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## A White Paper

*By Kathleen Goolsby*

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## Introduction

Determining appropriate service level specifications is a crucial foundation for a successful outsourcing relationship. Unfortunately, many buyers go to market without first determining service level specifications. In effect, they defeat themselves even before the work is transitioned to the service provider.

In outsourcing, an organization turns over the ownership of a non-core, important business process to a service provider in order to leverage the provider's expertise, economies of scale and access to resources. The buyer determines the results it wants to buy (which is the "value" created by outsourcing), but it does not specifically dictate all the nuances of how the provider is to perform the service. A buyer who tries to remain in control and dictate how the service provider should run the outsourced business process will rob the provider of its leverage. Unless the service provider controls its leverage, it will not be able to create much value for the buyer; nor will it generate profit for its own interests. In such an instance, the buyer dooms the relationship to failure.

Service level specifications play two vital roles in an outsourcing agreement. They ensure accountability on the part of the provider, and they determine the price of the service. In an outsourced situation – where the buyer gives control of an important business function to another company – the only way to ensure a comfort level for the buyer is to set required service level specifications and then regularly measure the provider's performance to determine whether it has achieved those levels. So that a buyer will know it is getting what it is paying for, a service level specification should be established for every important component of a process. Each component focuses on one of the buyer's

desired results (such as accuracy, timeliness, customer satisfaction or ensuring regulatory compliance).

The specifications also impact the price the provider will charge for its services. Buyers who set very high service level specifications raise the price of the provider's services. If the buyer wants 24 x 7 system availability, for example, the service provider will need to provide redundancy to accomplish that result. That will necessitate an increase in technology infrastructure and in staffing levels, thereby also increasing the price. If, for example, the buyer wants a very high service level for amount of wait time before calls are answered in a call center, the price will be higher because of the need for more resources – both people and technology.

The buyer's desired results (specified in the service level specifications) determine the price. Therefore, it is crucial to define service level specifications clearly. By avoiding ambiguities and ensuring service levels are tied to desired results, a service level specification can actually drive down the price.

This paper explains the role of service level specifications and how their components can be constructed to achieve maximum success. This paper is not a step-by-step manual for writing service level specifications, nor does it provide templates. It is a guide to the basic foundations and techniques but, in most instances, buyers will need the further expertise of an outsourcing consultant to finalize service level specifications.

 **DEFINITION: *Service Level Agreement***

A Service Level Agreement (SLA) is a legal document within (or attached to) an overall master contract for an outsourcing agreement. An SLA contains a description of the services to be provided pertaining to the buyer's outsourced business process. The SLA also states the service level specifications, which clearly describe the level of performance and results the buyer expects to receive from the service provider. The service provider must meet or exceed these performance standards.

# Laying the Groundwork

## *What to Measure*

Before the buyer determines service level specifications, it must first define the results it wants to buy. An organization might want to outsource one or more of its human resource (HR) functions, for example, in order to achieve any one of all of the following results:

- to gain flexibility and economies of scale necessitated by mergers, acquisitions, divestitures;
- to present higher-quality, flexible benefits options to employees;
- to consolidate and standardize data and the disparate services currently provided to employees;
- to implement Web-based, self-service formats for delivery of benefits services; or
- to reduce operational costs.

What should be measured – and thus stated in the service level specifications – will vary greatly for each of these results.

Furthermore, the buyer also must clearly determine the scope and boundaries of the outsourced process before it can measure results objectively. To outsource the HR process, for example, the buyer will need to determine whether to include:

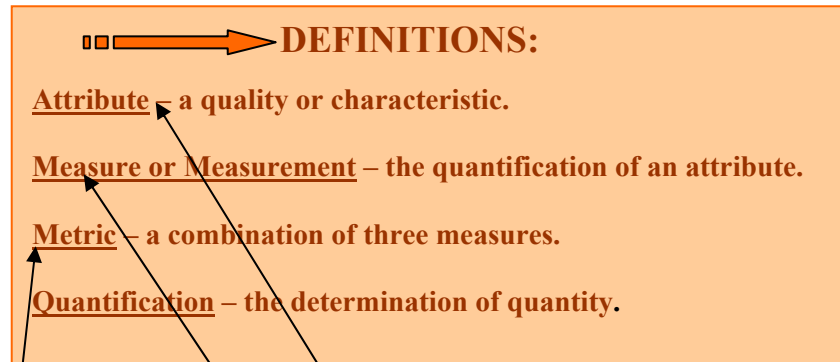
- *Scope:*
  - health and welfare benefits
  - pension
  - savings
  - recruiting
  - training
  - retention
  - payroll

and

- *Boundaries:*
  - Should the health and welfare benefits
    - include retirees and/or dependents
    - include program variances between executive-level and employees
  - Should call center functions include email and Web chat.

Each of these decisions will be reflected in the crafting of the service level specifications, and each is a cost factor in the provider's service.

## ***Determining the Measures***



Step One. Use a *metric* of at least three *measures*. Select the measures to be used according to the buyer's business objective (the desired result). The precision of the measurement depends on the business objective.

Step Two. Next, determine the most important *attributes* of the process to measure, according to the business objective. If, for example, the objective is to perform the process faster and better, it would be best to measure such attributes as speed, cost and quality of result. Use statistics in order to understand the behavior of occurrences of an attribute.

Step Three. Finally, determine the precision of the measures to be used by judging the context of how it is to be used.

## ***Service Level Specification Styles***

There are three styles of service level specification. The appropriate style is determined by the objective (result) the buyer hopes to achieve by outsourcing. Problems can occur when the style and objective do not match.

### ***1. Utility***

This style of service level specification is similar to what we expect from an electric company or a telephone company. If the service is on, all is well. If the service is off, we want a credit applied to our invoice for the amount of downtime. Basically, there are two

levels of service: acceptable and unacceptable. A penalty (a credit to the buyer's account, for example) is associated with the unacceptable level.

Examples of outsourced business processes that use the utility style for service level specifications are network, desktop, help desk, and data center.

## **The Role of Value Creation**

The next two of the three styles are tied to creation and capture of additional value that can be achieved by outsourcing. The objectives in this type of outsourcing are to contribute value beyond reduced costs associated with a particular function or transaction. Added-value outsourcing will have a strategic impact on the enterprise. As an example, the objective for a "utility-style" service level specification in a hospital's outsourced food service process might be to centralize the operation and, thus, reduce operational costs. But if the objective for outsourcing the food service process is to improve patient nutrition and satisfaction, the impact of the outsourcing will create a far greater value in addition to the cost reduction.

Where the objectives in outsourcing are to add value with a strategic impact on the organization, the service level specification style to use will be either the "process improvement" or the "value-added" style.

### ***2. Process Improvement Style***

This style of service level specification is used when the buyer's business objective is process improvement after the service provider takes responsibility for the process. This type of service level specification is often used in business process outsourcing (BPO). The service level specifications for a process improvement objective will measure success of changes introduced to the process, rather than the end result.

It is not uncommon for organizations to write utility service level specifications when what they really want and expect from the service provider is process improvement. In such an instance, the wrong things will be measured.

### ***3. Value Added Style***

This style of service level specification must describe the actual value – the quality of the desired result. Using an HR recruiting example, the service level should measure the right fit of talent in a position or duration of employment – not just how many people are recruited. A well-constructed value-added service level specification will measure the effectiveness of results in creating value for the buyer's organization.

This style is also used where the pricing structure of the agreement is contingency-based on a specified achievement of the provider or where the pricing structure involves the

buyer and service provider both sharing the risk and reward. Examples of such incentive structures include gainsharing agreements that apportion to the provider a percentage of savings achieved or equity stakes, where the buyer and/or supplier purchase stock in each other's companies.

## Steps to Determine a Service Level Specification

No process is too complex to measure if the buyer simply follows the steps outlined below:

1. **SELECT THE SERVICE TO BE MEASURED.** This will be one of the following:
  - (a) whether the objective is achieved,
  - (b) the process itself, or
  - (c) the product.

Since it increases the price to collect measurement/performance data, the selected service should be the most important one to analyze and measure.

It is this step that determines which style of service level specification to use (utility, process improvement or value added).

2. **CHOOSE THE ATTRIBUTES TO MEASURE.**

These attributes are the things the buyer determines to be the most critical components of service and the relationship. Together, the attributes paint a clear picture of what "success" looks like.

3. **SELECT THE PRECISION OF THE MEASUREMENT TO BE USED.**

Since it increases the price to collect measurement/performance data, being too precise is not the most effective plan.

4. **DETERMINE THE CURRENT IN-HOUSE SERVICE LEVEL AND THE COST FOR THAT SERVICE LEVEL. NEXT, COMPARE THE FIGURES TO INDUSTRY STANDARDS AND BENCHMARKING, AS WELL AS BEST-OF-BREED SERVICE LEVEL SPECIFICATIONS. THEN DETERMINE HOW MUCH IMPROVEMENT IS DESIRED.**

The process of determining current in-house costs is full of pitfalls, as most organizations are not aware of all the hidden cost factors affecting the total cost. If this procedure is not performed adequately, the parameters the buyer uses to determine its desired level of spending will not be accurate and may give rise to dissatisfaction later in the relationship.

This is one area where it is vital that buyers use the services of an outsourcing consulting firm with broad experience in cost assessments for a wide range of processes and industries.

Since improvements affect the price, the buyer must determine how much it is willing to pay, for that will affect the level of desired improvement.

If the business objective is one that lends itself to risk/reward sharing and contingency-based fees, Step Four also will include determining the premium to award to the service provider if it accomplishes the contingency, value-added performance.

### *Components of Service Level Specifications*

Each service level specification is composed of the following items:

- A *definition of the metric* and what is being measured;
- A *description of the reason for measuring* the metric;
- A *description of the method and process* for capturing the data; and
- A *statement of the timing interval* for measurement.

**Metric** -- the value that defines the data points that will be measured and reported.

**Value** -- a description of the level of performance to measure against. Typical values will be:

- **Service Level** – an acceptable level of service; however, a service provider is usually expected to perform above this level.
- **Impact Level** – where performance is unacceptable and adversely impacts the buyer's business. (Performance below Service Level may trigger automatic penalties; consistent performance at this level may trigger a lawsuit.)

## *Examples of How to Determine Service Level Specifications*

### **1. Outsourced Process: Call Center**

**Style: Process Improvement**

**Step 1: Determine the service to be measured:**

- first call resolution rate;
- cost per call;
- customer satisfaction; or
- call abandonment.

Sample Metric for First Call Resolution Rate:

<i>Values</i>	<i>Metrics</i>
<b>Service Level</b>	<b>90% answered with 50 seconds</b>
<b>Impact Level</b>	<b>90% answered within 55 seconds</b>

### **2. Outsourced Process: Maintenance of Point-of-Sale Equipment**

**Style: Process Improvement**

**Desired result (and service to be measured):**

- **Ensure minimal disruption of buyer's revenue**

Sample Metric for Maintenance Responsiveness:

<i>Values</i>	<i>Metrics</i>
<b>Service Level</b>	<b>98% of all POS equipment failures per period are resolved within 24 hours.</b>
<b>Impact Level</b>	<b>97% of all POS equipment failures per period are resolved within 24 hours.</b>

### 3. Outsourced Process: Food Services

In an instance of outsourcing the food services for a nursing home, the Step One process of deciding which service to measure would be similar to the following:

- *If the buyer decides the service to be measured [Step One] is achievement of the business objective, (and if the overall objective is to reduce the operating costs for the nursing home):*
  - (1) The attributes to be measured [Step Two] might be the food budget or the costs associated with personnel.
  - (2) The precision of the measurement for cost might be on a monthly, weekly, daily, or even meal unit basis.
  - (3) The cost would need to be figured on a unit basis rather than a total basis, because the fluctuation in number of residents would affect the total cost.
  - (4) The style would be utility.
- *If the business objective is to reduce overall costs and the buyer decides the object to be measured [Step One] is the process:*
  - (1) The attributes to be measured [Step Two] might be a metric (combination of three measures) of:
    - (a) speed (of delivery of meals to resident rooms as well as to the communal dining room),
    - (b) cost, and
    - (c) quality (customer/resident satisfaction).
  - (2) The measurement of cost might be a comparison of actual cost to budget, or it might be a measurement of increased revenue.
  - (3) The precision of the cost measurement might include individual requests for snacks and beverages between meals.
  - (4) The precision of the measurement for customer (resident) satisfaction might focus on complaints from residents, a survey of comments from their families, or a measure of how much food is left uneaten on the plates. A customer satisfaction survey might be measured with simple “yes” or “not” responses, or it might be measured more precisely on a scale from one to five.

(5) The style would be process improvement.

- *If the business objective is the same (to reduce overall costs), and the buyer decides the object to be measured [Step One] is the product:*

(1) The attributes to be measured [Step Two] might be a metric (combination of three measures) for the nutritional value of the food. The attributes might include measurement of:

- (a) the calories,
- (b) the fat content, or
- (c) compliance with doctor orders for individual dietary needs of residents.

(2) The style would be utility.

#### **4. Outsourced Process: Data Center**

To establish service level specifications, the thought process would be something along these lines:

- a) Determine the business objective. (We want our data center to be 99.9% operational 7 x 24.)
- b) Describe the various components and processes within the data center that the service provider will control.
- c) Select one of those components for which a service level specification will be established (system availability and uptime, for example).
- d) The measures which form the metric and service level specification are figured by the amount of time in 7 x 24 minus the amount of time the data center is not operational.
- e) Regarding the precision of the measurement, the amount of time could be measured by hours, minutes, or seconds. Seconds and minutes are too precise and will increase the price, due to management and administration of collecting the data for this performance measurement. Often, the most effective measurement uses the precision of hours.

## *Actions and Escalations*

Also included in the service level specification is a description of what shall occur if any service level specification receives a score below “Service Level.” At this point, the service provider must correct its performance. This section describes procedures associated with ensuring management attention to the problem area. The action matrix describes the consequences if the service provider fails to meet the service level specifications. It notes which entity is responsible for taking corrective action, preventive steps and doing root cause analysis.

## **Conclusion**

The most important focus for buyers in writing a contractual agreement for outsourcing is to eliminate risks. This is best accomplished through clear, effective descriptions of the process to be outsourced (including scope and boundaries), along with clear, effective, objective service level specifications.

To achieve a win-win relationship, both parties must be able to rely on the service level specifications to determine where the provider’s focus should be (based on the buyer’s critical needs). It identifies both the buyer’s goals and the service provider’s guarantees and also lays out the path toward continual improvement in the outsourced process.

Defining these vital components of the contractual relationship takes up-front time and effort, but it is well worth it. This is the only way the buyer can determine if it gets what it pays for. The key to successful outsourcing is the preparatory work.

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## **For More Information**

**For information on how Everest Group can assist your organization with service level agreements or other aspects of strategic solutions that create value, please contact Marc Liebman, Vice President of Business Development, at [mliebman@everestgrp.com](mailto:mliebman@everestgrp.com) or at 972-980-0013.**