Why does governance matter in IT outsourcing?

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Why is IT governance so important when an organization is in the middle of a complex IT outsourcing process? is a question often heard from senior management of organizations who are either already in the process of outsourcing their IT, or are considering doing so. Perhaps this belief comes from the fact that management within the end client organization trusts the guidance and advice given by external parties, and therefore feels that after the outsourcing has taken place, everything will run smoothly, as a matter of course.

In the case of an internal IT organization, however, poor governance isn’t always visible. IT organizations will improve or work around bad processes and weak decision making and will compensate for the unprofessional guidance of the business by partially taking over the role of business management. While this situation is by no means ideal, it does mean major disasters tend to be avoided. However, once the services in scope have been transferred to the external provider, responsibilities will be very clearly demarcated between the demand organization, the provider, and the new governance organization.

So why does governance need additional consideration when outsourcing IT?

There is a serious risk for higher IT costs because of misunderstanding in the area of IT business needs. If misunderstandings arise in the demand-supply chain between the customers of IT (the business), the organization responsible for managing the external parties, and the third parties themselves, it’s difficult to gauge if costs that are being invoiced are reasonable. For example, the customer may well receive a detailed invoice for application management services but how does the business know that the number of hours invoiced are reasonable? Furthermore, internal debate can start when it appears that simple amendments (from a business perspective) have a large financial impact because of the complexity of the infrastructure.
Roles and responsibilities should be clearly defined and agreed upon due to the formal, legal relationship

RACI-matrixes, in which responsibilities have been confirmed, and the various procedures of cooperation, may appear to be a maze of papers. However, in the event of an unexpected incident, such as a fire in a data centre, it is crucial to know who is responsible for what action. It is of major importance that particular areas of responsibility are frequently discussed and reviewed in order to prevent problematic discussions at a later stage.

Clearly defining roles and responsibilities helps avoid overlap in work and redundancies

Processes, roles, and responsibilities between the service provider and client organization that are not clearly defined and communicated can lead to duplicated efforts and wasted resources. For example, prior to outsourcing, employees of the retained organization can help determine what will be needed now and into the future. Technically the client organization is only responsible for defining the “what” while the service provider defines the “how” and the delivery of the required result. But if not managed well, money is wasted, which could hinder the business case for outsourcing.

Employees from the client organization often struggle to adapt quickly to the new situation

The history between people and the knowledge of the operational processes within the IT department can have both a positive and negative effect when initiating the new sourcing relationship. New people, coming in from outside the current IT working area, are able to have a clearer picture of the IT governance structure. To continue too long with the old style of working can negatively impact the relationship with the external provider and present problems for the service provider when.

Many customer organizations operate by implicit communication

Yet outsourcing requires very explicit communication because service providers are not a part of the organization and the informal communication network. As people and structures in scope are moved to an external organization, the informal communication structures are disbanded and business requirements no longer translate effectively. The business is not used to being very specific about its goals and requirements. As a result, client organizations often find that business needs are either not met at all or are met but at too high a cost. In outsourcing deals there is a need for a more formal governance structure between the two parties as well as between the business and the retained organization to facilitate a good level of communication between the parties.

Outsourcing leads to higher expectations from the business

Though, the service providers are specialized in providing services, they often find themselves at a disadvantage. They do not have access to informal communication like the in-house department used to. In addition, the price of their service is transparent to the business (via detailed invoices), which in turn escalates the expectations of the business—who want to see real value from the investment.

Timely attention to IT governance can save money

KPMG’s service provider performance studies, which involve major end client organizations across Europe show that the poor attention given to IT governance is causing increasing problems to the success of the outsourcing process. Despite a lot of money and time being spent on the outsourcing process itself, very little is being invested in transforming the organization towards a good governance structure. The real results of outsourcing are not to be found in a watertight contract but are realized during the contract execution and good governance.

In our opinion more money can be saved, and more added value can be given to IT through good governance which is far better approach than trying to squeeze the last percentage of cost savings during the contract negotiations.
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