

Should you step up to value-level management in Applications Management Services?



Service-level agreements or value-level management. Which is the most effective approach to applications management outsourcing? For years now, Applications Management Services (AMS) have been all about cost – driving down the expense base through offshore labor arbitrage. Further cost reductions, however, are getting hard to come by – as are needed innovations and process improvements. When applications are supported through a low-cost labor pool that’s isolated from the business, efficiency, knowledge transfer, and automation all suffer. To break the logjam, some companies are shifting their focus from service levels to value levels. Is that a wise course of action?

Here’s the debate:

	Point	Counterpoint
<p>Don’t make it complicated</p> <p><i>Stick with a service-level orientation.</i></p>	<p>Cost is king – and in AMS it’s the only thing that matters. By the time you move an application offshore, it should be stable and mature. Innovation isn’t all that important.</p>	<p>Cost is a foundational component of AMS, but it’s only one piece of the AMS solution. When you disconnect AMS from ongoing improvement opportunities, you sacrifice competitive advantage. Unless “stable and mature” means “static and end-of-line,” even the most mature companies can benefit by improving process and information automation.</p>
	<p>There’s no incentive to add value. AMS is in the expense base. No one is really expecting value-add. Let sleeping dogs lie.</p>	<p>The shortest and least expensive path to creating new value usually involves leveraging current assets. When you shunt assets off to a dis-integrated AMS function, you can actually incur new costs for integration and knowledge transfer. The business case never gets delivered. The vicious cycle continues.</p>

	Point	Counterpoint
	It's almost impossible to get significant value-add through an AMS structure using offshore resources.	You're wrong. Getting value is simply a matter of defining it, operationalizing it, and then measuring improvements. Do that once and you'll have the structure you need to extract ongoing value from any part of your technology lifecycle, not just AMS.
Step up to value-level management	The cost burden of applications management isn't getting any smaller – and the current AMS approach leads to an ever-increasing pool of software assets that are disconnected from the business. That approach doesn't solve problems, it locks them in.	Sorry. I don't have the money or people to take this on. We've driven costs down to rock bottom. Any new resources will go to new applications.
<i>It's not at all complicated when you have the right mindset in place.</i>	Markets, customers, and channels are changing all the time and application portfolios aren't keeping up. Value-level management squeezes more improvements from current assets.	There's nothing new about change – and there's nothing new about IT struggling to keep up. Better to isolate management so the best people can focus on new investments.
	The business expects more and more from IT, with not much appetite for a lot more spending. The current AMS model is like having one hand tied behind your back as you try to drive improvements.	That's not true. The current model is a proven way to drive down costs – which is a big chunk of what matters most these days.



My take

Janet Foutty, Principal, Deloitte Consulting LLP

IT landscapes today are large and diverse, trending toward more complexity, not less.

That complexity has become costly – our research indicates that four out of five IT dollars are now spent maintaining existing technology. To control spending, many companies created separate, specialized functions dedicated to managing applications and operations. These have become prime candidates for outsourcing, driving explosive growth in the Application Management Services (AMS) marketplace. Gartner projects operations and maintenance outsourcing revenues combined to reach \$97 billion in 2012. Which is all well and good except for one problem. AMS is mired down in a service-level mentality – and it's starting to hit the wall.

Ask any IT executive what matters in an AMS contract and you're likely to hear about the importance of Service-Level Agreements (SLAs). SLAs are essential for tracking vendor performance against technical service requirements – and they're relatively easy to measure. Unfortunately, they're often not measuring what's most important. Worse still, they can actually lock-in applications problems, instead of solving them.

When it comes to what's most important, measuring the efficiency of a specific machine on a shop floor is less important than measuring the value of the resulting product in the market. So instead of incenting mean-time-to-recovery for an application outage, measure the quarterly return of that application on the business. Similar thinking applies to locking in on

problems. The easiest approach to bug-fix or break-fix may not be the optimal direction given pending enhancements and release queues. Patch it now and un-patch it later in the new release is a risky proposition.

This shift to a focus on business results and outcomes requires an AMS delivery model designed from the ground up to uncover value opportunities and implement improvements throughout every phase of the application lifecycle. Think of it this way: If the real value opportunities begin to emerge when an application stabilizes, why would that be the time to put that application out to AMS pasture?

In practical terms, the difference between a service-levels approach and value-levels approach rests on choices about what to measure. For example, tracking the rate of billing accuracy and improving it from 95 to 98 percent has much more value impact than tracking how quickly a call center answers the phone. Measuring satisfaction with the resolution of problems taps into a higher value level than measuring the duration of the conversations involved. Until you're able to link knowledge gained in the back office to the outcomes expected in the corner office, you'll never break out of the downward spiral.

At a minimum, value level metrics should consider the full scope of value creation within and around the CIO organization – not just bug-fix and break-fix. But metrics for some applications will extend even farther, reaching outside the CIO's world to quantify benefits to sales, manufacturing, supply chain, or even direct customers. The role of IT is to enable the business of the business. Let's measure against that goal.

As you would expect, value metrics work most effectively when tailored to specific functions, industries, and IT organizations. For example, measuring performance improvements from ERP applications management would include tracking how quickly the finance organization can close the books. Value metrics for CRM or HR outsourcing, on the other hand, would track improvements in customer satisfaction and employee utilization rates.

Finally, while value-level management probably makes sense nine times out of 10, there are some applications and companies where there's simply no value gain possible. When applications are extremely stable and mature – or when no competitive advantage can be squeezed out of the system – don't worry about value-level thinking. Just keep your fingers crossed that no competitors are hot on your trail.

A view from the technology perspective

Larry Calabro, Principal, Deloitte Consulting LLP

In my experience, traditional AMS can create isolation between applications management and the rest of the business. So when an organization finally does get around to looking for improvements, the people and resources aren't in place to deliver. They end up shuffling talent, hiring consultants, relearning, and rebuilding. The practical knowledge needed to respond quickly to changing business demands is hidden in the heads of a floating labor pool, out of reach except at prohibitive cost.

Even worse, when improvements actually do happen, they're thrown onto the pile of outsourced applications for someone else to manage. Old assets get disconnected from new assets and the cycle continues. The minute an existing application enters a stable state, it's put out to pasture with a "keep the lights on" mentality. The message to your organization is unmistakable: Anything that is already implemented is "old."

And then there's the traditional AMS business model itself. For the most part, providers have a strategic interest in pure labor arbitrage. Stable processes and more utilization make contracts more profitable over time. Change is a cost, not an opportunity for improvement. Even when implementation and management are bundled for procurement purposes, there's no inherent motivation to help customers reduce the cost of ongoing maintenance. When your business depends on throwing an army of cheap talent against every problem, innovations that might shrink the army will be generally unwelcome.

Value Level Management can help preserve the market arbitrage benefits for the lower-level operations of any AMS contract. Vendors must continue to match cost structures and service levels as table stakes. But beyond cost and scale, the value-driven approach provides a vehicle for enabling business results – allowing for resource fluctuations, distribution of risk, and a full blend of specialized skill-sets that need to be accessible at any time by the organization.

A view from the ERP perspective

Craig Hodgetts, Principal, Deloitte Consulting LLP

Companies today want maximum flexibility with a minimal term and spend commitment. They want resources to be skilled and cheap – and scalable rather than fixed. They also want to be able to do more high-value projects using these low-cost resources. And in the case of organizations who use consulting firms to help them with their large ERP implementations, what they really want is to have those high-value resources stick around to stabilize the solution by helping to manage through the inevitable productivity dip to realize the benefits from the investment and to enhance those systems at a reasonable cost. That's where value-driven AMS comes into play.

Value-driven AMS provides a mechanism to keep high-value resources engaged. But it requires moving beyond traditional Service Level Agreements, which are often slanted to suit the outsourcer. It's not uncommon to have a deal where all service levels are being met, but where customer satisfaction is lousy. That's why the practice of aligning contracts around business value is gathering steam.

Effective contracts require incentives tied to both business value and services levels. At the high end of the value scale, the simplest and most basic metrics may be grounded in company earnings or stock price. As a more practical matter, however, activities tied to specific operational improvements may make more sense. These include such variables as time-to-close, outstanding payables, and reporting accuracy.

Driving down cost through labor arbitrage is the baseline foundation of AMS, but that is not all you should expect from a multi-million dollar contract that extends over many years. Not anymore.

A view from the health care perspective

Paul Roma, Principal, Deloitte Consulting LLP

You might assume that among health care companies, cost really is the only issue that matters. But talk to the executives I work with every day and you'll find a more nuanced view. Sure, they're looking for every possible opportunity to reduce costs, including labor arbitrage. But they're also looking for the higher-order benefits that come from adopting a value-oriented approach to AMS. So why are we still reading about companies that have repatriated AMS outsourcing because they're not seeing the value they signed up for?

In this case, the devil's in the details. Like everyone else, health care companies move to an AMS outsourcing model first and foremost to cut costs. And all those other benefits, like infrastructure improvement? "Our internal leadership is going to manage our outsourcing relationships in a way that delivers value beyond pure cost reduction," they'll say. That's wishful thinking. In the best case, you may get a year of value-oriented results from your vendor – and when you move on to the next thing, so will they. If you're paying someone to do X and hoping for Y, well, you're going to get X. It's about accountability. If you're not holding your AMS vendors accountable for anything beyond cost savings, you're missing half the boat.

Perhaps even worse, your organization could find itself standing still at a time when you need to be constantly innovating and reinventing. Improvement doesn't happen in the margins. It happens when you make it a top priority among your outsourcing relationships. Now is the time to make it happen.

For further information, please visit: www.deloitte.com/us/debates/AMS.

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