Partnership and Risk Reward within Local Government ICT Managed Services Contracts

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effective management consultancy services for the public sector

Introduction

1. Nineveh Consulting is the UK local government's favourite consultancy. Our involvement in ICT service review and outsourcing goes back nearly ten years and we have helped many IT departments to restructure and revitalise themselves as well as aiding those that needed to externalise their service or re-shape and re-let established contracts. Nineveh also works on customer service, transformation management, and major change programmes in local authorities across the UK. In all there are currently 63 local authorities in the UK who have benefited from our consultancy services with many more who have attended our training courses, seminars and conferences. Our new Interim Management service, Betwixt, provides experienced managers and professionals from all areas of expertise to local government.

2. We decided to undertake a simple survey of the use of risk and reward components in ICT contracts after finding that the published information on this topic was very sparse, whilst interest from clients was very strong.

3. IT outsourcing in local government started in the late 1980s. It was driven primarily by consideration of costs, particularly those associated with running large scale computer operations. Early players were mainly mainframe makers, notably ICL (CFM now Fujitsu) and Bull (Integris now Steria). By the mid to late 1990s the main driver for local authority outsourcing had changed to the need to protect continuity of service in the light of increasing problems with ICT staff retention. Many smaller local authorities, particularly in the South East, outsourced all or part of their ICT at this time. By 1998 it was estimated (CIPFA IS/IT Market Directory) that 102 of the 467 local authorities in the UK had at least some significant part of their ICT service provided by an external provider. Many of the larger authorities at this time were encouraged by what was seen by central government as a strengthened role for the private sector, to look at a wide range of managed service opportunities in their back offices, commonly bundling Finance, Revenues and HR as well as ICT in the same contract or developing "strategic partnerships" for modernisation. New larger corporate players like BT, Deloittes, Siemens and Hyder (now HBS) entered the market at this stage and other established public sector ICT providers such as CSL (now Liberata) Capita and ITNet (now part of Serco) diversified into Business Process Outsourcing. Also at this time some traditional ICT service companies with an interest in the local government market place started to bid for and win IT Service TUPE contracts. The leaders in this final group were Securicor (now Sunguard Vivista), Sema (no longer in this market sector) and Fox IT (lately Digica and now Computer Centre Digica).

4. Since this time the market has matured. The emphasis now is on using ICT partnerships to share services, achieve efficiencies and facilitate change. Partners and contracts vary considerably in scope and ambition. Indeed the range of managed service contracts in place now is bewildering, but it is likely that whereas many of them are called "partnerships" few are really much more

than traditional client / contractor relationships. A recent study by SOCITM (A Marriage of Convenience? SOCITM Insight 2005) concluded that:

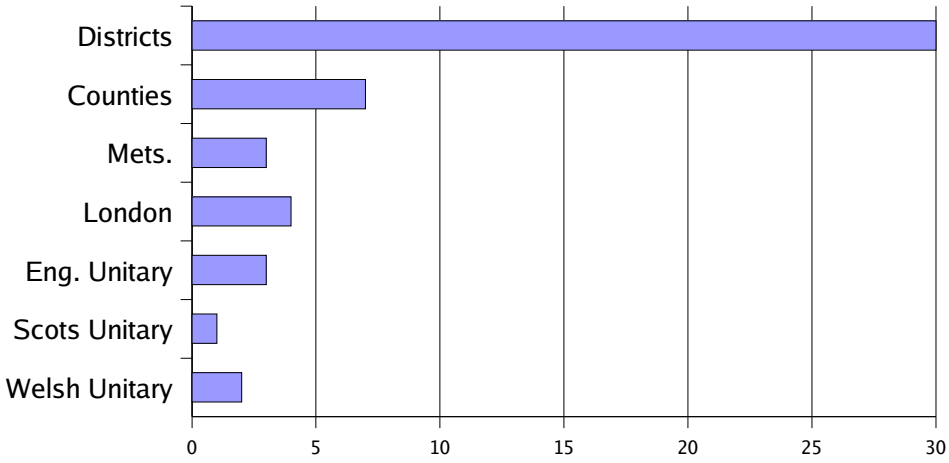
> *"We found that too many arrangements are labelled as 'partnership' purely for political expediency. There is little evidence of mutual trust: indeed some councils are cynical about their partner's motives".*

The Survey

5. We sent out simple e-mail questionnaires to 329 different English, Welsh and Scottish local authorities. That is 75% of all British local authorities. We excluded Northern Ireland local authorities, police, fire and other allied bodies such as housing associations. Only named IT officers who where assumed to have received the e-mail (i.e. we had no notification of delivery failure) are included.

6. A total of 50 IT Managers completed the questionnaire; a response rate of 15.2%. The table below shows the distribution of respondents by type of authority.

Figure 1. Survey respondents by authority type.



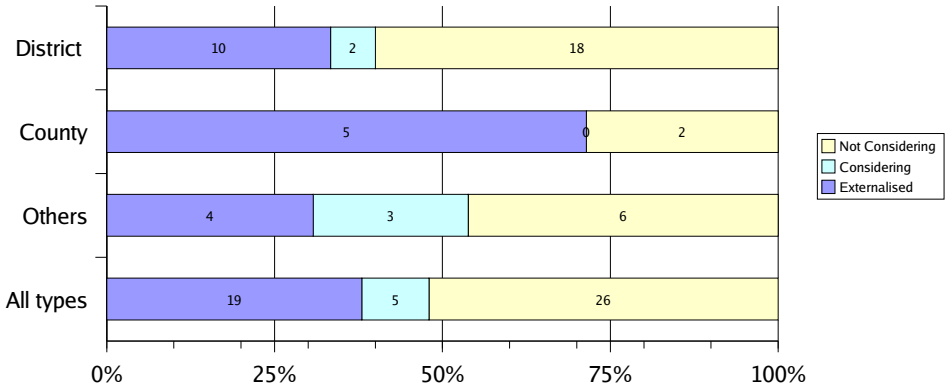
7. The survey e-mails were all sent out on 17th and 18th January 2007 and responses accepted until noon on Thursday 25th January 2007. The questionnaire is reproduced in Appendix 1.

Survey Analysis

8. 19 respondents said they had outsourced all or a major component of their IT service. Surprisingly perhaps, only one of these, a County, had externalised IT as part of a contract including other major services. 2 of the others qualified their "IT only" response by adding "and transformation". Several of those reporting existing outsourcing, including four of the districts, had contracts for limited sections of the service. We asked those who had not externalised if they were currently considering doing so. 5 respondents said they were considering outsourcing IT, or part of IT, for the first time and a number of others qualified their negative response to this question, suggesting they might reconsider the

position in the future.

Figure 2. Externalisation by type of authority

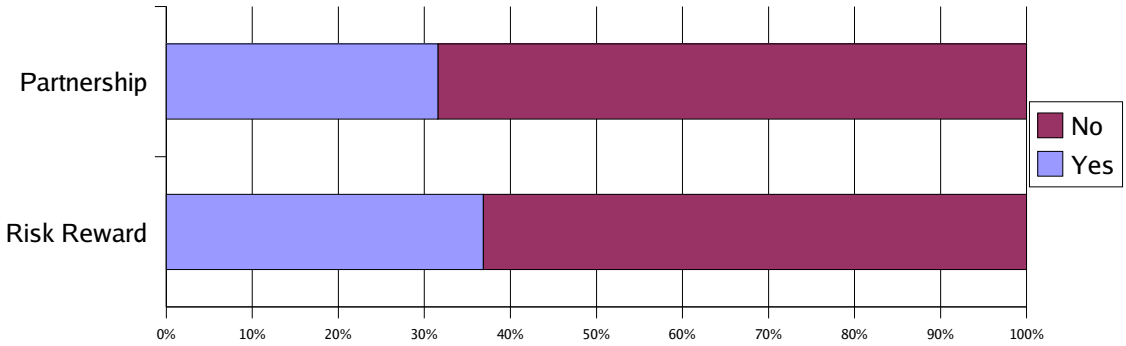


9. Whilst this analysis appears to show that nearly half of local authorities have either externalised major parts of their IT service or are actively considering doing so, we believe that this result might be slightly biased by the greater inclination of those managing external contracts or considering letting new ones to complete the survey. This is because they are more likely to want to see the summarised results. This said, most respondents not considering externalisation did ask for a copy of the survey analysis.

10. Although we did not ask a question on this topic, two of the districts responding made the point that they were looking to shared service initiatives rather than outsourcing to improve IT value.

11. For the purposes of a formulating a simple question we defined partnership as as a contract containing some form of joint ownership or governance. We asked those who had externalised their IT service if the arrangements included a partnership. We also asked if their contract included any element of risk and reward. In all those considered to be a partnership, there was also a risk and reward element. Only 1 currently outsourced authority had a risk reward element without having a partnership. The table below summarises the respondents answers to these questions.

Figure 3. Partnership and risk and reward

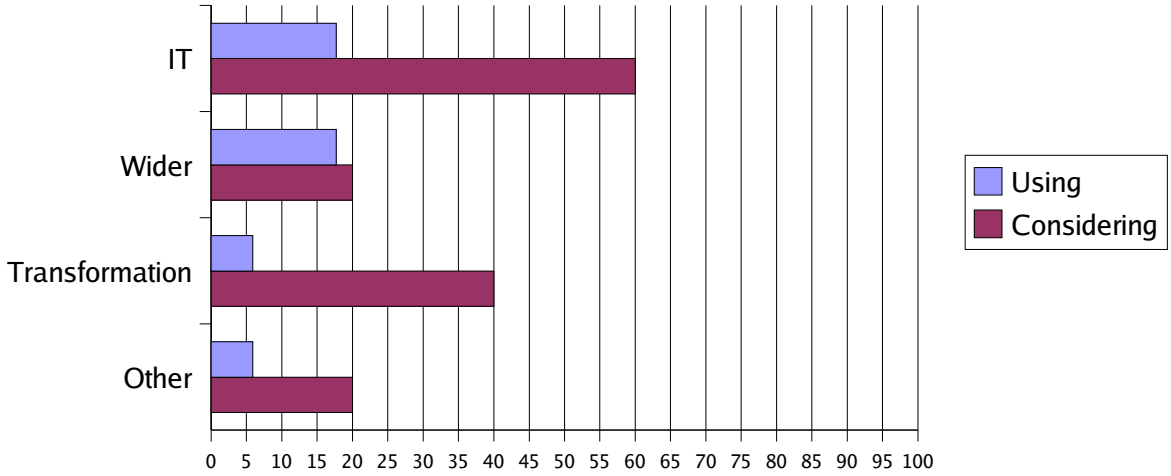


12. We asked both those already with risk and reward elements to their contracts and those considering letting external IT service contracts for the first time (all of whom said they would use risk and reward of at least one type) what element of measurement they would use in connection with risk and reward. Respondents were invited to choose one or more of the following options:

    i. Payment linked to attainment of IT Service related targets.
    ii. Payment linked to attainment of wider service objective targets.
    iii. Payment linked to attainment of transformation strategy objective targets.
    iv. Other - please specify.

13. It can be seen from Figure 4 below that risk reward is much stronger as an aspiration than in actuality. Whether this reflects a change in attitude making Risk/Reward more likely to be required in future or the result of a tendency to drop risk reward in the negotiation, or even the operation, of a contract is not clear. Certainly the survey produced some evidence of the later. One district respondent said that there had been an element of risk and reward in an earlier contract, but he had dropped in when the contract was re-let. Another district admitted that there was some provision in the contract, but that it had never been used. One county admitted that whilst its contract had been set up as a partnership with risk reward components it had subsequently reverted to a "straight outsource" and a "straight payment profile without risk reward".

Figure 4. Percentage using or considering different types of risk reward



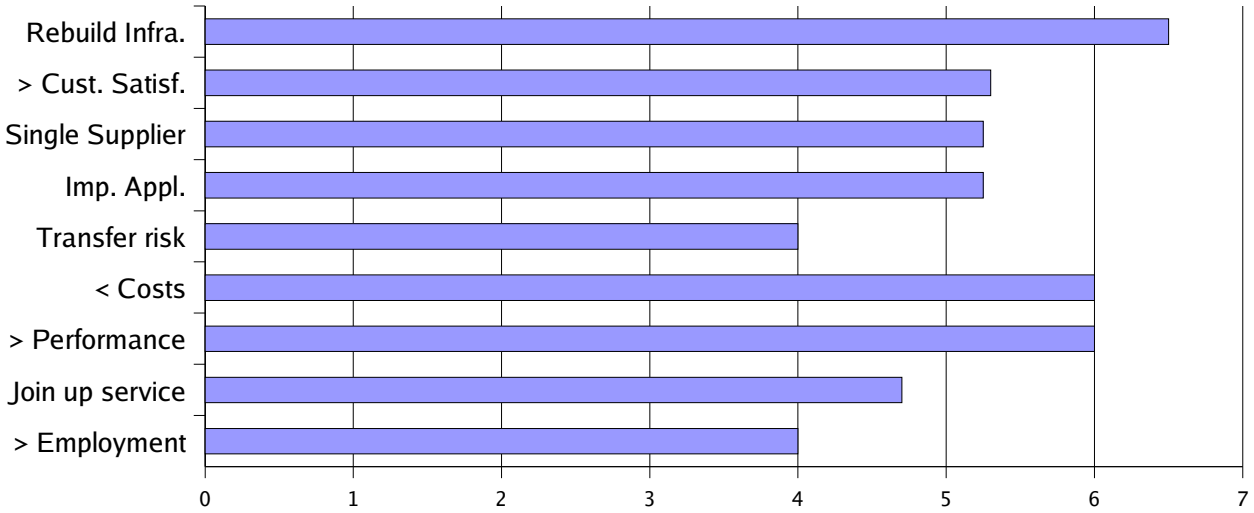
14. Our survey showed some evidence of interest in a new round of outsourcing. It is likely that costs are a key driver in the present financially strident climate. However, 4 of the 5 respondents who said they were currently considering externalising IT for the first time were in or near London, suggesting that staff retention may be a major factor.

15. All the comments and clarification included by respondents (rendered anonymous as necessary) are reproduced in appendix 2 of this report.

Other Evidence

16. The 2005 SOCITM Insight publication "A Marriage of Convenience" was based on an in-depth survey of 21 local authorities with outsourcing experience. It identified a number of things that councils wanted to achieve from outsourcing. The most common was "rebuild infrastructure" (12). Second (equal) with 10 each were: "improve satisfaction"; "single supplier"; "implement a major application" and "**transfer risk"**. "Reduce service cost" was noted by only 6. However, when asked about satisfaction as to how these initial objectives had been achieved, risk transfer did rather badly. See Figure 5 below:

Figure 5. Satisfaction of Achievement (scale 1- 7)



Source: A Marriage of Convenience? SOCITM Insight 2005

17. Note how "transfer risk" and "reduce costs" change places before and after the start of the contract.

18. Most recent contracts at smaller districts have not, in our experience, included risk and reward – even though the question was asked at qualification or tender stage and the responses may have been factored in to evaluation models. In the current "management by target" culture councils may feel obliged to ask the question, but may be less inclined to follow through when it becomes clear what risk and reward involves or when otherwise favoured contractors appear averse to taking on these arrangements.

19. Some new IT contracts, especially those linked to transformation or where a basket of services including IT are packaged together, clearly do have elements of risk and reward in them. Most appear to contain a mixture of pay by performance (linked to IT KPIs) and the realisation of benefits on new projects. The project based schemes are common in large business process transformation programmes, but have also featured in smaller otherwise traditional IT externalisation contracts. The initiatives in these later cases often come from suppliers who, responding to tentative enquiries about risk and reward options, use their project based risk and reward experience to gain competitive advantage. However, these kinds of arrangements (as has been

seen recently reported at Swansea - Computer Weekly 16.1.07) often fail to move forward to the big transformation areas, with their significant risk and reward components, whilst continuing to deliver their more-or-less conventional IT service elements.

Conclusions

20. The more complex the contract the more resources it takes to manage from the local authority side. A small district with, say, one relatively inexperienced IT Client Manager is unlikely to favour a complex contract; or if its senior managers insist on it, the mechanisms may never be used in practice. As has been noted above, some decide to drop complex management mechanisms, like those associated with risk and reward, on re-letting or revert to "straight forward" management process once the contract is in operation.

21. We conclude that most local authorities, including those currently looking to externalise some of their IT for the first time, feel under an obligation, in the current climate, to ask for risk and reward schemes from their potential suppliers. In practice when the negative implications for having these (i.e. premium cost, uncertain budgeting, complex contract management requirements and extended negotiations) becomes clear they often, the evidence appears to suggest more often than not in fact, drop the idea.

22. It is appropriate here to quote from our own briefing on risk (i.e. from a consultant to a local authority). A typical section from one of our recent IT service review reports reads:

> *"It makes good sense to transfer some technical and operational responsibilities from a local authority, whose prime purpose is local service delivery, to a private sector organisation whose main function is professional ICT services. But not all risks can be sensibly transferred. If the contractor cannot predict or control a risk any more than the Council, it will require a disproportionately large premium to take it on."*

Appendix 1 – The text of the e-mail questionnaire

Nineveh Consulting is in the process of completing a short research study into risk and reward elements in local government IT Service contracts. I would be grateful if could take two minutes to answer the questions below and return e-mail to me. Responses will be treated completely confidentialy and results presented without any reference to particular authorities. A copy of the results will be sent to anyone completing the survey who requests them.

Many thanks

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Q1. Have you outsourced (or transferred in any way) responsibility for all or a major portion of your IT Support Service to a private sector provider?

Answer:

If NO, please go to Q2.

Q1a. Is the contract just IT or is IT included with other major services (eg Finance, HR)?

Answer:

Q1b. Is the contract formally structured as a Partnership (ie some form of joint ownership or governance)?

Answer:

Q1c. Does the contract contain an element of risk reward.

Answer:

If NO, please go to Q3.

Q1d. Please indicate by adding YES to the item on the list below if the the risk reward element involves any of the following:

i. Payment linked to attainment of IT Service related targets.
ii. Payment linked to attainment of wider service objective targets.
iii. Payment linked to attainment of transformation strategy objective targets.
iv. Other - please specify.

Please GO to Q3.

Q2. Are you considering outsourcing IT?

Answer:

If NO please go to Q3.

Q2a.

Please indicate by adding YES to the item which of the elements in the list below you consider including in any such contract:

i. Payment linked to attainment of IT Service related targets.
ii. Payment linked to attainment of wider service objective targets.
iii. Payment linked to attainment of transformation strategy objective targets.
iv. Other - please specify.

Q3. Would you like a copy of the survey results?

Answer:

Thank you; I very much appreciate you taking the time to help with this survey.

Appendix 2 – Additional respondent comments

Existing externalisers clarification

R/R other target: "for new projects - payment linked to achievement of elements of the project".

R/ R wider service target: "Linked to a Best Value Review Plan which, if adopted and results in an increase in the charges to be paid will be shared 50:50; and if results in a decrease in the charges to be paid will also be shared 50:50 between *** and our supplier".

Considering externaliser clarification:

R/R other target: "payment relevant to HR/OD strategy"

Other comments:

"The sub-questions you ask are is not the only possible risk/reward mechanism.***supplier name*** (to their credit, they offered this in the contract, we didn't ask) invoiced in stages for their CRM implementation, on pre-agreed deliverables when signed-off as working. As a result they ran over on some elements, because they had to show they actually worked on the live system (rather than the usual with payment in advance, which is, 'we' ve installed the software, byeeee!' I would recommend this to anyone implementing a new system)".

"My initial thoughts are that the logical area to base targets on are Service related targets. There's no point in doing IT better, just for IT's sake, and I'm not sure there much point in Transformation if it doesn't result in Service improvements. However having said all that I suspect IT Targets and Transformation objectives are easier to measure, and would be less contentious. Can you imagine the arguments between the service provider and the council if the Service provider delivered lots of improved services, but the Council didn't exploit them".

"We are looking at the potential for shared service delivery - which is potentially similar to outsourcing".

Are you considering outsourcing IT? Answer: "No; we will consider it if we need to but at present we are assuming that a shared services arrangement with partner councils is likely to be better and more cost effective."

"The big issue now (not the magazine!) is sharing sharing sharing; we would be more likely to look to other LG sites for shared service delivery, rather than venture into the private sector."

"I did apply a small-scale Performance Management scheme under a previous ***supplier name*** contract (which included the ability to earn some low-level performance bonuses), but that is not used now."

“There is a service credit scheme, but it' s notused in practice.”

Partnership: “Set up on that basis, but subsequently reverted to a straight outsource”. Risk/Reward: “Set up on that basis, but subsequently reverted to a straight payment profile with no risk reward”