

Hostile IS Outsourcing: The Story of Manufact

Success has many fathers. Failure is an orphan.

In February 1998, John Smith, 52 years old, hair graying but with a deep suntan, leaned back in his spacious deck chair and reread a letter from Jim Lawler, his former boss. In the letter, Jim asked him to come back to his old company, to help sort out a tricky situation.

IS outsourcing in ManuFact

Up to March 1997, John had been IS director in ManuFact, a mid-sized European company in the kitchenware industry. He had the job for eight years, leading a centralized IT department of 39 people, with a budget of about US \$4 million and a largely mainframe-based technology portfolio. Including three subsidiaries, ManuFact had a total of 3,500 employees, mainly in production and distribution. The financial situation was stable and good. John had reorganized the IS capability from a not very successful semi-independent subsidiary to an internal department, and was getting good feedback on his ability to keep the IT costs down and maintain a satisfactory service level.

In May 1996, Jim Lawler took over as John's boss. Jim, with a background as Chief Counsel for Manufact, was part of a three-man top management committee with responsibility for administration, personnel and legal issues as well as IS. Jim was also a member of the Board. He had little IT experience, but had read about "downsizing" and "facilities management" and wanted to know what these terms meant and whether they could apply in ManuFact. Jim also wondered whether IS was running their operations as efficiently as they could. John thought so, but suggested looking into facilities management as an option. Jim also asked about outsourcing the development side, but John did not think that was a good idea, given the high degree of company-specific knowledge needed there. In agreement with Jim, John contacted the three main vendors of facilities management in the country, one of which was ISCorp, the local subsidiary of a large, international technology corporation. After some research and talks with the companies, John wrote a report to Jim indicating that ManuFact, by employing facilities management, would save about \$275,000 per year over a five-year period. However, the transition costs—personnel and to a certain extent the costs of getting out of some equipment contracts—would make it a break-even proposition at best.

When John went to discuss the report with Jim, he was in for a shock: Jim had been approached by ISCorp directly, and had entered an agreement with the local ISCorp

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office to outsource the entire IS department. ISCorp, which was very keen to move into outsourcing as a new line of business, had indicated that this would save ManuFact \$6 million over 5 years. The contract meant that all IS employees would be made redundant on November 15, 1996, but be offered work at ISCorp. Jim asked John to stay on to negotiate the contract with ISCorp and manage the transition.

John thought, given the situation, that the best he could do was to try and make the transition as smooth as possible. He soon found that the savings were nowhere close to what was promised, chiefly because ISCorp had underestimated the complexity of the systems, particularly in manufacturing. Eventually, ISCorp came back with an "extra bill" of \$1.5 million, to cover work not specified in the contract. Furthermore, John found that the number of system development hours specified by ISCorp was only half of what the IS department currently was putting in—but each hour was billed considerably higher. The IS department would have been less expensive than ISCorp if they had calculated with the same number of hours. However, John was not successful in communicating this to Jim.

ISCorp had expected 10-15 of the system developers to continue with their current work for Manufact as employees of ISCorp. However, when the outsourcing agreement was announced to the department, and ISCorp representatives showed up negotiate, the employees refused to talk to them. Within two months, the whole department, save two developers, had quit and found new jobs—several of them on better terms than ManuFact had offered. ISCorp had to recruit and train new people, meaning that no development was done for nine months while the new employees and consultants from ISCorp tried to understand the systems. During this period, the corporate data center was closed, and the technology moved to ISCorp's premises.

John had not been successful in finding a new job. His severance terms included full salary payments for one year. Jim had given John excellent recommendations, describing his handling of the transition as conscientious, competent and very professional.

The situation in February 1998

In February 1998, the systems were finally running reliably, but substantial new systems development had still not started. There were increasing complaints from the line organization about ISCorp's lack of customer service. The subsidiary companies, which had not been consulted on the outsourcing, complained about an aging technology infrastructure. The outsourcing contract did not contain any provisions for upgrading the technology, effectively locking the company in at the same technology generation for the next five years.

Recently, John had heard that some of the subsidiaries were trying to break out of the outsourcing contract altogether, wanting to move on to new technology. And here he was, looking at the letter from Jim, where he was asked to come back to help ManuFact