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A desperate embrace

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Companies do not always outsource for the best of reasons

IN 2001 and 2002, KPN, a Dutch telecoms carrier, signed several long-term deals to outsource 80% of the work done by its IT department to Atos Origin, a European provider of IT services. Three years later, both parties are still putting a lot of effort into reworking these contracts. It shows that not all decisions to outsource are straightforward and problem-free.

In 2001, KPN, like most telecoms firms, was in desperate trouble: having run up huge debts as it expanded during the telecoms bubble, it was close to bankruptcy. Atos Origin said it could help, and not just with the IT. In return for a guarantee from KPN to buy about *euro*300m-worth of IT from it every year for the next six years, Atos Origin paid KPN *euro*206m up front for the IT assets that the telecoms firm had handed over.

But as the spread of mobile phones and digital fixed-line technology ate into KPN's sales, the firm had to make drastic cuts. Within two years its headcount had shrunk from 28,000 to 18,000. It was now less than two-thirds its size when it signed its IT deal, yet it was still bound by contract to buy the same *euro*300m-worth of IT services a year.

Both parties admit that relations over the past year have not been easy. Neither party, however, can easily walk away. The solution they are groping towards is that in the next two years Atos Origin will work to transform KPN's IT systems. KPN's fixed-line division, for instance, runs 779 different applications, which the company itself thinks it can shrink to 80. That should keep its IT purchases up for a while, and so avoid any immediate damage to Atos Origin's revenues. After that, hopes Atos Origin, it will have earned the right to more transformation work from its customer, thus maintaining the value of its original contract.

Whether such “transformational” agreements are the best way forward is the subject of much debate in the industry. Supporters argue that they help to align the interests of outsourcing firms with those of their customers. Critics say they are a way of landing the industry's customers with the risk that something may go wrong: the criteria for a successful transformation are sufficiently nebulous for clever lawyers to claim that they have been met, whatever the outcome.

The larger issue, however, is the way IT firms sell financial engineering along with their systems and software. Governments, for instance, are avid advocates of long-term contracts because they can spread the cost of a large IT investment over many years, making it look more manageable. So long as the industry continues to offer this sort of balance-sheet support along with the technological variety, its customers may sometimes be tempted to make the wrong decision.