology innovation.

The companion guide *IT Outsourcing Part 1* discusses the reasons for outsourcing in some detail. In this guide we are concerned with understanding how the reasons for outsourcing will influence the choice of contract approach and the relationship with the service provider.

For example, if you want to reduce costs, you are likely to be looking for economies of scale with a service provider who offers similar services, such as payroll, to a number of customers. The transactions are straightforward and repeated on a regular basis; you do not need a close working relationship for the contract to succeed.

Conversely, you are looking for specialist expertise to help you develop a new service that is complex and important to the business; there is also the possibility that the service provider will be able to offer added value. You are likely to want to have a much closer working relationship, possibly sharing the benefits of innovation.

The business case will evaluate the likely costs, benefits and risks in relation to the purpose and objectives of the outsourcing decision. One aspect of cost that is important for contract management is the cost of the resources required to manage the contract, as discussed earlier in Chapter 2.

You will want to review the contract at regular intervals during its operational life, to check that the business case for the IT outsource is still valid and the expected benefits are being achieved. The UK Office of Government Commerce (OGC) has developed a set of suggested questions to ask at these reviews: OGC Gateway™ Process Review 5: Operations review and benefits realisation. These are summarized in Table 3.1.

Question	Typical evidence
Is the business case still valid?	Good fit with business priorities; achievable and affordable
Are business benefits (the reasons for the outsource) being delivered?	KPIs achieved; project successes; planned benefits such as cost reductions/improved efficiency
Has the business need changed?	Reviews of business and end-user needs
Are the end-users satisfied with the service?	Customer satisfaction reviews

Table 3.1 Questions to ask about the business case (source: OGC)

3.2 The RFP

At this stage you have made some key decisions about the important features of the service and the type of service provider who is likely to provide what you want. The development of the RFP helps you to begin to pin down exactly how the contract would work in practice – why, who, what, when, where and how.

The recommended structure of the RFP is shown in Table 3.2 below, with notes on what this means for contract management.

Section in RFP	**Relevance to contract management**
Introduction	Sets the context of the contract
Objectives	Important, because these are the reasons why the outsource is required – and thus how success will be assessed. These objectives should set the style of the contract and its management.
Background information	Further contextual information
Description of current situation	Important for planning the transitional stage of the new contract, and also to set the baseline for measuring performance
Service requirements	Important because this describes what is required and how performance will be measured – the basis for an SLA
Transition requirements	Important for establishing contract management and transfer arrangements.
Governance requirements	Critically important in defining who is involved in contract management, development and improvement; reporting arrangements; roles and responsibilities of customer and provider
HR requirements	About the arrangements for transferring staff, not directly relevant to contract management
Financial requirements	Used in contract administration, for managing and monitoring providers' charges, rebates and settlements
Legal requirements	Important to ensure that all legal aspects are covered in the contract, including intellectual property rights (IPR) and termination. If the subsequent contract is managed well there should be no need to refer back to the legal aspects.
Provider selection process	Important in identifying the type of provider and relationship that would best meet the customer organization's needs.

Table 3.2 The RFP and relevance to contract management

The timetable for developing and issuing the RFP to providers will depend on whether the customer has to follow public procurement rules, which set very specific timeframes and rules for dialogue with providers, or whether there is more scope for flexibility in a private sector outsource.

Table 3.3 below is a simplified version of a sample schedule in the companion guide *IT Outsourcing Part 1*. It shows the main stages where the customer communicates with potential providers, which are important opportunities to develop good foundations for contract management.

Activity	Notes
Customer organization sends RFP	There is usually some form of pre-selection, so that it is clear that all providers invited to respond are likely to be able to supply the service
Providers submit written questions	These questions ask for clarification of points of detail
Pre-bid session and/or written responses to questions	All providers should be allowed to see all the questions and answers
Sessions for the customer and providers to meet, to familiarize providers with the customer's business processes	Providers would not normally attend these sessions as a group, as they are in competition
Customer receives proposals	Providers have been given detailed instructions about the format of their proposals
Customer selects shortlisted providers	The customer has published their evaluation criteria, so that providers have a clear understanding of the customer's priorities
Customer and providers begin information sessions and mutual due diligence processes (data room, reference visits etc)	These sessions provide important clues about cultural fit and how well the parties will be able to work together
Customer receives definitive proposals	
Customer selects provider	
Customer and provider begin contract negotiations	Note: there is little scope for negotiation in public sector contracting.
Customer and provider sign contracts	

Table 3.3 Sample schedule for the RFP

3.3 The service requirements

The task of specifying the service requirements is described in detail in Chapter 4 of *IT Outsourcing Part 1*. From a contract management perspective, the important considerations are that the service specifications are clear and unambiguous so that the service provider knows exactly what is required.

If the customer organization already has a Service Catalogue and SLAs, these should form the basis of the service specification – assuming that the current Service Catalogue and SLAs will be appropriate for the outsourced service.

The service specification should cover:
- the IT objects (assets) to be managed, which will determine the scope of the managed service
- the required tasks, such as service desk and incident management, including customer and provider responsibilities
- the required service levels, focused on activities, IT objects and provider-specific aspects.

The specification should state that information about the volumes of the tasks and services is indicative at this point; the provider must potentially manage different volumes – larger or smaller.

The service levels are particularly important for contract management, because they form the basis of performance measures – how well the provider is delivering the service.

Service management in everyday operations is discussed in detail in Chapter 6 of this guide.

3.4 The governance requirements

The governance requirements are introduced in Chapter 8 of *IT Outsourcing Part 1*; they are critically important to the success of the contract because they will describe how the customer and provider work together.

Early on in the RFP process you should start thinking about how the relationship with the provider should be managed. The demand and supply management organization is the formal structure for customer responsibilities at the operational, tactical and strategic IT management levels, which coordinates demand (the business need) and supply (the provision of services to meet the business need). There are three ways in which this can be established:

- centralized, where the function is positioned between the business as a whole and providers, providing a single point of contact
- decentralized, where each business unit has its own demand and supply management function
- federated, where a central function sets up the contract and ground rules such as a Service Catalogue with providers, then allows individual business units to make direct contact with providers.

The main consideration for contract management is that the roles and responsibilities are clearly understood, with the right people selected to take up those roles, and reciprocated with the same levels of responsibility and accountability in both parties' organizations. It is important to ensure that individuals have appropriate skills and experience. Wherever possible there should be continuity, so that key people have been involved in the outsourcing process from the beginning and understand the background to the contract.

Chapter 4 discusses the governance arrangements for the operational contract.

3.5 HR, financial and legal requirements

HR and financial aspects should be straightforward. HR will only be important up to the transfer of staff (if applicable) and does not affect contract management. Financial aspects are relevant after contract award, because you should be tracking that you are within agreed budgets, for instance; this is a function of contract administration. With the legal aspects, the important point is that you need to think through how things will work in practice – for example, termination. Is this fair and reasonable, in relation to risk and standard practice? If so, and you have done it properly, you should never need to look at the legal aspects of the contract again.

The HR, financial and legal requirements for the RFP are discussed in Chapter 9 of *IT Outsourcing Part 1*. This section outlines how these topics are translated into the contract and its management.

3.5.1 HR aspects

An IT outsource does not automatically involve transfer of staff from the customer organization to the IT services partner. If staff are transferred, this takes place during the transition phase, at the same time as the transfer of business assets; responsibility for the transfer is shared between the old and new employers. After transition, HR considerations are handled by the IT service partner's HR function and are not part of day-to-day contract management. Note that HR laws may be different from country to country; you will need to be aware of the relevant HR laws for the countries you are dealing with.

3.5.2 Financial aspects

The financial aspects are a key concern of contract administration. During the development of the RFP, there will be detailed discussions about the pricing models for:

- the one-time transaction at contract award - transfer of staff and acquisition of business assets
- the transitional activities – setting up the new arrangements for service delivery
- operational service delivery.

A set of different pricing models should have been developed for the operational service, covering:

- application, infrastructure, desktop and network management services immediately after signing the contract
- application, infrastructure, desktop and network management services as the IT service partner will deliver it following the transition
- delivery of projects.

IT Outsourcing Part 1 recommends that pricing models should be based on shared risk and reward, where an agreed proportion of payment is dependent on satisfactory performance. The customer and IT services partner will have agreed a set of KPIs for this purpose. However, public procurement might not permit variable charging because of the need to spend a previously fixed and allocated budget.

It is usual to expect annual price adjustments as a result of continuous improvement, benchmarking or indexing - for example, the retail price index in the UK, which is based on annual rates of inflation) For price adjustments based on improvements, you must have an agreed baseline at the start of the contract; be aware that arriving at an agreed baseline can often be a difficult task and hotly contested, so it is important to allocate enough time and resources for the task.

Cost models are discussed in detail in Chapter 9 of *IT Outsourcing Part 1*.

3.5.3 Legal requirements

IT Outsourcing Part 1 recommends three sets of contractual agreements:

- the transfer agreement, which focuses on the one-time transactions – transfer of employees, acquisition of assets
- the project agreement, which focuses on the transition projects
- the service delivery agreement, which focuses on the services that will be provided.

Legal requirements vary from country to country. For contract management of everyday operational service delivery, the most important legal requirements in the service delivery agreement are concerned with performance and audit. Table 3.4 shows some examples.

Legal requirement	Examples
Performance	Service descriptions make performances tangible and measurable with performance indicators, and specify how often the IT service partner must report on performance Describe what sanction options the customer organization wants to enter into with the partner, in the event that the partner's performance does not conform to the agreements; specify the customer organization's understanding of these sanctions. Sanction possibilities could take the form of a bonus/penalty system Examples of sanction options: • non-payment of invoices • imposition of penalties • compensation for damages incurred • for recurring poor performance: termination of the contract Compensation for damages incurred and termination of the contract can only be implemented after a formal notice of default and the opportunity given to rectify the damage

Legal requirement	Examples
Audits	Indicate the type of audits the customer organization wishes to implement; specify for each audit who will pay, who will issue the assignment, how the results will be discussed, who will select the auditor and what the audit's consequences might be for the partner. Common types of audits are: • audits on the organization of the service delivery processes (chargeable to the customer organization) • audits on the market conformity of the price/quality performance of the partner's services (chargeable to both parties) • audits on the traceability of the IT processing by the partner for the customer organization, in support of the customer's annual report process; this is a component of the contracted services provided by the partner (chargeable to the partner) • audits on the reported metrics for performance and volume, to verify that the information given by providers on SLAs or activity is true • regulatory and compliance audits, such as Sarbanes-Oxley and Basel II • audits on the security measures.

Table 3.4: Examples of legal requirements for performance and audit

3.6 Transition

Transition is a one-time exercise, but it is critically important in laying good foundations. Get this right and everything else should follow on smoothly; get it wrong and both parties could be in for unpleasant surprises sooner or later.

Transition is covered in detail in Chapter 7 of *IT Outsourcing Part 1*. From a contract management perspective, the most important aspects of transition are:

- implementing the new service delivery organization
- finalising the SLA/SLAs and Service Catalogue
- establishing the demand and supply organization.

Transition is not just between the customer organization and a new service provider; there will also be transitions from one service provider to another. Every transition is unique, so the requirements and planning must be tailored to circumstances. *IT Outsourcing Part 1* recommends managing the transition as a one-time project and designing it as a set of six transition tracks, as shown in Figure 3.1.

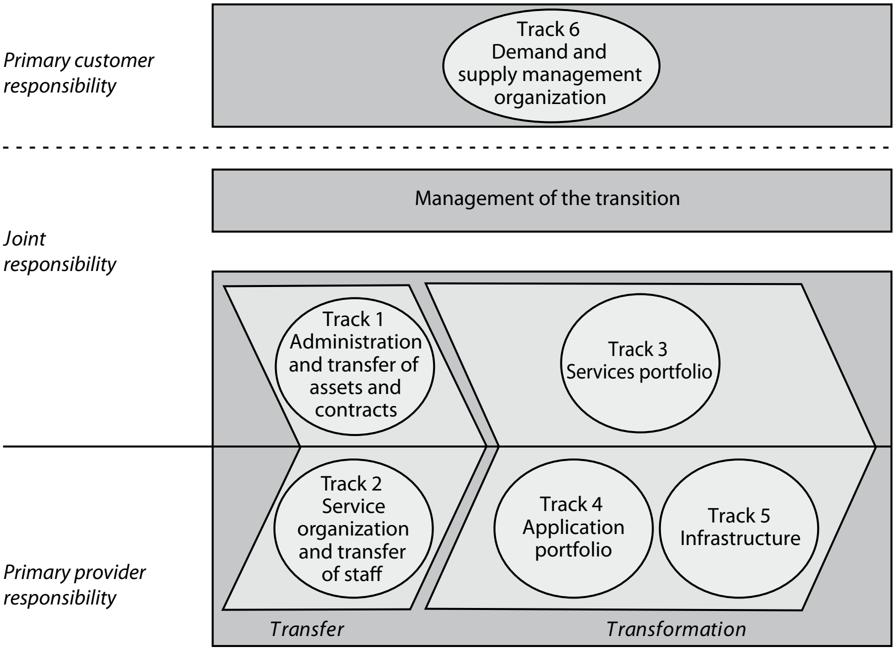

Figure 3.1: The six transition tracks

3.7 Readiness for the new service

A successful transition to the new outsourced services requires that everything is in place for operational service delivery. Table 3.5 provides a readiness checklist.

Who needs to be ready	What needs to be in place
Customer organization	New processes have been designed and tested, ready to go live Information and support is available (for example, the service desk) Customer roles and responsibilities are clearly defined and the right people are in post The demand and supply organization is in place Customer contract management is in place, including sourcing management and governance processes The customer contract management team is familiar with the aims of the contract and has processes in place for contract administration Methods/tools for measuring service levels are in place
Staff in the customer organization (the end-users of the service), including the retained organization and key users	They know what to expect of the service They have been given training, if required

Who needs to be ready	**What needs to be in place**
The IT service partner and its suppliers	Systems have been tested and are ready for roll-out Service provider roles and responsibilities are clearly defined and the right people are in post The IT service partner's part of the demand and supply organization is in place The IT service partner's contract management is in place The IT service partner's contract management team is familiar with the aims of the contract and understands what to do about contract administration
People responsible for service management	The process framework is agreed, including interactions and governance across both organizations The SLA has been formalized The current performance has been baselined for future performance measurement KPIs have been agreed Plans are in place for managing risk and business continuity
People responsible for relationship management	A formal communication system is ready and tested Relationship managers are in post in both parties' organizations and already meeting regularly A partnering 'code' is in place, which sets out both parties' commitment to the relationship, the behaviors expected for mutual success etc

Table 3.5: Readiness for the new service