

■ Lance B. Eliot, Feature Editor, Elliot & Associates

Moving from Outsourced to In-House: How to Turnback

Lance B. Eliot, Feature Editor

Marriage is a serious matter. A couple contemplating marriage usually anticipates having an intense commitment to each other that will last for a very long period of time. In the beginning (at least), there is great enthusiasm, a feeling of blind trust toward each other, and tremendous emotional sentiment that often leads couples to throw caution to the wind and take a chance on each other.

Statistically, nearly half of present day marriages will actually end-up in divorce.

If marriages are likely to have problems and result in separations, just imagine what might happen when two companies come together in an outsourcing arrangement. Though they both might initially be excited about the potential "marriage," one seeking an outsourcer to handle some or all of their I/T function (the outsourced party) and the other providing said services (the outsourcer), the odds are that the marriage will eventually end-up in divorce.

Indeed, the real question is not so much whether the two parties will eventually go their separate ways, but, instead, when and how the two parties will go their separate ways.

In a typical outsourcing arrangement, there are two main conclusions to the coupling: *expiration*, or *termination*. Expiration is the condition when the agreement between the parties has reached its natural end (for example, a 10-year contract and the 10 years have occurred). On the other hand, termination involves the premature conclusion of the outsourcing agreement, perhaps due to mutual agreement to terminate or possibly due to a dispute between the couple.

One of the most important elements of any outsourcing agreement therefore is the portion that specifies how the two parties will agree to separate from the agreement. Similar to a marriage and a

prenuptial agreement, it is best for the parties to anticipate the eventual end of the agreement and make sure that they have devised a reasonable way to exit from the endeavor.

As a consultant who advises firms about outsourcing, I find that in most instances the whole notion and specification of the termination clause is difficult for users of outsourcing to deal with. Unfortunately, users of outsourcing often sign outsourcing agreements that leave them in the lurch when a termination is desired by them, but not simultaneously desired by the outsourcer (of course, most outsourcers do not want the agreement to end).

If a user of outsourcing wants out of an outsourced agreement, and if the outsourcer does not want out, and if the agreement between the parties is loose regarding the termination clause, the user of outsourcing is likely in for a rough time. I have seen outsourcers that threatened to pull out and leave the user without I.T. capabilities at all (a negotiating tactic to scare the user back into the marriage), and I have seen outsourcers that hang in with the customer but reduce their service performance to a dismal level and otherwise make the exit process as tortuous to the customer as possible.

As with any divorce, termination is bound to be ugly, costly, and protracted.

How to Turnback

In my methodology for outsourcing, I have a six-step process for handling a turnback situation (note that the term "turnback" has become a commonplace way to describe moving from outsourced to an insourced or in-house role; other terms used include insourcing, reverse transitioning, and disentanglement).

The six steps are:

1. Assessment of the Existing Outsourced Arrangement



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2. Decision to Terminate/Reduce and Turnback
3. Development of a Turnback Plan
4. Turnback Transition
5. Turnback Completion
6. Ongoing Re-evaluation of Outsourcing/In-House Mix

I briefly provide some highlights of each of the steps in the remainder of this article.

Throughout the turnback process you will need to have a turnback team assembled that can help make decisions and guide the turnback effort. The team should contain, at a minimum, representation from your legal counsel, human resources function, facilities function, corporate communications function, top management, and, of course, I.T. If the entire I.T. function has already been outsourced, the firm should either employ a top I.T. executive such as a CIO with the interest and ability to lead the turnback effort and/or make use of an I.T. consultant with expertise in outsourcing.

Step 1: Assessment of the Existing Outsourced Arrangement

The first step involved in turnback is reviewing the existing outsourcing arrangement.

A careful and detailed scrutiny of the outsourcing contract must take place. Can the firm terminate the contract without having to indicate a reason for the termination (so-called termination for convenience)? If the only option to terminate is for breach (meaning that the outsourcer has possibly committed a significant fault of one kind or another), then the outsourced firm will need to amass a documented record of how the outsourcer has faltered or failed, and will need to notify the outsourcer and allow an opportunity for response or cure of the problem (thus, making termination a very protracted affair).

The better option from the outsourced firm's perspective is termination for convenience (allowing the outsourced firm to terminate without necessarily justifying and defending the reason to do so). Remember that the outsourcer is normally resistant to termination, not only due to the potential financial loss of the customer's business, but also due to the possible em-

barrassment and ill-will that might be generated in the overall business community after they've lost a contract. Do not underestimate the powerful force of an outsourcer that wants to avoid a separation.

Find any legal safety valve and loophole you can in your existing contract. And, realize that once you start down the path toward turnback that the outsourcer will also be trying to find loopholes to prevent you from separating, or at least make you pay substantially for the separation. Prepare to counter-attack against such outsourcer beneficial loopholes.

Step 2: Decision to Terminate/Reduce and Turnback

After performing the review of the existing outsourcing arrangement, the next step involves deciding how and when you want to initiate and bring about the turnback. Do you want to try to turnback all of the outsourced activity or just some of it? Do you want to try and do the turnback all-at-once or possibly do so in distinct stages?

There are advantages and disadvantages to each approach. For example, a partial reduction or gradual reduction might be more acceptable to the outsourcer since they continue to have you as a customer. And, your risk of being able to take the I.T. function in-house can be lessened if done over a gradual period rather than overnight.

But, the outsourcer may sour on you as a customer and provide poorer level of service for the reduced activity. Furthermore, it may be difficult to hire I.T. personnel into an in-house function that is only slowly being constructed and that might swing back entirely into the outsourcer's hands if the firm tires of trying to do the turnback.

Your own particular circumstance should be used to determine the appropriate approach for the turnback.

Step 3: Development of a Turnback Plan

You will need to develop a turnback plan that comprehensively covers all of the issues that will arise during the turnback itself. You will need to gain commitment from the top management of your firm, and the users of I.T., realizing that the I.T. function may be fraught with difficulties dur-

ing the turnback transition period. Are they willing to stay the course? Do they understand the nature of the turnback?

For example, a contingency should be anticipated for a circumstance where the outsourcer decides to pull out suddenly from the agreement or otherwise make life hard on the outsourced firm. Is there a disaster recovery plan that can be invoked under an abrupt leave by the vendor?

Here are some items to include in the plan:

- How will hardware ownership be transferred from the outsourcer back to in-house?
- How will software ownership be transferred from the outsourcer back to in-house?
- Do software licenses allow for the transfer to in-house from the outsourcer?
- Do hardware leases allow for the transfer to in-house from the outsourcer?
- How will hardware maintenance be done and do the existing agreements allow for transfer?
- How will software maintenance be done and do the existing agreements allow for transfer?
- Does real estate need to be transferred from the outsourcer to in-house?
- Is new real estate and facilities needed to accommodate the in-house I.T.?
- Is new hardware needed for the in-house I.T.? New software needed?
- Can documentation be transferred from the outsourcer to in-house?
- For I.T. related knowledge that the outsourcer has and that is undocumented, how will it be transferred?
- Can the I.T. personnel of the outsourcer be transferred in-house? Do they want to transfer?
- How well will newly hired I.T. personnel interact with transferred personnel?
- Are data and databases able to be transferred? Will conversions need to be made?
- Who owns the intellectual property rights in the systems and data? Can the rights transfer to in-house?
- How will the communications hardware and software infrastructure be impacted?
- How will internal and external processes be modified due to the changes in I.T.?

And so on . . .

The turnback is actually much more difficult than starting an I.T. function from scratch. If starting from scratch, you could design whatever kind of I.T. function you might wish to have. With a turnback, you normally want to leverage the existing I.T. base and must therefore figure out how to untangle a very tangled web of people, processes, technology, etc.

Step 4: Turnback Transition

The turnback transition consists of implementing the turnback plan. A schedule with timelines and milestones should be used to guide the turnback effort. Regular meetings of the turnback team will be required throughout the transition.

Interaction with the outsourcer may be rough at times. Be cautious in all communication with the outsourcer and make sure that the legal counsel on your team reviews all correspondences. You want to avoid going to litigation if possible, and, moreover, want to avoid providing ammunition

for the outsourcer if the turnback does get stuck in a legal fire fight.

Keep in mind that you may also need to do specialized reporting for the SEC and the investment community (if the turnback is large-scale). Also, watch out for any regulators who might wonder about your turnback, and realize that the I.T. community may be watching the turnback as well (impacting your ability to create the new in-house I.T. function).

Step 5: Turnback Completion

At the completion of a turnback you usually have an I.T. function that works, but has not yet begun to mature. Give the I.T. function some additional time to mature. Make sure that reliance on the outsourcer does not interfere with the in-house efforts and maturation.

Watch for integration problems that might arise between the in-house I.T. and whatever leftover outsourced I.T. you have allowed. Hostility may linger.

Step 6: Ongoing Re-Evaluation of Outsourcing/In-House Mix

Organizations should always make sure that they have the right mix of outsourced I.T. and in-house I.T. In some instances, a firm that goes in-house might later decide to re-outsource some of the I.T. sub-functions, perhaps to the same outsourcer used before or to a different outsourcer. Then again, a partially in-house and outsourced I.T. function might decide to switch and become entirely in-house. The right mix depends upon the strategic value of I.T. and the particular circumstances facing the firm.

Conclusion

Is your firm interested in disentangling themselves from their I.T. outsourced arrangement? If so, make sure that you use the six steps that I have identified above. A turnback can be a tricky operation, and you will want to operate during and after the turnback without suffering any bodily and financial losses. ■

NAMES IN THE NEWS

CAROL LATTA, Feature Editor, Home Office, Georgia State University



Joseph R. Carter, National Association of Purchasing Management Professor at Arizona State University, has been named chair of the Supply Chain Management Department. As chair, Dr. Carter will manage a diverse and competent group of Supply Chain Management faculty specializing in various aspects of logistics, purchasing, and operations management, and oversee Supply Chain Management academic programs at the undergraduate, masters, and doctoral levels.

Jaideep Motwani, director of Seidman Business and Research Center and associate professor of operations management at Grand Valley State University, recently received the Distinguished Faculty Award from the Michigan Association of Governing Boards of Colleges and Universities. Professor Motwani was honored for his teaching, campus and community involvement, communication and leadership skills, and research efforts. In addition, Dr. Motwani was also awarded the Outstanding Teacher Award at Grand Valley State University.

Ram Narasimhan has been appointed a University Distinguished Professor at Michigan State University, as of Fall, 1998. Ram was also elected a Fellow of the Pan Pacific Business Association at its annual conference in Seoul, Korea in June 1998.

Richard J. Schonberger's book, *World Class Manufacturing—The Next Decade: Building Power, Strength, and Value* (New York: Free Press/Simon & Schuster, 1996), was awarded the 1998 Shingo Prize for research. Schonberger is president of Schonberger & Associates, Inc., and affiliate professor, Department of Management Science, University of Washington.



Scott M. Shafer, Member Services Coordinator and feature editor of the "Membership Roundtable" column in *Decision Line*, has joined the faculty of the Babcock Graduate School of Management at Wake Forest University as an associate professor of operations management. His new textbook (with Jack Meredith) entitled *Operations Management for MBAs* is being published by Wiley for a December 1998 release. ■

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