



RISK ASSESSMENT IN IT OUTSOURCING

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Introduction

There are four significant areas of risk associated with the outsourcing of information technology (IT) support to an external Service Provider by a major public sector entity. They are: Service Risk, Business Risk, Market Risk and Political Risk. This paper identifies the major risk components in each area and suggests mitigation strategies.

Service Risk

Service risks relate to the failure of the Service Provider to deliver the required services to the required standard either temporarily or permanently and are similar for each of an Agency's business units.

The main Service Risks are:

- the cost of having any service problems corrected;
- the cost of re-tendering and transition to a new Service Provider if the Agency terminates the contract as a result of a breach; and
- the risk to the viability of the contract if the structure of the Agency changes.

Risk Area 1 - Rectification of Problems

Significant difficulties could be experienced by business units if the Service Provider is unwilling or unable to correct service problems or is temporarily unable to provide the required services to the required standard. To mitigate against this, risk management plans should be put in place in the contract as follows:

- The Service Provider is made responsible for the cost of delivering the services to the required standard. As a consequence, the Service Provider is also responsible for the cost of correcting service problems and for the provision of alternative means of service delivery should the Service Provider be temporarily unable to provide the service through circumstances which are not of the Agency's making.
- The Service Provider is required to develop procedures, including backup and recovery and business continuation plans, which detail the means of maintaining service delivery capability. The Service Provider is also required to effect



insurances to cover the cost of failures in circumstances unforeseen by these procedures or where the procedures prove inadequate.

Risk Area 2 - Termination for Breach of Contract

The major risk to service provision is that the Service Provider is unable or unwilling to provide the required services to the required standard, causing the Agency to terminate the contract for a breach. Under these circumstances, while some of the costs of restoring service delivery may be retrievable through insurance arrangements, it must be assumed that the cost of re-tendering will be borne by the Agency. This cost of these processes will vary depending upon the duration of the service delivery prior to the termination.

- If the failure occurs within the first few months of the implementation of the contract, the cost of re-tendering may be minimised by re-opening negotiations with one of the unsuccessful but acceptable tenderers for the original requirement. While such an approach weakens the Agency's bargaining capability, this must be offset against the cost (to both the Agency and industry) of repeating the tendering process.
- If the failure occurs later in the contract period, some reduction in the cost of tendering may be possible through the use of the knowledge gained in the conduct of the initial tendering process.
- The cost of transition should be borne by the defaulting Service Provider but would, in a worst case scenario, be borne by the Agency. Transition costs will include any costs imposed by an interruption of service while the transition takes place. A worst case scenario involves a temporary interruption in service delivery.
- In order to address the risk of the Service Provider defaulting on its responsibilities for service delivery, the Service Provider should be selected using a rigorous selection process designed to eliminate tenderers whose corporate integrity, financial viability, qualifications and capability, or experience in the provision of similar services is in doubt.
- In order to minimise any loss of reputation or confidence by the Agency caused by a failure of the Service Provider which leads to termination for a contract breach, robust contingency provisions need to be built into the contract to ensure a swift transition to a new Service Provider while providing continuity of service delivery. The contingency plan should not rely upon assistance from the terminated Service Provider.



Risk Area 3 - Structure of the Agency

The RFT should describe the structure of the Agency in order for the tenderers to be able to scope the work and to price the service delivery accordingly. Should the structure of the Agency change, for example through restructuring as a result of government policy changes, the scope of the work is likely to change. If the overall volume of work changes significantly as a result of restructuring, then the Service Provider may have grounds for modifying prices, which could lead to uncertainty in the financial management of the contract.

This uncertainty should be addressed in the RFT and contract as follows:

- The RFT should identify a requirement for the tenderer's solution to provide flexibility in terms of pricing and service delivery to accommodate changes in the structure, business, services and functions of the Agency during the term of the contract.
- The contract should address the possibility of variations in service requirements as a result of Agency changes. Any charges which the Agency will pay the Service Provider in the event that such a change takes place should be specified.
- Inclusion of the foregoing information in the contract addresses the risk of instability in the Agency. The Service Provider should be contractually obliged to continue to provide the required services, even if a significant change in the structure of the Agency takes place.

Business Risk

The Business Risk analysis covers the potential impact on the Agency's business units of lost productivity, any reduction in business service levels and outcomes, or Agency dissatisfaction arising from substandard system performance due to:

- inadequate definition of IT strategic directions;
- inadequate business requirements definition;
- inadequate service level definition; or
- consequences of the adjustment to a commercial approach to the delivery of IT services.

Risk Area 1 - IT Strategic Directions

The IT Strategic Plan should define future business requirements and service levels. It should also describe the potential for the exploitation of technology. Tenderers will base



their assessment of future requirements upon the published plan and should reasonably expect it to be an accurate reflection of the Agency's requirements across the contract period.

Tenderers are likely to treat an unclear IT strategic direction as a risk, and will factor in increased costs to cover that risk. If the RFT seeks future direction solutions from vendors, these may also be supplied at a cost due to the inherent risk that the Service Provider's liability increases.

It is recommended that future IT directions be articulated as clearly as possible in the RFT document, particularly in terms of platform.

Risk Area 2 - Business Requirements Definition

Where the Agency operates government programs which are subject to policy and legislation changes, future business requirements may not be fully documented in the RFT. As a consequence, Tenderers' forward planning of business requirements, service levels and costs may be significantly compromised through an inadequate picture of the business needs.

It is recommended that the definition of business requirements be given high priority and that a method for incorporating known and potential business developments be provided for in the RFT.

Risk Area 3 - Service Level Definition

Service levels are a sub-set of the wider business requirements. In the development of service level definitions, the Agency should identify existing service levels, compare them with industry standard benchmarks and decide whether to define expected service levels at the existing level or the industry standard benchmark.

If service levels are inadequately defined, then tenderers will be obliged to build risk loadings into their cost structures in order to cover uncertainties as to the required level of service, (ie, a higher price for the service). This could lead to a reduction in savings to the Agency.

It is recommended that the definition of existing service levels be given a high priority so that meaningful comparisons of actual performance against the industry benchmarks can be made. The accurate definition of service level expectations is fundamental to the success of the competitive tendering process.



Risk area 4 - Adjustment to the commercial approach to delivery of IT Services

Where the current environment for IT service delivery is a non-commercial approach, business units typically request changes to applications and subsequent capacity increases and, depending on the priority of the business, will receive those increases.

As a consequence, some business units have, over time, developed unrealistic expectations of IT services. Business requirements for virtually “24 hour, 7 day” access are thought to have rightful precedence over any cost issues, which are borne by the Agency as a whole. There also exists a general expectation of unlimited processing capacity for new or enhanced applications, which can translate into user dissatisfaction when that capacity is not delivered.

Under a commercial arrangement where business units would have to bear the actual costs of additional services or capacity beyond standard levels, the Agency may be exposed to:

- an unexpected increase in service costs to the Business Units;
- increases in service levels for some programs at the expense of service quality in others;
- the abandonment of some programs or in-program initiatives for lack of funding; and
- a reduction in quality and of business services or an inability to respond to Agency needs to the same extent to which business units have been accustomed.

The risk of a reduction in business outcomes or financial strains in maintaining business service levels, as a consequence of a change to a commercial arrangement for the delivery of IT services, may be reduced through an education process which helps the business units fully understand the real costs of improvements to systems.

High level executive commitment to managing change in this area is seen as imperative. In order that business units embrace the new commercial culture, the financial and business commitment must come from the top.

Market Risk

The market risk analysis covers the potential risks with the overall competitive tendering process. The objective of the process is to obtain the best value for money provision of IT services to the Agency. The philosophy of competitive tendering assumes that sufficient competition exists between suppliers whose core business is the provision of



the required services, and that the Agency organisation will benefit from that competition in acquiring services at a price which offers better value than current provision. However, if there is no competition, then the advantage of competitive tendering is lost, and expected savings are unlikely to accrue.

The following risk areas may affect the competitive tendering exercise:

- the timeframe for the competitive tendering;
- the potential for a lack of adequate tenders; and

Risk area 1 - Timeframe

The quality of the tender bids received and the improved value for money which the Agency expects to gain depend heavily on the quality and completeness of the RFT documentation, in particular the clear and unambiguous articulation of the requirements and the service levels expected. The more accurate these are, the more effective the tender process is likely to be.

If the Agency sacrifices the quality of the RFT to meet an unrealistic process deadline, the resulting responses may not satisfy the aims of the program and will probably not bring the expected savings or increase in service capability. If on the other hand, the Agency employs enough resources to complete the RFT to a satisfactory standard and meet the process deadline, the cost of the tendering process will be increased. The third option, to slip the process deadline to some later date, may exacerbate the delay in evaluating tenders and negotiating and implementing the contract.

The principal risk to the RFT process is the inadequate definition of the requirement resulting in inappropriate tendered offers. It is recommended that Agencies acquire the resources necessary to complete the requirement definition in time to meet the proposed RFT date. The short-term cost involved will be offset by the improved value for money of the tender bids received and the long-term benefits that this will deliver.

Risk area 2 - Lack of Competitive Tenders

The RFT schedule should provide an adequate timeframe for transition arrangements and should also recognise other unrelated tendering activity which may limit the service provider industry's ability to respond to complex requirements.

Even if interest has been shown in the Agency RFT by the major Service Providers, the commercial reality is that, if they are confronted with the situation of responding to two large bids at once, they may be unable to resource the necessary bid teams to prepare both responses.



Given the investment in resources necessary for a Service Provider to submit a bid which they believe will be successful, it is more likely that they will respond to an RFT which contains minimal risk than one which is unclear or ambiguous in its requirements. In issuing an RFT, the Agency is, in effect, competing for the attention of the tenderers.

It is recommended that the Agency reduce the risk for Service Providers by investing the resources necessary to define the requirements in as complete a fashion as possible, thus making the Agency's RFT more attractive to prospective tenderers. As part of the process, communication with prospective tenderers should be encouraged, while maintaining the principles of probity and fair dealing. If possible, the draft Statement of Requirement should be circulated to potential tenderers for comment prior to the issue of the RFT.

The due diligence period should be utilised to the fullest extent possible in order to eliminate misunderstandings, clarify service requirements and make all parties aware of operational environment and the issues.

Political Risk

The Political Risk deals principally with the reputation of the Agency and associated Government areas, and covers the following:

- political harm including lack of confidence, electoral backlash etc; and
- failure of contract management process.
Risks to Government have similar components for all Business Units involved in the Agency IT outsourcing.

Risk area 1 - Politically Sensitive Programs

Almost every public sector business unit administers programs that are politically sensitive. The risk of sub-standard delivery of IT services directly affects these programs.

Minimising the risk of political harm from a reduction in business service standards can only be achieved by reducing the service and business risks identified in the preceding sections. Of paramount importance is the setting of accurate service levels and business requirements, together with effective management of the relationship with the Service Provider.

Risk area 2 - Contract Management

The major risk associated with the management of an IT contract is that the relationship between the contract manager and the Service Provider is not effectively implemented. If



the balance of power lies in favour of the Service Provider, they may tailor the service delivery more to suit their operational needs than the Agency's business requirements. To avoid this imbalance, it is important that the contract manager take the initiative in establishing the relationship. A strong support for the achievement of this initiative is that the service levels, and any sanctions for failure to meet the service levels, are based upon business outcomes and not, as far as practicable, on IT metrics. This gives both Agency and provider common goals to aim for, and a common purpose which strengthens the relationship.

Once the contract manager is established as the significant partner in the relationship, a true partnership may be established with the Service Provider. It is important to realise that a strong partnership relationship must be based upon an enforceable contract.

While a partnership may bring benefits to both sides, it needs to be underpinned by a clear and agreed statement of the relationship and the mutual obligations defined in the contract.

Conclusion

Risk assessment is important in preparing for all competitive tendering exercises, and particularly important where the provision of IT support to Government Agencies is the objective. As has been suggested in this paper, tenders for IT support require the careful management of a range of risk areas, any of which could be damaging to the success of the enterprise, but all of which can be mitigated or eliminated by adequate planning, forethought and relationship management.

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