Shared KPIs in Multivendor IT Outsourcing

Turning "I" to "We"

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Most companies that outsource to multiple IT suppliers treat those relationships as discrete arrangements, with each vendor assigned a unique set of performance metrics and compensated on the basis of its ability to deliver. But this approach can lead to difficulties when challenges arise that straddle functional boundaries—and can trigger a "not my problem" response on the part of suppliers. ABN AMRO found that using shared metrics aligned its suppliers' interests and fostered collaborative solutions to problems, with superior results.

The practice of outsourcing components of a company's IT to multiple vendors is increasingly common. An estimated 60 percent of large companies currently outsource to four or more suppliers, driven by a combination of factors—including the desire to tap individual vendors for particular areas of expertise as well as the aim of avoiding vendor lock-in.

Companies typically view and manage these supplier relationships as discrete arrangements. Once chosen, a vendor is assigned a unique set of performance metrics and compensated on the basis of its ability to deliver against those metrics. Although typical, this arrangement can be suboptimal, however. Interdependencies often exist between and among outsourced functions, calling for a collaborative approach to problem solving. But with each vendor oriented solely toward its own tasks and key performance indicators (KPIs), such cooperation can fail to materialize. Indeed, the opposite is more common: vendors scramble to establish that a problem isn't theirs and is therefore not their responsibility. The end result can be a combination of lower-than-expected performance and higher-than-expected costs because the company winds up having to intervene—hardly the best-case outcome for an outsourcing effort.

The recent experience of ABN AMRO Bank suggests that there may be a better way. The bank decided to stand the business-as-usual model on its head by basing a significant part of its vendors' compensation on a *shared set of KPIs,* which forced the individual players to work together toward a single set of management objectives (such as high business satisfaction and assured end-to-end system availability), rather than acting as independent agents focused on their own separate tasks. Implementation has entailed working through some thorny logistical challenges. But the bank is highly encouraged by the early results and expects the approach to translate into major performance improvements on all key fronts. And the vendors themselves have been won over and are excited about the new paradigm and its potential, viewing the program as a win-win. A new era in collaborative IT outsourcing could be at hand.

Where the Standard Approach Breaks Down

The standard divide-and-conquer approach to IT outsourcing is certainly practical, in addition to being relatively straightforward to implement and setting clearly defined expectations and KPIs for each vendor by contract. Its key weakness is that it fosters tunnel vision among vendors (and often among the vendor contract managers within the outsourcing company): there is little incentive for them to look beyond their own to-do list, to say nothing of proactively collaborating with other vendors to resolve issues that straddle functional boundaries, or thinking in terms of maximizing their broader business impact on the company.

Instead, a range of undesirable side effects prevails. Emerging problems spark a rush among vendors to transfer blame and responsibility. A company's efforts to optimize one domain can increase costs in another because of interdependencies and the fact that the respective vendors are focused on their own performance rather than on finding an optimal solution for the company. For example, an effort to improve storage efficiency can increase the need for bandwidth and CPU power, compromising their availability for other applications. Managing vendors' contributions to optimally serve the company's different value chains becomes highly complex, given the potential for conflicting interests.

For ABN AMRO, there were significant practical consequences in terms of system availability, capacity utilization, project delivery, and business satisfaction. For example, handoffs from the application development team to the maintenance team had frequent delays owing to conflicting objectives—the development team's task was to deliver on time and within budget, while the maintenance team was focused on application stability.

Clearly this was a problem in need of a fix. But what should the fix consist of?

A Better Approach—Shared KPIs

ABN AMRO considered a number of options for addressing the problem. It determined that the breadth of the work, which ranged from application development and maintenance to voice and network services, necessitated using more than a single vendor. The bank considered contracting to a lead vendor that, in turn, would subcontract work to other vendors—but concluded that this approach would simply shift the burden of enforcement to the lead vendor and ultimately might result in higher costs to the bank. Such an approach would also limit direct access between the bank and the vendors it deemed particularly critical.

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Ultimately, ABN AMRO decided on a radical idea: to fundamentally reorient its relationship with its suppliers by instituting a *common set of performance objectives,* one that would put all parties and the bank on the same page. The bank believed that its pending vendor-contract renewal period presented an optimal time to launch such a plan, because it gave the bank negotiating leverage and was also a logical reset point.

Under the bank's proposed scheme, individual suppliers would still be compensated, in part, on the basis of their performance with regard to function-specific, task-oriented metrics, as in the past. But a significant share of their compensation going forward would be driven by their collective ability to meet management's objectives. Those objectives would be designed with a number of guiding principles in mind:

- Simplicity and clarity
- End-to-end performance measurement, irrespective of the contributions of individual vendors
- Shared goals for vendors and the company
- Transparency and visibility of performance for all parties
- Flexibility to accommodate changes in the company's business priorities

The objectives the bank ultimately chose included the following:

- Specific, ambitious performance targets for the availability of critical IT business services
- A high degree of business satisfaction
- Managed growth of IT capacity (with an emphasis on reducing the overall amount of IT hardware and software consumed)
- Improved project delivery, looking not only at timeliness but also at quality and cost versus budget

Critically, these objectives were *identical* to those of senior IT management, ensuring complete alignment between the bank and its vendors. This is rare indeed in the relationship between companies and suppliers.

The program is still in its early stages, but all indications are that it will meet its goals and also deliver a range of indirect benefits. The IT organization believes that the program's success will give the organization much greater freedom to focus on business objectives, as well as an enhanced ability to align its activities with management's objectives. (See the exhibit "A Shared-KPI Approach Can Offer Significant Advantages over the Traditional Approach to IT Outsourcing.")

Challenges to Making It Happen

Aligning supplier interests through shared KPIs is conceptually simple. But implementation is quite complex and poses numerous challenges. One of the biggest is potential vendor resistance. ABN AMRO encountered some initial pushback from its vendors when it introduced the concept—the vendors were particularly uncomfortable with the idea that part of their compensation would be determined by the performance of others. Overcoming this resistance took a concerted effort: the bank spent considerable time with the vendors, both individually and collectively, to explain (and reexplain) the concept, to introduce the players to one another, to orient them to the idea of shared commitment, and to address their specific concerns.

Perhaps the most critical element of this campaign was convincing the suppliers that the KPIs were ultimately fair in that they were the same for everyone and provided not only penalties for underperformance but also rewards for outperformance, and that they would be implemented reasonably—for example, they were back-tested before full implementation and phased in gradually. The bank's thorough, methodical, and respectful approach to gaining vendor buy-in has been a critical enabler of the overall program. Without strong vendor commitment, the program could never have been launched successfully or continued to function.

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But potential vendor resistance is only one of the challenges to establishing a shared-KPI program. Each of the other major development thresholds—diagnosing issues and deciding on focus areas, designing the KPI model, negotiating with vendors and formalizing contracts, and implementing the shared KPIs—requires a considerable amount of time and focus. This includes the time and focus of senior management, especially at the launch of the effort.

Instituting a shared-KPI program entails a host of actions on a range of fronts. But on the basis of ABN AMRO's experience, we believe that there are several elements, especially with regard to the negotiation phase, that demand particular attention. Addressing them effectively requires the following measures:

- *Make sure you are targeting the right shared KPIs—because adding shared KPIs adds complexity.* Shared KPIs are meant to be a complement to vendors' individual KPIs, not a substitute. Limit their use to issues that cannot be easily solved via individual agreements, particularly issues stemming from high (shifting) interdependencies between and among suppliers.

A Shared-KPI Approach Can Offer Significant Advantages over the Traditional Approach to IT Outsourcing

Traditional approach	Shared-KPI approach
Individualized performance targets and KPIs for each vendor foster tunnel vision and a "pass the buck" mentality when problems emerge that straddle domains	Shared KPIs that are based on the company's end-to-end business objectives compel vendors to think outside their own functional areas
The company is forced to intervene to resolve issues	The vendors themselves collectively address any problems
Attempts to optimize one domain can increase costs in another, given interdependencies and vendors' focus on their own area	A shared focus on business outcomes drives vendors to find optimal solutions for the company

Source: BCG analysis.

- *Ensure that the shared KPIs are aligned with management's objectives.* This can serve as an especially useful lever in negotiations with vendors ("we're asking of you precisely what the business is asking of us") and can expose any conflicts of interest.

- *Be willing to invest considerable time up front with vendors.* Explain concepts slowly, patiently, and repeatedly if necessary, and allow time and space for emotions. Hold joint sessions with multiple vendors only after a basic understanding and degree of acceptance by individual vendors have been established.

- *In negotiations, show an understanding of the program's incentives and financial ramifications from the vendors' perspective.* Be prepared to demonstrate to vendors that the program is not an indirect attempt to reduce their compensation; that the new threshold levels are reasonable given the vendors' past performance; and that there is significant financial upside for the vendors if they exceed the defined performance levels.

- *Write flexibility into the contract to protect yourself.* Ensure that the contract has sufficient flexibility to accommodate necessary changes in KPIs, weightings, and targets in response to changes in your company's business priorities.

A shared-KPI approach puts all parties—vendors, IT, the CIO, and the company—on the same path.

- *Be prepared internally for program implementation before commercial closure with the vendor team.* Confirm that the necessary internal preparatory steps, including the establishment of reporting structures and governance procedures, have been taken.

The outsourcing of IT is here to stay, and the use of multiple vendors has much to offer in many instances. But companies must manage those relationships optimally in order to reap the potential benefits. A shared-KPI program represents a highly promising approach to the challenge because it aligns the interests of the vendors, the IT organization, the CIO, and the company as a whole, putting all parties on the same path. Yes, implementation can be challenging. But the payoff can more than compensate for the effort.

The next time you face renegotiation, consider at least discussing the idea of shared KPIs with your vendors. It could open up a whole new world of possibilities and rewards for both sides.

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