

Real outsourcing for **RETAILERS**

A pragmatic guide to successful IT outsourcing in retail

Despite the continuing stream of significant contract awards, IT outsourcing has not been able to shake off a reputation tarnished in the retail sector by some high-profile early terminations and moves to bring components back in-house. It's our opinion that, provided four simple rules are followed, outsourcing will generate real value and strengthen the core of any retail business.

Andy Taylor

RULE 1: DEFINE THE SCOPE OF SERVICES

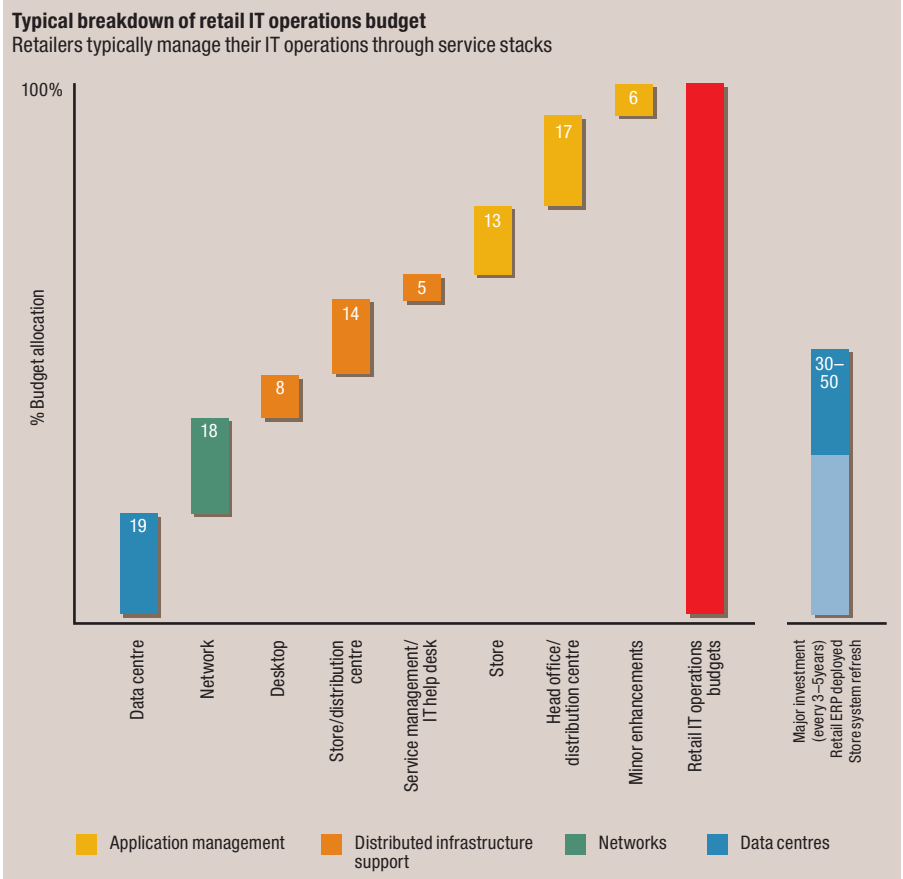
After the events of the last few years, retail CIOs are justifiably nervous about outsourcing all of their IT services to a single party. This is not surprising. After all, retail buyers avoid relying on a single manufacturer for the merchandise they source; multiple providers guarantee supply and ensure healthy price competition. Why should the sourcing of IT be any different?

The typical retailer has four main sets of services ('service stacks' in IT parlance) that might be delivered better in either a managed service or outsource arrangement. These are: data centre and core infrastructure; networks and telephony; distributed infrastructure support across stores, distribution centres and head office desktops; and retail and corporate applications. A typical breakdown of functionality by stack is shown in figure 1.

CIOs must regularly test the market to understand whether the in-house option really provides the best long-term value for the company. In many cases it does, but the benchmarking is a useful exercise in itself. Whether to retain functions in-house or to outsource is driven primarily by the business agenda or, more specifically, by the degree of change in IT that business strategy dictates, rather than the cost to deliver these services. Retailers can find that the required degree of change is too great for them to tackle all aspects themselves – lack of time, project budget and available talent are typical bottlenecks. Outsourcing therefore becomes the best vehicle to provide the necessary financing, delivery scale, proven methodologies and access to additional talent pools. Transformational outsourcing has a place too and can be successful provided that the change agenda is incorporated within the agreement.

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FIGURE 1. RETAIL'S FOUR IT STACKS

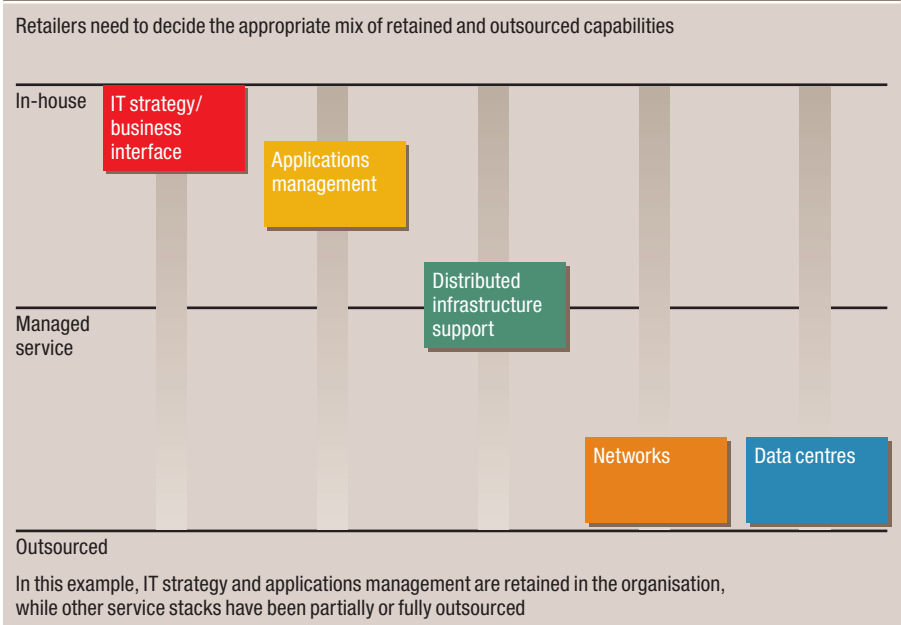


Some retailers consider a move to outsourcing only once a significant change has been successfully deployed. They outsource as a means to further drive down operational costs, particularly for more commoditised data centre or ERP support skills that can be more easily off-shored.

Whatever the approach, the key to success is determining the right mix of capabilities to be retained or bought in. Each retailer is unique in this respect and there is no universal outsource solution.

In our experience outsourcing works best when retailers identify three or four parties to provide outsourced services, each capable of covering more than one service stack. This enables the formation of a competitive framework and provides additional support where one provider is unable to react to changing business needs. However, clear rules of engagement need to be agreed across all parties: retailers should be assembling a consortium of cooperating partners, not a group of competitive vendors.

FIGURE 2. EXAMPLE OF A RETAINED/OUTSOURCED CAPABILITY MIX



RULE 2: DESIGN THE BUSINESS ENGAGEMENT PROCESS

Once there is a clear definition of scope and agreement on what each party does, the rules of engagement need to be established. Defining the role of the retained organisation is vital. The CIO must choose how much of the IT organisation to retain and how much (if any) should be outsourced. The IT strategy should then evolve to show how the retained and outsourced functions will together deliver the business strategy; the former managed by the retained IT function, the latter through managing the contracts with third-party providers.

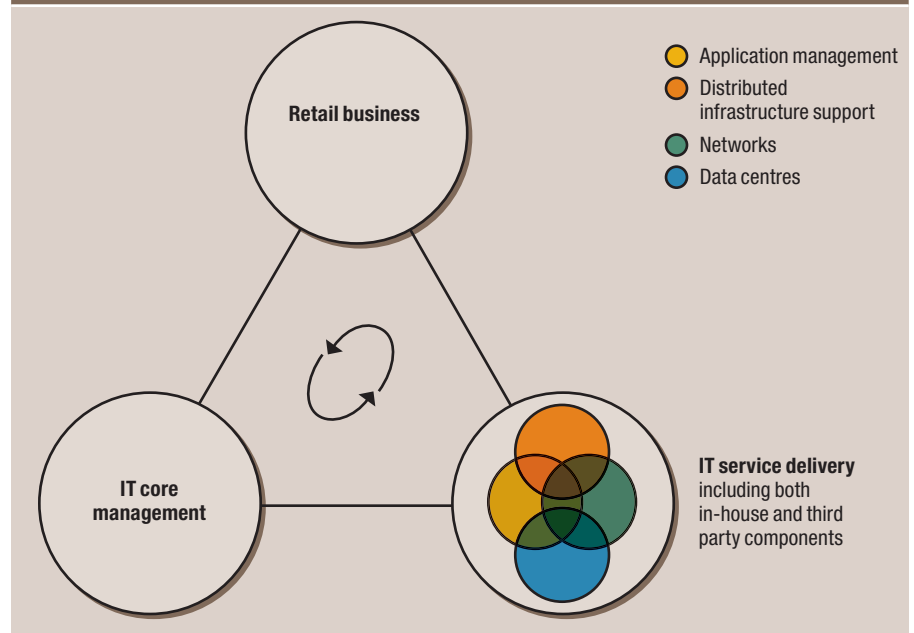
But too often we see retailers and suppliers adopting a transactional approach to relationship management and business engagement. In these cases, the retained IT function acts as gatekeeper to the business with all interaction conducted at a distance via functional specifications, service level agreements, and other documents. This practice has the advantage of enabling the CIO to micro-manage the approach (and cost) of the outsource vendor in delivering its work. Where it fails, however, is when the vendor does not engage enough with the core retail business; this typically results in a disconnect between the provider and the needs of the business. At best, this prevents the supplier really understanding its customer's needs. At worst, service delivery departs radically from the customer's expectations and conflict follows.

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Our experience across multiple industries and government shows that the pendulum has swung too far towards the transactional or arm's length approach, with too much focus on cost and service metrics that are not aligned with business outcomes. The industry has suffered when IT service providers have been kept too distant from the end-user community (such as trading, retail operations, etc) and ultimately deliver less value and innovation as a result.

We propose a model for a three-way relationship in which IT service provision is split into core IT management and service delivery elements, some of which may be outsourced (see figure 3).

FIGURE 3. THREE-WAY MODEL OF IT SERVICE PROVISION



This division of IT responsibility allows the organisation to move to a more business-centric structure that makes it easier to move to either managed service or outsourced options. Each party has both clearly defined scope and well thought-out rules of engagement with the business; we now need to consider how each of them musters the efforts of the many sub-contractors and partners that together will ultimately deliver the IT services.

RULE 3: USE MULTI-PARTY CONSORTIA WITH DEFINED ADDED VALUE

‘Margin-on-margin’ is a term often heard during IT services contract negotiations and universally considered a bad thing. However, what it fails to capture is the degree to which a service integrator adds value to the service being delivered. It’s only where the value cannot be determined or agreed that the premise of service integration begins to fall apart.

In most IT managed service or outsourcing arrangements the services are delivered by a consortium of sub-contracted providers. This makes perfect economic sense, since it allows the service integrator to provide the best value for money for each of the service elements that the retailer requires. The retailer retains the commercial flexibility to select the most appropriate service provider over the lifetime of the contract – either performing the task itself or using third parties as appropriate.

Service integration is a core capability that should neither be underestimated nor undervalued. However, determining the actual value that is added is often difficult and can be hidden in opaque contract structures. We believe that there must be greater transparency in the service contract and a clear understanding of the service that is delivered for the money. In determining the amount of value added by the integrator, CIOs need to consider the degree to which it “touches” the service provided by a third party and effectively relate this activity to the service fee (if any) that is applied.

Greater value does not necessarily mean greater cost. Those IT providers that invest in industrialised pre-configured templates (eg, using standard IT components and third-party specialists) to deliver infrastructure, application solutions and services can often do so more quickly and at lower cost. Those that continue to develop bespoke service solutions might initially appear more customer-centric but may be adding unnecessary complexity and cost which will ultimately be reflected in the contract – somewhere.

Retailers should be wary of IT providers who deliver added value which relies on (and is used as an excuse to build) proprietary lock-ins that create artificial barriers to change. Good service, transparent commercials, clear value-add and delivery against promises is the best way to achieve partnership – and repeat business.

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RULE 4: DEVISE FLEXIBLE CONTRACTS THAT ENABLE TRUE PARTNERSHIP

Change is the one thing that can be guaranteed in the retail environment. Many IT service providers have historically seen change as a source of margin. They secure a service deal at the lowest possible cost and then charge through the nose for the high level of service change requests that can be expected.

These practices make the agreements between IT service providers and retailers untenable. For IT companies, a business model that relies on ad hoc change requests for its profitability is bound to fail eventually. This approach undermines the correct behaviours of service delivery excellence, responsive solution building and commercial flexibility. For the retailer's part, these practices penalise them every time they want to change and grow the business. Neither party really benefits from these arrangements, which are a source of constant irritation to the contract managers from both parties.

No CIO would be willing to sign up to a ten year deal with a fixed scope and service definition. Even five years would be a stretch unless something new is available in the contracting space: contracts that clearly define the scope of arrangements and make genuinely adequate provision for business change.

This can be achieved by implementing agreed pricing formulae for likely business changes such as new store openings, movement to new formats and thresholds for transaction volumes. Formulae can also provide for minor enhancements, technology refreshes and framework agreements for project work. Combining these approaches provides the contract flexibility that businesses need. The model can be further refined by re-baselining services on a frequent rolling basis within a longer-term service contract.

Interestingly, most outsourcing agreements that are failing still largely meet the original contracted measures – a strong indication that they are measuring the wrong thing. Agreeing contractual objectives based on business outcomes helps to ensure that outsource partnerships continually evolve to remain relevant to the needs of the business. For example, a focus on till availability (to serve customers) rather than on time to fix (to manage engineers) drives a more proactive approach to store support and demands greater engagement with retail operations.

Clearly, the question for decision makers is not whether they should be seeking flexible contract models, but which elements will drive the strongest partnership for best-value IT delivery. The use of external benchmarks of discrete service elements is also a valuable tool when used appropriately.

ALIGN AND ENGAGE

Common sense is breaking out as more organisations adopt more sensible and sensitive approaches to defining how IT services are best delivered to meet the needs of the retail business. Only when these services are clearly defined can the IT organisation and its chosen partners successfully engage with the business. This requires a new approach to transparent contracting in order to define exactly how IT can meet retailers' ever-changing needs.

Whose **OPINION?**

ANDY TAYLOR



Andy is our European retail principal, responsible for retail strategy and customer experience innovation. He is particularly interested in exploiting technology to create a superior customer experience in a multi-channel retail environment. A former channel marketing manager, he started his retail career selling welding equipment and gases. Subsequently, he became a retail process specialist and industry consultant to UK and global retail organisations covering retail formats from convenience to department stores. Andy is married with two children and spends what spare time he has left frequenting DIY stores and learning to play the piano and guitar.

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YOUR OPINION

Andy would welcome your comments by email (andrew.3.taylor@uk.fujitsu.com) or at uk.fujitsu.com/opinion



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