

Approved 5-10-92
Date

MINUTES OF THE House COMMITTEE ON ~~Computers, Communications & Technology~~.

The meeting was called to order by George Dean at
Chairperson

12:30 ~~xxx~~
~~xxx~~ p.m. on March 26, 1992 in room 529-S of the Capitol.

All members were present except:

Representative Kline - Excused
Representative Patrick - Absent

Committee staff present:

Julian Efird, Research
Donna Stadel, Committee Secretary

Conferees appearing before the committee:

Susan Seltsam - Secretary of Administration
Chuck Klusener - Electronic Data Systems (EDS)
Scott Cobb - Seltmann, Cobb, & Bryant, Inc.

Others attending: See attached list:

Chairman Dean called the meeting to order at approximately 12:30 p.m., and introduced Chuck Klusener, Director of State Government Marketing in the State Operations Division who discussed outsourcing and systems management (attachment 1).

Scott Cobb, President of Seltmann, Cobb & Bryant, Inc. appeared before the committee discussing their perspective of outsourcing (attachment 2).

Discussion followed concerning proprietary information and the security of data.

Susan Seltsam appeared before the committee expressing her concerns in regard to outsourcing/privatization (attachment 3).

With no further questions or business, the meeting was adjourned until Friday, March 27, 1992.

*EDS Presentation on Outsourcing
before Kansas' House of Representatives' C.C.T. Committee*

March 26, 1992

*by
Chuck Klusener, Director
EDS State Operations Division*

Chuck Klusener is Director of State Government Marketing in the State Operations Division, the EDS unit responsible for business with state and local government agencies. Until October of 1990, he was responsible for the operations of the contract between Kansas SRS and EDS related to the Kansas Medicaid/MediKan program. Chuck has been with EDS for 14 years.

EDS is an international, multi-industry company with annual revenues over \$7.0 billion, more than 3,000 vendor contracts, and a customers base over 7,400 spanning 28 countries worldwide. Founded in 1962, the company was built upon a commitment to customer service, helping our customers use technology to meet business objectives and operating requirements. While EDS has grown and diversified, our commitment to customer service has remained our first priority.

We are the world's leading provider of information technology services. Our team of more than 65,000 professionals is committed to adapting computer and communications technologies to the benefit of a highly diversified customer base. EDS customers range from small business to the world's largest corporations and governments.

One of the ways EDS helps its customers succeed is through outsourcing partnerships. EDS pioneered the concept of outsourcing, and, while outsourcing may be a new term, the concept of providing comprehensive Information Technology (IT) services to a government or business is what EDS has been doing for 30 years.

EDS' State Operations Division, one of thirty-eight divisions within EDS, serves state government agencies in 23 states and the District of Columbia, and has more than 400 local government customers nationwide. We offer

consulting, systems development, systems integration, and systems management services across a wide range of areas to meet state government needs. The State Operations Division is headquartered in Herndon, Virginia, with nearly 5,000 employees nationwide.

WHAT IS SYSTEMS MANAGEMENT?

"We asked, what do we do best around here? What do we not do so well that someone else does very well? The answer that kept coming back to us was, 'We're very good at making fuel system componentry. We ought to maximize the focus of every single person here on that.'"

--Diesel Technology Corporation CEO Derek Kaufman, on teaming up with a systems manager and allowing it to run Diesel Technology's MIS division.

It is a working partnership. The contractor works with the customer to design and develop an information processing system and then provides ongoing operations. The contractor assumes full responsibility for a customer's information processing needs, and works with the customer to achieve the customer's business goals and long-term results.

It is a route to achieve goals and objectives. Organizations use a systems management approach to meet a variety of measurable goals and objectives. These goals and objectives may be to decrease operational costs, improve accountability, increase revenue and improve service to customers -- often under budgetary constraints.

It is a situation in which the contractor provides results, not just products. In a systems management partnership, a contractor provides comprehensive information technology services, not just software and hardware. A systems manager also manages the day-to-day operations of that software and hardware.

It is a way to share risk. Systems management ensures results are achieved at contractually agreed-upon levels and at a fixed price. A systems manager assumes responsibility for operating, modifying and maintaining a customer's systems for a firm fixed price. This enables the customer to plan and control costs, yet still retain control of information management resources.

It is a money-saving system. Outsourcing, or using an outside systems manager, can save government agencies and companies 20 to 40 percent of their information technology costs, according to computer analysts at Merrill Lynch & Company.

HOW DOES SYSTEMS MANAGEMENT WORK?

When the customer makes the systems manager responsible for delivering specific results for a project, it frees the customer to focus on its main business. A systems management approach also gives the customer better control of shrinking budgets.

The Systems Manager's Responsibilities

Translate customer goals into plans with definitive tasks. The systems manager must examine the project complexity, time frames, special customer needs, required technology and potential problem areas, then establish a plan to provide the agreed-upon services.

Meet established deadlines. By establishing and committing to a realistic schedule, a systems manager delivers measurable results on time, or ahead of schedule.

Provide qualified staff, the best technology and training. A systems manager should have the most qualified, experienced personnel available.

Provide management reporting. Effective communication between the partners is crucial for project success.

The Customer's Responsibilities:

Develop a strategic plan, set priorities. Based on the goals it hopes to achieve, the customer must determine exactly what needs to be accomplished and communicate that to the systems manager. This includes setting priorities.

Establish goals and objectives, define requirements. The customer must establish reasonable goals and objectives to which the systems management approach will be applied.

Provide access to management and facilities. To achieve desired results on or ahead of schedule, the customer must provide access to both management and facilities.

Review and approve work. The customer must be involved in the design and development of its concepts.

As can be seen from my description of the customer's responsibilities, the state cannot outsource with the idea the vendor is now totally responsible. The state must exercise their function or the process will fail.

HOW DOES IT DIFFER FROM WHAT I AM DOING NOW?

The systems manager is responsible for achieving business results and success through technology. The systems management approach shifts responsibility to the contractor to perform the agreed-upon work within a fixed time and at a fixed price.

The systems manager makes a long-term commitment to provide results, even when needs change. The systems manager chooses, coordinates and manages a tailor-made solution from myriad hardware and software pieces provided by many vendors. The systems manager supports the customer, maintains the system once it is installed, and manages hardware vendors.

WHAT ARE THE BENEFITS OF SYSTEMS MANAGEMENT?

Cost savings. The customer has control of costs, because from the outset all costs are clearly defined and services are provided for a fixed price.

Better service. A systems management approach results in better service in two ways:

Better service to the customer agency: A customer can negotiate to have a system installed in shorter-than-usual time, and the systems manager will deliver.

Better service to the public: Hiring a systems manager frees a customer to focus on its core programs and services, rather than making hardware and software decisions.

Single point of accountability. Because the systems manager is responsible for operating the system and managing all vendors, the customer can turn to the systems manager for accountability on all facets of the system.

Predictability. Systems management clearly defines the costs and gives the customer the ability to accurately forecast long-term costs.

Flexibility. As needs change, the customer is not locked into a particular type of hardware or software.

Refocused capital and talent. Customer employees, free from responsibility of operating their management information systems, can focus on operational issues and how best to use technology in combination with the organization's overall strategic business plan.

Innovation. By adopting a systems management approach, a customer gains access not only to worldwide computing and telecommunications infrastructures, but also the latest technologies.

WHEN SHOULD I USE IT?

When downsizing and cutting costs are top priorities. Systems management allows customers to: save money in operating expenses; reduce staff time and energy used on technology issues; and reduce duplication of effort by employees and equipment.

When there is a need to improve service. When efficiencies result from systems management, money saved can be re-directed toward providing better services.

In public or highly visible projects. When an organization that has a history of problems must demonstrate publicly that it is accountable and responsible, systems management is an effective tool. Systems management allows an organization access to state-of-the art technology and expert management for problem-solving that may not be available in-house.

WHAT STEPS SHOULD I TAKE?

Before considering a systems management approach, an agency must perform a complete, objective assessment of its situation. It must determine: what works and what does not; how to improve service; how to maximize available resources; how best to adhere to the agency's strategies; and how to remain competitive. Based on the experiences of other organizations, the following steps could be applied.

Convince in-house decision-makers and management information system professionals. Choosing a systems management approach means redirecting critical vital resources, not necessarily reducing them.

Develop a mechanism for soliciting proposals from expert systems management companies. To encourage the interest of the best systems managers, a results-driven bidding process must be established. In such a process, companies are invited to propose solutions in which the systems management approach is used to provide management information services for specific departments or defined activities.

Review procurement processes and contracts used by other government agencies. There are many state and local government agencies that use procurement processes for the systems management approach to problem solving.

In conclusion, systems management - outsourcing - privatization can result in the following benefits for Kansas:

- Cost Savings
- Better Service
- Single Point of Accountability
- Predictability
- Flexibility
- Refocused Capital and Talent
- Innovation

In order to achieve these benefits, you need to focus on the results, not the means.

Many projects do not meet expectations because they attempt to automate the old process. In order to apply IT effectively, state government needs to be open to re-engineering their existing processes.

However, you must remember that the bright opportunities of outsourcing can be turned into the dark gloom of night if the State of Kansas is not prepared to meet their responsibilities to the process. The success of such an undertaking relies on the state and the use of an experienced vendor who has assisted public and private organizations successfully outsource.

PRESENTATION TO HOUSE COMMITTEE ON COMPUTERS,
COMMUNICATIONS AND TECHNOLOGY
MARCH 26, 1992

My name is Scott Cobb, President of Seltmann, Cobb & Bryant, Inc. I have brought with me today Steve White, our Chief Operating Officer, and Bob Brown and Jerry Lindsay, two of our Business Development Managers. We certainly appreciate the opportunity to introduce our firm and hope the next few minutes will provide benefit to the committee.

Seltmann, Cobb & Bryant, Inc. started in 1976. We currently have over three hundred (300) professionals with an average of over eight years experience in the data processing field. We specialize in providing data processing services to State and local Governments and Electric Utilities. Our services include the following:

- Software Packages
- Consulting Services
- Contract Services
- Outsourcing

The purpose of today's meeting is to discuss outsourcing. Outsourcing is a broad term that places the management and deliverable responsibility of any or all of the areas of your

department with an outside firm. Outsourcing is not for everybody. There are a number of general reasons given for why companies consider outsourcing. The following is a listing of some of these reasons:

- Some want an influx of cash.
- Some want to rid themselves of a hard to manage or understand area.

So as you can see, it is very important for you to understand what you want to accomplish before you set a direction for your department. You need to know where you are going and where you are before you decide on how you are going to get where you need to be. Outsourcing is just one of several options for accomplishing the goals of a data processing organization. If you were to ask the Chief Executive Officer, the Key Users and the Data Processing Manager of an organization what do you think of your data processing department you would get the following answers. The Chief Executive Officer would say it could be better, the user would say we never get anything when we need it, and the data processing manager would say everyone wants everything yesterday, but no one will provide the resources. What is obviously missing is an agreed upon plan that identifies all the resources and time requirements necessary to meet the plan. In addition, the plan must be supported by the highest

levels of management both in terms of time commitment and funds commitment. Without proper funding, the plan is of no real value. There are multiple ways which you can meet this plan once it is in place.

I would like to give you two examples of methods of meeting your plans if you do not have adequate resources in-house to accomplish the plan:

- Outsourcing
- Team effort of in-house and vendor personnel

Let me first discuss the team effort concept. We did this for the State of Arkansas a few years ago. The Department of Computer Services for the State had a plan for their operations, but did not have adequate resources to accomplish their plans objectives. The Governor contracted with us to provide the necessary direction and resources to fulfill the plan. We provided the supplemental staff to assume management responsibility of the department to make sure the plan was met. In addition, we were charged with the responsibility to develop proper operating procedures, to train the existing staff where it was needed and to recruit and train our replacements so the Department could function properly in the future. We accomplished all of these items within eighteen months and left a

department that was able to provide outstanding services to their users without any outside help. This is the final judgement on this type of working arrangement.

The second method I would like to discuss is outsourcing. We have an outsourcing contract with Nashville Electric Service, the city owned electric utility of Nashville, Tennessee. NES Management simply wanted to be rid of the problems associated with a major data processing department. They felt that they could better spend their time running the daily business of the utility which was the distribution of electricity and leave the managing of data processing to someone else. They knew they could not do this with in-house personnel, so they looked to us as an outside firm to take over the department. The Management of NES had two major concerns as they considered outsourcing their department. They were as follows:

- What happens to the employees? They did not want the employees to lose any benefits when they transferred to us. We were able to assure them this would not happen and showed them how we would accomplish it. Forty-one employees transferred to SCB and no one lost their job or benefits. Since they transferred, seventeen have received promotions either at the NES site or through transfers to other SCB accounts.

- How do we keep control of our data? NES's Internal Audit Department sets the security requirements for NES and we simply manage the security so that only the users authorized by NES have access to data they need to do their jobs.

In order to make sure that the objectives of the contract were met, NES identified a liaison for us to report to on a daily basis. He is the Director of Finance and Administration and had responsibility for data processing before it was outsourced, so it fit very well with him. He provides day-to-day guidance to our Data Center Director if needed. In addition, a Steering Committee was established to provide overall approval of the work done under this contract. The committee consists of three members of NES's Senior Management, our data center director and myself. A monthly meeting is held to review any problems and to approve our workplans to ensure that we are only working on those things that are approved by NES management.

While in some outsourcing arrangements the vendor takes ownership of the hardware, we did not do this at NES because they had bought a new computer within the last couple of years, and if we bought the computer equipment at the current market value, then NES would have lost money. We recommended that they wait until

they had to upgrade either, because of needed capacity or due to prohibitive maintenance costs. It would then be advantageous for NES to allow us to provide the needed hardware because they would only have to pay for the capacity needed and would not have to buy unused computer capacity. In any outsourcing arrangement, careful consideration should be given to how you treat hardware, so that you do what is best for you both from an operational and monetary point of view.

As I said earlier, outsourcing is not for everyone and should be looked at as just one of the many alternative solutions to solving data processing problems.

In summary, the approach you take should clearly address the results you want to achieve. Are there any questions?



DEPARTMENT OF ADMINISTRATION

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Office of the Secretary

Joan Finney, Governor

TO: The House Committee on Computers, Communication and Technology

FROM: Susan M. Seltsam, Secretary, Department of Administration

DATE: March 26, 1992

In the last few days, I have received correspondence and briefings regarding possible privatization of data processing functions currently performed by DISC and SRS. During the past two weeks vendors have met with legislators and the agenda for this committee hearing was scheduled. Only recently have these vendors set up appointments to meet with me.

I have been informed that vendors are advocating that DP functions could be more efficiently and effectively performed through a formal contractual service level agreement with a private sector provider. Recommendations have also surfaced that an interim committee be established and/or a Legislative Post Audit review be conducted concerning data processing functions. During these next two days, this committee will hear testimony from IBM, EDS and Seltmann, Cobb and Bryant (SCB) representatives on the issues of outsourcing/privatization.

I am deeply concerned with vendor-driven initiatives to discuss these issues with you. I am equally concerned that only their side of the issue is being presented and that you may have been misinformed that the Executive Branch supports the vendors recommendations.

Outsourcing/privatization is not a new concept or approach. My staff and other cabinet agencies have had discussions concerning the possibility of using an outside vendor for various data processing functions. While this approach may have demonstrated some successes at various levels of government, we are also aware of some failures. I wish to assure you that this administration is highly interested in cost-savings and quality performance and is not opposed to meaningful proposals. However, I strongly prefer that proposals which involve the executive branch of government be coordinated with us in conjunction with legislative review. I believe that it is inappropriate to request a legislative audit of DISC in advance of a needs analysis of any specific proposal.

Studies indicate that outsourcing may cause a loss of valuable human resources, direct control of operations and added costs when unexpected changes occur. This last point is important. The outsourcer profits from unexpected changes because the change falls outside the scope of services identified in the contract. Thus, the outsourcer is able to raise prices to cover the new initiative. This is an important consideration in environments such as state governments who serve many different users who have changing operations. Other factors the Department of Administration and the legislature should consider are:

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1. assurance that the qualified outsourcer offers services that currently exceed those provided by the state;
2. examine carefully the underlying assumptions in the outsourcer's proposals;
3. understand the costs that remain with the buyer as well as the costs covered by the outsourcer;
4. identify all charges to include, but not limited to, incremental and hidden charges and competitive pricing; and
5. analyze termination charges, the rights to software, and the full impact on all customers affected by the outsource agreement.

The present market strategy avoids the data processing (DP) department and circumvents the executive level. This strategy is used to approach policy makers who have influence over the funding of the DP department. The policy makers are told they are losing money because the existing DP department either overcharges, is incompetent, or wastes too much money. In turn, policy makers may invite the outsourcer to study the DP department for purposes of making recommendations for improving operations. The outsourcer performs the review and uses this information to sell their own services.

Additionally, the outsourcer uses the public forum to panic staff and to gain information. The DP department is at a disadvantage because management must defend its organization, while the outsourcer is free to make allegations of inefficiencies and poor management. Since the DP department is leveraged against a public forum, the outsourcer remains in control because requirement definitions and careful analysis are precluded.

I also remind you of the 1989 Legislative Post Audit (LPA) report "Reviewing the Cost of Operating the State's UNISYS Computer Center". A summary of this report states that 16 states, including those surrounding Kansas, all handle their payroll and central accounting duties using state-owned computer equipment and state employees - as Kansas does. The LPA report also found that DISC operating costs were 12% less than outsourcing.

Outsourcing is presently being utilized by some agencies. However, the outsourcing decision was determined after a needs assessment was completed and deemed to be cost-effective. The one reason these outsourcing arrangements tend to work well is that they involve federal programs that have little variation from state to state. May I also remind the committee that DISC's costs continue to decrease and these savings are passed to the user agencies.

In conclusion, I believe that an interim committee or another LPA study is premature at this time. The Department of Administration continues to study the outsourcing/privatization issues. The Council of State Governments and the National Association of State Information Resource Executives (NASIRE), among others, will be contacted as sources for additional information. Once this information is obtained, the Department of Administration will provide you with a summarization and recommendations. If outsourcing/privatization appears to be viable, specific vendor proposals should then be requested.