



# Update

## Getting the Most Out of Your Outsourcing SLAs (Part I in a Series)

by Barbara Beech

Once you've agreed that you are going to outsource to a particular service provider, you quickly face the task of developing service levels for that provider. The turn-around time is usually rather quick, so it is helpful to give this issue some thought while the contract is in its initial stages.

Earlier this year, my colleague, Cutter Consortium Senior Consultant David Herron, addressed the issue of how to properly frame a service-level agreement, or SLA (see *Executive Update* Vol. 4, No. 3). Here, in Part I of a two-part series on structuring SLAs for outsourcing deals, we will cover the best way to structure an SLA; Part II will focus on how to set up your "at-risk" service-level dollars and penalty structures. ("At-risk" dollars are the maximum amount that a provider would have to pay on a monthly basis based on sub-par SLA performance. This amount is factored into the overall price of the contract and protects the provider from excessive fees.)

Before defining your SLAs, you should determine your business's priorities and its main focus or objectives. This isn't an easy task, but it pays to spend some time in discussion with your business partners to determine what is important to overall company objectives.

In general, you should attempt to capture SLAs that cover cost, responsiveness, quality, customer satisfaction, and business processes.

Depending on the kind of contract you develop, the number and type of SLAs will differ, but many of these considerations are the same no matter which kind of SLA you incorporate. First and foremost, though, each item should be documented in an overall service-level document that should become part of the overall contract to which both parties can refer in the future. This part of the contract should contain general agreements around SLAs as well as detailed definitions of the SLAs. As you add and modify SLAs, you should minimize the amount and instances in which contract language requires revision. You will add and change SLAs after the first year and in subsequent years as your business needs evolve and as you discover what motivates the desired service provider behavior. Over the years, I have found that my group at AT&T generally changes targets each year on most SLAs but also adds and deletes some targets to better match business needs. So you should ensure that the capability exists to add or change SLAs throughout the contract. I would recommend using language that allows a certain

number of SLAs to be added on a quarterly basis at a minimum.

The following is a list of SLA components you should consider as you develop each agreement:

- **Service-level name.** This is the name of the measure. Include the exact service-level name here and use it for reporting the service level.
- **Service-level category.** This is the category into which the measure falls (e.g., cost and quality). Include the area based on your categories of service levels of which this service level is a part (e.g., cost).
- **Service-level type.** Determine whether a critical or key service level is being measured. When setting up SLAs, you should tie some agreements to financial penalties and have others that are merely reported. Critical service levels are measures associated with financial penalties. You should identify those service levels most critical to the business and place them in this category. Key service levels are those you would like to have reported but that are not tied to financial penalties because they are less important to the business. You can have different service levels in the critical or key categories or use the same service level but reported for only a portion of the systems (e.g., defects for critical systems, defects for noncritical systems). Having these two distinct categories (which you can name differently; e.g., Tier 1, Tier 2) allows you to incorporate additional service levels into your contract. The more critical service levels you have, the fewer penalty dollars you have to leverage, so think carefully about what you want to include.
- **Definition.** This describes the measure and how to calculate the measure; it is critical that you and the service provider

have a clear understanding of this. Any misunderstanding here will lead to the reporting of inaccurate data. Be as specific as possible; include formulas if appropriate. Also include start and end times for any time frame during which the service delivery will be measured. You may also need to include days of the week and time of day.

You should also include how any data will be aggregated. Be careful not to aggregate too much data, otherwise you will end up with a great deal of data washout; that is, the good and bad data will get washed out based on the amount of data you combine. For example, if you have one large project that has good results and many small projects without good results, the large project will carry more weight and hide the fact that your small projects are not doing well. If you must aggregate data into one measure, try to ensure that it's weighted appropriately so that good and bad results don't cause the data to be skewed. In many cases, we have found that it is best to look at SLA data by itself rather than try to combine results in an aggregate view, such as operational deliverables or business process measures. My group at AT&T, for example, has a service-level category of critical deliverables that includes a list of system-file deliverables that are looked at separately for assessments and targets. These file deliverables relate to different systems and have different time and day requirements, so it makes more sense to evaluate them separately rather than in aggregate.

- **Base measures.** These are additional supporting measures on which the primary calculation may depend. Include any other measure that is part of the overall service level; for example, defects and size as part of your overall measure.

- **Reporting frequency.** You must specify the frequency for data reporting. All data should be reported at least monthly so that you can monitor trends. You should also require reports at the lowest level of detail even if you are not assessing or establishing a target at these levels. It's important to see as much detail as possible to understand the components of any measure.
- **Data source.** If the service level comprises several base measures, you must indicate the source for each of them.
- **Continuous improvement.** In most contracts, there is a provision for continuous improvement of service levels on an annual basis. This area indicates whether a service level is subject to the continuous improvement clause. Most service levels should be included, but some may already be at a level at which it might not make sense to improve based on business needs. It is important to have a mechanism that specifies targeted percentage improvements. Don't limit yourself too much; allow for a minimum of 10%. The service providers will want to limit this, but you should allow for a larger improvement if monthly data over the course of the year supports that. A good maximum ceiling would be at least 25%.
- **Measurement/assessment period.** This is the time period for the service level and when it will be assessed against the target for a penalty (e.g., annually, quarterly, or monthly). This area requires a great deal of thought and is coupled with setting a target. It's important to note that this measure can have a different value than reporting frequency. You may want the data reported monthly, but plan on assessing the data against the target differently. Here you should consider the supplier's

behavior you wish to influence and what you want it to focus on. There are several options that we have used:

- **Annually.** Use this option when you care about the overall yearly results and expect a service level to fluctuate monthly but don't necessarily want to penalize the service provider monthly. In many cases, this option allows you to get to a lower annual target than you would achieve if you assessed the service level monthly. It might make sense, for example, to assess system availability on an annual basis.
- **Quarterly.** Use this option when the number of opportunities for a service level may not be high enough each month to warrant a monthly target. With each service level, you should look at the possible opportunities and determine the impact if the service provider missed one. This allows you to have a higher quarterly target than you would achieve if you assessed a service level monthly. For example, on-time delivery of enhancements might be best assessed quarterly based on the number of enhancements.
- **Monthly.** Use this option when a monthly miss of a service level can have a major impact on your business. For example, it probably makes sense to assess defect data and business impact data on a monthly basis.

- **Earn-back windows.** This allows the service provider to earn back any penalty if its performance is at or above target for a specified period (usually months). When incorporated into SLAs, this is a useful concept to drive the desired behavior without imposing penalties if the service provider improves. These windows can last one month, three months, six months, or longer. The longer the window, the longer the vendor must sustain improved performance.

- **Reporting commences.** This indicates exactly when the service provider should begin to report results data on a service level. The beginning of the contract may include a honeymoon period before reporting begins. Or you can add a new SLA with a specified time to begin reporting.

- **Target.** This is a critical component of the service level that requires care and thought. Most service providers require a baseline period of collecting data prior to a target being set, unless there is historical data that can be used to develop an appropriate target. This baseline period is typically six months. After that, an analysis will be done on the data and a recommendation made as to what is an appropriate initial target. There may be some SLAs where, regardless of the baseline data, you may want to negotiate for a better target and not just agree on the baseline results.

Sliding targets are another method of setting a target based on the number of opportunities

of a particular service level. For example, when measuring on-time delivery of enhancements, you can set various targets based on the actual number of enhancements that you have in an assessment period. For example, if you have greater than X requests, your target can be Y%; if you have less than X requests, your target can be lower than Y% (such as Y - 5%) because you have fewer opportunities and therefore a greater opportunity to miss the target.

I recommend that this information be kept in a contract document separate from the contract's SLA definitions, because this area will change most frequently and you should minimize the amount of the contract language that requires updating as these targets change. Targets change annually, but they also change as you are in the process of gathering and baselining data and setting targets.

## ABOUT THE AUTHOR

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