THE EXPERT'S VOICE® IN IT MANAGEMENT

# Managing Your Outsourced IT Services Provider

## How to Unleash the Full Potential of Your Global Workforce

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# Contents

# Introduction

Organizations seek to focus on their core business processes while delegating noncore processes; they consequently select a service provider to manage these noncore tasks. In the information technology (IT) services industry, a business that provides services is referred to as a *service provider organization (SPO)*, and the receiver of such services is called a *service receiver organization (SRO)*. In such a scenario, personnel from the SRO become customers of the SPO.

Over the past several decades, IT outsourcing has become increasingly common; many organizations find that they are able to reduce their costs and focus on their core business processes when IT outsourcing is adopted. However, a common concern expressed by executives from many IT SROs is that even though they partner with well-established IT SPOs, they are unable to extract the full potential of those SPOs. In my discussions with several such executives, they have consistently reported that the SPO is not sufficiently proactive or innovative to bring added value to its customers.

Although this topic is debatable, the essential point is that the SRO should ideally be able to follow an approach that will help it to obtain maximum benefits from its SPOs. This book explains the key concepts related to this topic and adopts the mantra, "Understand your service provider to manage your service provider." But to succeed in this journey, it is essential that SRO fully support the SPO to achieve the expectations.

This book is divided into two sections. The first section discusses the classification of different types of IT SPOs based on their size and location, how these companies are organized, their strengths and weaknesses, and their goals and objectives. This section also provides information about the financial targets of IT SPOs and the strategies that such organizations typically adopt in order to achieve these targets. Reading this section, you will be able to comprehensively understand IT SPOs, with the objective of using this information to manage your SPOs in a more efficient manner.

After establishing the basics of SPOs, the second part of this book explains in detail how to manage your SPOs. It explains various concepts you need to address when establishing a relationship with an SPO, what to expect (and what not to expect) from an SPO, how to utilize its strengths and mitigate risks related to its weaknesses, and how to use this information to secure the best service available. Using several case studies and examples, this section explains how to do the following:

- Engage and manage SPO staff
- Define financial targets to achieve the best value for your money
- Extract full value from each staff member of the SPO
- Define contracts that can provide long-term benefits
- Understand potential pitfalls in contracts with SPOs and how to manage these challenges
- Manage vendor lock-in: a situation in which an SRO becomes fully dependent on an SPO product or service and does not possess the required knowledge to perform the work in-house or transition to another SPO

This part of the book also discusses single-provider sourcing strategies, including the advantages and drawbacks of such arrangements. The salient topics for organizations motivated to enter into a single-sourcing model are addressed. Further, this section discusses the evolution of captive units, including how captives should be empowered and structured by organizations to enable them to deliver optimal results. A captive unit, in an IT outsourcing context, is a business unit of a company functioning offshore as an entity of its own, managing part or all of the company's IT needs with close operational ties to the parent company.

Although the concepts presented can be applied to any industry, this book has been written with a focus on IT. It is targeted to all individuals who outsource their IT business to a service provider.

Reading this book, individuals from SROs will learn how to better understand their SPOs and will gain skills in managing them in order to gain the maximum value for the benefit of the SRO.

PART

I

# Understanding the Outsourced IT Service Provider Industry

Part I of this book is designed to help you understand the basics of the IT services industry and to explain the different types of IT service companies in the market today. It includes an explanation of the goals and objectives of IT service provider organizations (SPOs) in addition to providing a detailed overview of how a typical IT SPO is organized, the different roles in the organization, and those roles' responsibilities. This part also explains the SPO's profit-and-loss parameters, its strengths and weaknesses regarding its financial targets, and what organizations typically do to achieve their targets.

After reading this section, you will have a general understanding of IT SPOs and will be able to use this information to manage your own SPO in a more efficient manner

CHAPTER

1

# The Organization of IT Service Providers

A service industry provides services to aid its client companies in achieving their business objectives. An organization that intends to continue focusing on its core business processes while delegating noncore processes selects a service provider. The expectation in the business environment is that every organization should be innovative in its core business processes to achieve frontrunner status in its industry.

**Definitions** An ***organization***, in the context of this book, is a company that performs business in any industry such as manufacturing, retail, banking, insurance, aerospace, or information technology.

A ***service provider*** or a ***service provider organization*** is a is a company that provides other organizations with consulting, software, hardware, legal, real estate, education, communications, and many other types of services based on each service receiver organization's core area of business. In some instances, the concept of *service provider* refers to organizational subunits, but—in more general terms and throughout this book—the term *service provider* refers to a third-party or outsourced supplier.

An ***IT service provider*** or an ***IT service provider organization (SPO)*** is a company that provides other organizations with information technology (IT). Organizations that receive IT services (from IT service providers) are called ***IT service receivers*** or ***IT service receiver organizations (SROs)***.

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There are different types of service organizations; the IT industry is one type. Worldwide IT spending is projected to total $3.8 trillion in 2014.[1] This suggests the pace at which the IT industry is expanding, and IT service companies are taking full advantage of this growth.

In the IT industry, personnel from the SRO become customers of the SPO. The SPO is also often referred to as a vendor of the SRO.

# Classification of IT Service Organizations

Broadly speaking, there are two types of IT **SPOs,** depending on the location of their headquarters. As detailed in the next two sections, *multinational companies* (MNCs) have their headquarters in developed countries (defined **next**), whereas *pure players* have their headquarters in *developing countries* (defined **next**).

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**Definitions** A developed country, in the context of IT outsourcing, is a country where the cost of performing IT services is high relative to other countries. This is because a developed country has a high cost of living, a developed industrial base, and a high human-development index relative to other countries, which translates to a high cost for IT services. Some examples of developed countries are the United States, the United Kingdom, Canada, France, Australia, and Spain.

A developing country, in the context of IT outsourcing, is a country where the cost of performing IT services is low relative to developed countries. This is because a developing country has a low cost of living, a developing industrial base, and a low human-development index relative to developed countries, which translates to a low cost for IT services. Some examples of developing countries are India, China, Thailand, and the Philippines.

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IT **SPOs** are alternatively classified as *Tier-1, Tier-2, or Tier-3* IT service providers, based on their year-on-year revenue and employee strength, as detailed in the appropriately headed sections.

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[1]Gartner, "Gartner Says Worldwide IT Spending on Pace to Reach $3.8 Trillion in 2014", *Gartner Newsroom*, January 6, 2012, `www.gartner.com/newsroom/id/2643919`.

## Multinational IT Service Providers

*Multinational IT service providers* are MNCs that have their headquarters in developed countries, with development centers and sales offices across the world in both developed and developing countries. IBM, Accenture, and Capgemini exemplify multinational IT service providers. Typically, in this type of organization, more than 60% of the company staff operates from developed countries. With changing market conditions and pressures on cost, some of these organizations have started to adopt a long-term goal of increasing their staff in developing countries. Table 1-1 shows a 2013 estimate of the sizes of the workforces of several MNCs in a developing country—in this instance, India—as fractions of their global workforces.

**Table 1-1.** Employee Figures for Several MNCs in India (2013)[2]

| MNC | Base Location | Total Number of Employees | Total Number of Employees in India | Percentage of Employees in India |
|---|---|---|---|---|
| Capgemini | France | 125,000 | 44,000 | 35% |
| Accenture | United States | 275,000 | >90,000 | 33% |
| CSC | United States | 98,000 | 24,000 | 25% |
| IBM | United States | 430,000 | 130,000 | 30% |

## Pure-Play IT Service Providers

*Pure-play service providers*—or simply *pure players*—have their headquarters in developing countries such as India, China, and the Philippines. With their headquarters and a large portion of their workforce deployed in developing countries, pure players conduct business with clients across the world in both developed and developing countries. Table 1-2 shows the sizes of the work-forces of several pure players in a developing country—in this instance, India or China—all of which fall well above the threshold rule that 60% of a company's global workforce be in the base developing country for that company to be considered a pure player.

[2]Shilpa Phadnis and Sujit John, "Top Global IT Firms Have More Staff in India Than Home Nations," *Times of India*, November 6, 2013, http://timesofindia.indiatimes.com/tech/jobs/Top-global-IT-firms-have-more-staff-in-India-than-home-nations/articleshow/25280494.cms.

**Table 1-2.** Employee Figures for Pure Players (2013 and 2014)

| Company | Base Country | Total Number of Employees | Total Number of Employees in Base Country | Percentage of Employees in Base Country |
|---|---|---|---|---|
| Infosys[3] | India | 160,405 | 123,847 | 77.2% |
| Hexaware[4] | India | 8,854 | 6,835 | 77% |
| Neusoft[5] | China | 22,403 | 21,712 | 97% |

## Tier-1 IT Service Providers

Organizations with revenues of more than US $1 billion and having an employee base of more than 50,000 are categorized as Tier-1 IT service providers. From their strengths in legacy application development and application maintenance, these organizations invest to provide end-to-end software services spanning consulting, *business process outsourcing* (BPO), and IT infrastructure services.

Tier-1 IT service providers are further classified as *Tier-1 MNC* or *Tier-1 pure player*, based on the location of their headquarters and predominant geographical presence. Typically, these types of organizations have offices in most countries across the world and service their customers with a global delivery model.

## Tier-2 IT Service Providers

Tier-2 IT service providers are organizations with revenues less than US $1 billion and employees numbering between 10,000 and 50,000. This type of organization specializes in and services clients of specific industries such as banking and financial services, aerospace, retail, and manufacturing, with a focus on specific geographies. Within these verticals and geographies, these organizations compete with Tier-1 service providers.

Tier-2 IT service providers are further classified as *Tier-2 MNCs* or *Tier-2 pure players*, based on the location of their headquarters and predominant geographical presence.

[3]Infosys Ltd. Form 20-F (p. 16), US SEC, May 9, 2014, www.infosys.com/investors/reports-filings/annual-report/form20f/Documents/form20F-2014.pdf.
[4]Hexaware Technologies Ltd. 2013 Annual Report, http://hexaware.com/fileadd/Hexaware-Annual-Report-2013.pdf.
[5]Neusoft Corporation 2013 Annual Report, www.neusoft.com/upload/files/20140716/1405493519488.pdf.

## Tier-3 IT Service Providers

These companies have revenues less than US $100 million and an employee base of fewer than 1,000. These organizations focus on very niche and narrow services, with a focus on limited geographies, and they aim to provide end-to-end services within these services and geographies.

## The Corporate Organization of an IT Service Provider

Although each organization has a unique method of managing its operations and business, at a broader level, almost all IT SPOs structure themselves in a similar fashion. Every organization consists of three broad pillars: industry verticals or business units, service lines or practices, and support functions (Figure 1-1).

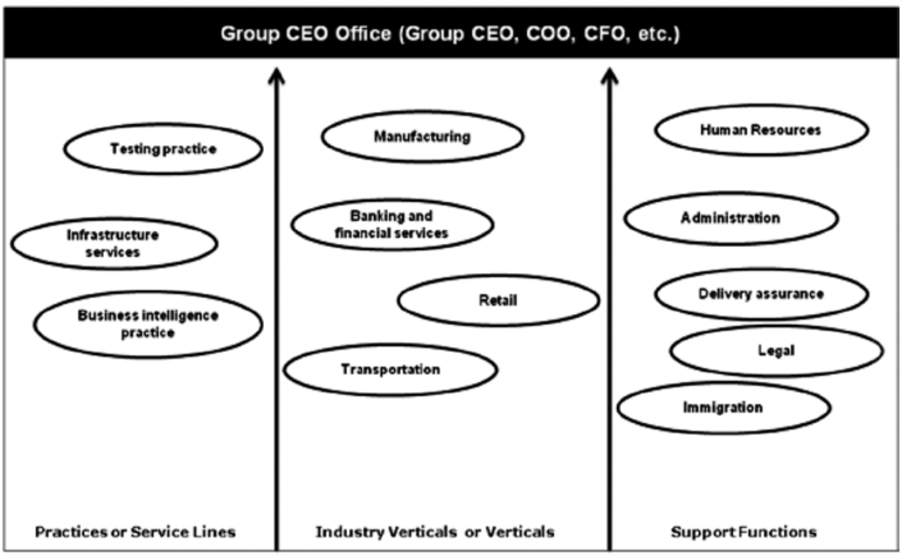


**Figure 1-1.** Organizational structure of an IT SPO, with three core pillars

## Verticals

A *vertical* is an entity within an SPO that specializes in selling and delivering services to clients belonging to a specific industry or domain, such as the banking industry, financial services industry, or manufacturing industry. In some organizations, verticals are also referred to as *business units* or *strategic* *business units*. Staff in a vertical are experienced and knowledgeable about their respective domain and services. Examples of verticals include the following:

- *Banking and financial services vertical*—Services all banks and financial institutions. IT needs are serviced by this vertical across geographies for retail banks, investment banks, and credit card companies, among other clients.
- *Insurance vertical*—Services the IT needs of all types of insurance companies, including life insurance, auto insurance, travel insurance, and so on.

Typically, personnel from verticals hold profit-and-loss accountability. The profitability and revenue achievements of a particular vertical are measured in relation to three targets: the top line, the bottom line, and utilization of resources.

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**Definitions** The ***top line*** is a company's gross sales or revenues. In other words, it indicates the total money that is being paid by customers to a service provider. Therefore, a company's *top-line growth* refers to an increase in gross sales or revenues.

The ***bottom line*** is the net income on a company's income statement. This is the income after all expenses such as salaries, interest charges, taxes, and general and administrative costs have been deducted from revenues. The bottom line is also referred as the *profit margin*.

The ***utilization*** or ***utilization rate*** of an individual is the billing efficiency of that individual. In other words, it indicates the labor cost of an individual that is paid by the client.

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The utilization rate is calculated as the number of billable hours divided by the number of working hours recorded over a particular time period by an individual. For example, say an employee was in the office 30 hours last week, but only 20 of those hours were paid for by the customer. In this case, the utilization rate for this employee is 20 ÷ 30 = 66%.

The utilization rate of a practice, a vertical, or an organization is calculated as the sum of all billable employee hours of each employee within a practice, a vertical, or an organization divided by the total number of working hours recorded by all those employees in a particular period. For example, say a practice has 100 employees out of which 90 employees were in the office and paid by customer for the complete month. In this case, the utilization rate for this practice is 90 ÷ 100 = 90%.

## Practices

A *practice* is an entity within an SPO that specializes in selling and delivering services that address a specific technology or domain. Such technologies or domains are also referred to as *subject matter areas*. In contrast to a vertical, which services customers belonging to a specific industry or domain, a practice serves customers in a *horizontal* across several or all verticals (discussed in the "Practice Structure" section). Practices closely liaise with verticals to understand customer needs, and they bring their services to customers by collaborating with verticals. Two examples of practice subject-matter areas follow:

- *Testing practice*—Provides automation and manual testing services for customers across manufacturing, banking and financial services, and retail.
- *Business intelligence (BI) practice*—Provides an end-to-end suite of BI services to assist customers with devising business insights to enhance decision-making and financial management. Organizational offerings range from devising BI strategies to implementing best-fit tools and solutions, including creating dashboards and scorecards. These organizations service clients across verticals and work hand-in-hand with vertical teams to sell and deliver to service clients.

Typical practices have top-line and utilization targets in their area of business, in addition to the objective of establishing new services within the domain. Top-line targets indicate that they must retain business in their existing client base and increase business by acquiring new clients. However, they are mandated to liaise with teams from verticals in order to achieve business development.

Most organizations create an entity within each practice horizontal called a *center of excellence*—a group or department that focuses on specific areas looking both inside and outside the organization to capture new knowledge and practices. In addition, this group is responsible for developing tools and techniques within the purview of the horizontal subject-matter area that can bring value to the customer. Within their testing practice, for example, most organizations create an automation-tools group whose main goal is to develop custom tools and interfaces that can enhance automation over and above the tools available in the market. These tools are the intellectual property of the SPO.

## Support Functions

A *support function* is an entity within an organization that stands as a pillar in support of overall organizational structures, such as verticals and practices. Verticals and practices are considered to be the core functions of any IT SPO, whereas support functions are non-core and serve to facilitate the core operations of the business. Support functions include finance, human resources (HR), legal, and administration. Support functions do not directly interact with customers.

# The Governance of an IT SPO

The governance of any particular organization is structured in strict accordance with the particular strategy the organization employs. At a broader level, however, all IT SPOs have similar forms of governance. Figure 1-2 depicts the typical organizational governance followed by most IT SPOs.

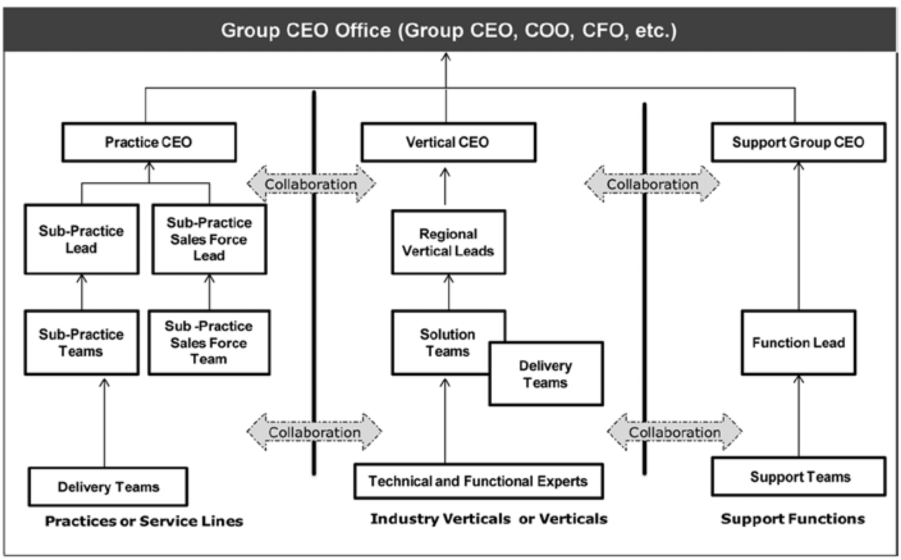


**Figure 1-2.** Typical governance of an IT SPO

Each organization starts with the group chief executive officer (CEO): the head of the organization, who reports to the board of directors and the chairperson or founder of the company. One level down, all entities of the organization reporting to the group CEO, such as the verticals, practices, and support functions. Each vertical and practice of an organization has a CEO whose core function is to ensure that the CEO's business is profitable and