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Unilever: The Financial Implications of Outsourcing Information Technology Services in a Global Organization

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INTRODUCTION

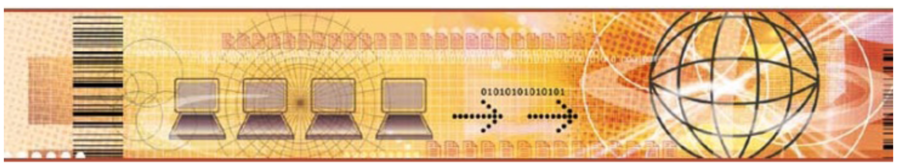
Unilever products are found on the shelves of almost every large grocery store, drug store, and super store around the world. Although the company's name isn't familiar to everyone, Unilever's brands are household names that include *Vaseline Intensive Care*, *Dove*, *Hellmann's*, *Ben & Jerry's*, *Axe*, *Knorr*, and *Lipton*. The company's mission is to add vitality to life. To add vitality to its own business, however, Unilever not only needed to focus on increasing market share, but also on reducing operating costs levels. The Information Technology (IT) department played a key role in supporting this mission by developing an unerring focus on the bottom line while also enabling employees to do their jobs more effectively.

In the highly-competitive consumer products industry, the company focused their attention on core competencies to provide a sustainable competitive advantage. While IT infrastructure services are critical for connecting end users, they aren't a source of competitive advantage. The company faced the challenge of outdated client technology, non-standard services inhibiting flexibility, scalability, and an ever-increasing amount of overhead. Unilever wanted to completely refresh its IT infrastructure while reducing deployment and maintenance costs. The CFO and CIO chose a business partner that wouldn't only provide the hardware, but also the implementation services, ongoing desk-side services, and Service Center support. This case will focus on the actual business process outsourcing decision made by Unilever in 2006. A diagram of Unilever's IT department is presented in Table I.

Outsourcing of IT services is a business trend that has dramatically increased in the past 10 years and is expected to continue (Plugge and Jannsen, 2009). Technology is constantly changing and the outsourcing of IT services can provide the latest technology without the organization making large capital investments in new equipment or acquiring the skills (human capital, knowledge base, and so on) needed to manage IT services. Management accounting professionals need to partner with the IT department to carefully develop a business case that identifies cost-cutting options and the impact of an outsourcing agreement on selling, and general and administrative expenses, while also considering availability and security of services. It's also critical to have a good idea as to how costs are recorded in the financial records for different outsourcing arrangements. Some of the project costs require capitalization, while others are recorded as immediate expense and impact the income statement of the company, reducing its net profit. The business case must achieve lower total cost of ownership, while delivering critical services 24 hours a day, seven days a week. It must also help Unilever achieve significant cost savings while generating cash. A primary objective of outsourcing is to achieve high-quality IT service delivery while enabling core IT personnel to interact and innovate with the rest of the company, thereby increasing the company's cash flow and earnings.

Table 1
Unilever IT Services

Service	Description
Service Center	• High-quality IT help desk for support of: • Hardware • Software • Other IT peripherals
Desktop Support	• Full support for computers, printers, and software: • Initial installation and setup • Customization for the user or department • Diagnosis and correction of reported problems
Application Packaging and Distribution	• Automation of the process of installing, upgrading, configuring and removing software package for a computer's operating system
Client PC Deployment	• End User hardware deployment and refreshment for desktops, laptops, printers, and peripherals



COMPANY DESCRIPTION/BACKGROUND

Unilever is a global manufacturer of consumer products. A company profile is included as Exhibit 1. Unilever's purpose is to "meet the everyday needs of people everywhere--to anticipate the aspirations of our consumers and customers and to respond creatively and competitively with branded products and services which raise the quality of life." The company has deep roots in local cultures and markets around the world giving it a wealth of knowledge and international expertise about local consumers. Unilever has two parent companies: Unilever PLC, based in the United Kingdom, and Unilever N.V., based in the Netherlands. The two companies, which operate virtually as a single corporation, are run by a single Board of Directors and are linked by a number of agreements. These agreements enable Unilever to achieve unity of management, operations, shareholders' rights, purpose, and mission. The objective of these agreements is to allow the shareholders of both companies the same position as if they held stock in a single company.

Unilever's top 12 brands generate sales of $1 billion and the top 20 brands account for 70% of sales. Underlying volume growth in 2006 was 3.8%. Unilever operates in 11 product areas (i.e., skin care, deodorant, ice cream, tea, spreads, savoury, dressings, hair care, laundry, oral care, and household cleaning) and is a global leader in seven of them. Brands like *Dove*, *Lux*, *Pond's* and *Rexona* have made Unilever a global leader in the deodorant and skin care markets. *Lipton*, *Brooke Bond*, *Ben & Jerry's* and *Heartbrand* are among the brands that have made Unilever a global leader in the ice cream and beverage markets. The company employs more than 167,000 people and more than 50% of their business is in emerging markets. These emerging markets are the future for many companies, particularly for Unilever, which sells everyday household products such as bleach and *Sunlight* soap. Emerging markets are defined as countries where social or business activity is in the process of rapid growth and industrialization. Countries such as China and India are considered to be the largest.

COMPANY/IT STRATEGIC GOALS

The goal of the transformation of IT is to build leading-edge technology services capable of playing a pivotal role in the company's overall "Path to Growth" strategy. This strategy includes very specific targets for sales, margins, and earnings growth over a five-year period. The case illustrates how an outsourcing program, integrated with an organization's overall strategic plan, can be a competitive advantage. To contribute to the "Path to Growth" strategy, the IT leadership team determined that information and technologies would need to be managed as a critical enabler. The people, hardware, software, and processes that make up the IT organization were considered a primary driver for developing sustainable business practices. The commonly used term "business and IT alignment" is extremely important to the provision of efficient solutions, but also to the provision of lower cost alternatives--as consumer goods organizations are faced with lower product margins and increased competition. In short, the following are the strategic goals that need to be addressed by the IT organization:

- Flawless business and IT operations
- True understanding of user needs
- Integrated management processes
- Identify key success factors and metrics that resonate with the user community

The mission statement for the IT organization is "to be a high-performance, customer-focused IT service organization--providing dependable, quality services that fully meet the needs of the business."

TRANSFORMATION OF GLOBAL INFORMATION TECHNOLOGY

In 2006, Unilever's global IT organization began to shift its management focus from operations to services. The IT organization was focused on the simplification of technology processes along with providing the business agility and flexibility to quickly adjust to new business opportunities.

Companies have been debating the role and value of IT (Harris, 2008) and whether IT should be treated as a commodity like electricity or gas. By keeping IT as a commodity, costs and vulnerabilities are minimized and risk-taking is avoided. In addition, any competitive advantage gained through IT is short-lived because of the speed of technological advances. This form of debate is only possible when a function has reached a certain level of maturity (Glavan, 2012). Relevant topics in the CIO agenda have shifted from, "which technology is next?" to "which service delivery model at what cost?" For Unilever, standards like IT Infrastructure Library (ITIL), CobIT (a framework created by ISACA for IT management (Shuja, 2010)), and IT Governance (Shuja, 2010), among others, provide actionable roadmaps and a reference model that facilitate the functional and process alignment required to establish a high-quality IT Services Utility, releasing the core of IT to engage with the business through innovation and to make other contributions for growth. Challenges facing the IT organization include current hardware configurations, operating systems, and Office Suite software versions that lack updates or are obsolete. Threats included:

- Capacity and Scalability issues are critical because business needs and requirements are constantly changing. The IT organization must be able to adapt quickly, either with an increase or decrease in services provided, to minimize overhead costs.
- A paucity of the management tools necessary for meeting the increasing demand to deliver world class Client Services.
- Difficulty complying with new IT service management processes and regulations such as ITIL, which is a critical component of providing world class IT services. It's defined as a series of best practice books that provide recommendations on ways to optimize their delivery or management of those services.
- Difficulty complying with Sarbanes-Oxley (SOX) regulations, Section 404. IT supports the corporation's drive to comply with SOX by securing and protecting financial data in the company's systems and IT network. Without IT support, a corporation simply can't comply with the testing and validation of the internal control structure required by SOX (Section 404). If the internal control structure of the company is inadequate, the company will be subject to retribution from the Securities & Exchange Commission, for noncompliance with SOX regulations (Bonnie, Kevin, and Marcia, 2012.)

Unilever's strategy is to manage technology deployment to support business goals. The IT organization provides advice, assistance, and leadership to the business to maximize benefits from the products and services available. The finance team works together with the IT organization and acts as one face to the rest of the company. (Exhibit two includes an organizational chart of the global IT organization.) The finance organization works with IT to establish vendor partnering sources and manage external suppliers. In addition, an important role of the finance team is to negotiate contracts to continuously improve everything from risk management to network infrastructures. The finance team also designs information management structures, sets policies for sourcing, and performs financial analyses of the services provided by third-party suppliers.

OUTSOURCING DECISION

Unilever supported the business case for outsourcing IT services by ensuring that they would get all computers and IT services needed, while freeing the department to focus on growing the business instead of managing infrastructure services. They made the case that relieving the IT department of the administrative burden of managing and deploying personal computers (PCs) would enhance productivity and enable the team to provide better services to users. In addition, by outsourcing IT services, Unilever was able to scale IT support to adapt the changing market conditions.

Unilever's finance team played a key role in developing the business case for proceeding with the investments and associated costs required to carry out the outsourcing of Unilever's IT Client Services in 2006. The Finance Leadership Team was tasked with finding a way to address and solve, as well as establish a long-term plan for IT Client Services, given the complex nature of the area, including:

- Complex, detailed, and multi-layered technologies, processes, and services
- Regional spreading of Unilever business
- End user help desk, also known as Client Services (See Exhibit two)
- Total cost of ownership and management of client infrastructure
- The need to keep up with emerging technology
- Workstation and server management--asset control and administration
- Install, move, add, and change assets and all personal computing equipment (e.g., PCs, software, or printers.)
- Keep up a career plan to attract, develop, and retain highly skilled finance and IT professionals

It was critical to identify the project success factors to keep the team focused on the implementation deliverables. All of the critical success factors were monitored throughout the transformation.

GOALS OF OUTSOURCING

Unilever's main goals of outsourcing IT client services were to:

- Provide end-to-end desktop lifecycle support for the organization and the end user
- Address total-cost-of-ownership concerns with a predictable long-term cost structure
- Improve end-user productivity, quality of service, and critical skill access
- Better align end-user capabilities with business requirements
- Complete lifecycle management—manages a lifecycle of service from planning and procurement through support and disposal
- Global managed infrastructure enabling rapid, global implementation and efficient operations; provides the foundation for continuous improvements
- Multi-vendor support—seamlessly supports a heterogeneous, multi-vendor desktop and mobile environment
- Transition and transformation methodology—enable a smooth transition to new technologies and applications without service disruption
- Single point of contact and accountability

RISKS

With transformation of services of this magnitude, there are a number of risks to consider. The majority of these risks arise during the transformation in the Service Center, Desktop Support, and Application Packaging and Distribution areas. A risk assessment is necessary with a developed, detailed plan, which includes appropriate milestones and go/no-go decision points. One of the major risks in deployment of PC equipment is disruption of end-user productivity. In addition, ensuring that no data is lost in the transformation is critical. Delivering the correct equipment in a timely manner in a secure environment is also necessary to mitigate the risk of losing critical information. Service interruption and obstacles during the services transition may also impact on-going business operations. From a financial perspective, a major risk is not delivering the identified savings. To address these risks, Unilever worked with the third-party service provider to ensure the agreement identified the appropriate tools and resources to be used to ensure that they performed the deployment and management of services according to the agreed plan.

SUMMARY OF OUTSOURCED FUNCTIONS IN NORTH AMERICA

In 2006, Unilever North America (NA) had 17,000 end users in 100 distinct locations. The company invited six potential suppliers to participate in a Request for Proposal (RFP) to not only upgrade the existing desktops and notebook computers at all these locations, but also manage the on-going support services. The NA team concluded that three suppliers met the requirements to submit proposals and, subsequently, two suppliers partnered to submit one proposal.

The objectives of the RFP in selecting this Client Services supplier were:

- Lead the PC deployment phase of the One Unilever PC Programme, offering standard hardware, processes, tools, and a standard desktop configuration
- Provide support services upon the completion of the new PC deployment
- Deliver technological improvements and service flexibility that will allow IT to contribute further to business opportunities
- Offer year-over-year declining costs
- Refresh Unilever's PC environment as dictated by ITIL, which defines computing best practices

The services included in the Client Services Proposal are (See Table I):

- Service Center—The facility where the computing equipment resides
- Desktop Support—The organization that provides assistance to users of technology
- Application Packaging and Distribution
- New PC Equipment Deployment

These services were to be offered to all business groups in NA and eventually to Unilever's global IT organization. The existing hands-on, local support services model was changed into a centralized support model. All computing calls would go into a centralized Service Center, and Desktop Support resources will be placed in large locations (i.e. Greenwich, Toronto, Englewood Cliffs, and Chicago). These resources would also provide remote support for all other sites in NA. Any support that can't be provided by the central team will be handled by a dispatch service.

The service provider is required to measure all services against formal service level agreements. So, in changing from the existing End User Services (EUS) support model of "one service level fits all," the vendor solution will offer Service Baseline Assumptions. This vendor solution is known within Unilever as "Choice of Service, Choice of Cost." The finance team developed different cost models with the third-party service providers to offer a menu of services to the Unilever business groups. For example, the business group could select the highest level of service (i.e. Platinum—seven by 24 Service Center and Desktop Support), but the cost would be higher, reflecting the premium support level provided by the supplier.

COST OF OWNERSHIP AND PROGRAM SAVINGS FORECAST

Table II outlines the total investments cost related to outsourcing the IT services operation and one-time project costs to transition to new equipment and services provided by the third-party vendor. Unilever was required to incur the software licensing costs for all existing programs. The table also includes all one-time capital and project expense to implement new PCs in all NA locations. The EUS costs in Table II reflect the dual running costs while the transition to the third party is in process. This includes, primarily, employee related costs of the existing departments supporting EUS. The contract termination fees reflect the termination fee of an existing contract with a third-party provider, previously supporting part of the internal function within Unilever.

Table III outlines the project savings as a result of the outsourcing agreement. The savings model compares the "per seat" or "per PC" pricing of the third-party supplier to the existing service model cost of Unilever's EUS. The annual savings was projected to be $12.6 million as compared to Unilever's current operating costs.

MEASURING SUCCESS OF THE OUTSOURCING AGREEMENT

The implementation of the outsourced services agreement critically enabled Unilever's overall IT strategic vision. It introduced simplified technology and processes, and provided flexibility to quickly adjust to new business opportunities, reorganizations, and restructurings. Success of the deployment was measured by key milestones. The controller worked with the VP of IT services to ensure the project was managed according to plan and delivered targeted savings. In addition, service-level agreements were monitored and reviewed by end users and IT staff to ensure the level of service provided was in accordance with the plan.

CASE REQUIREMENTS

1. What were the critical success factors, those things that must go right, for this initiative to achieve its mission?
2. With transformation of services of this magnitude, there are a number of risks to consider. The majority of these risks will arise during the transformation in the areas of Service Center, Desktop Support, and Application Packaging and Distribution. What do you think are the main risks in outsourcing this service? How can these risks be mitigated?

Table 2
Outsourcing Investment

(All financial information in the case was provided by Unilever from the actual Request for Project approval (RFP) document - Submitted to the Unilever NA Board of Directors during October 2005.)
One-time capital costs ($11.4 million) for new equipment and one-time project expense ($15.3 million) are detailed below:

	Odyssey – New PC Equipment Costs				EUS Transformation (related to transfer of services to 3rd party provider)	Total
	2004	**2005**	**2006**	**2007/2008**	**2005–2008**	
Capital	**$2.2**	**$8.6**	**$0.6**		**-**	**$11.4**
Software/Licenses		5.1	0.6			
Servers (W2K/Messaging)	1.3	1.3				
LAN/WAN Upgrade		2.2				
Client (PC) Back Up	0.9					
One Time Project Expense	**$0.5**	**$5.5**	**$3.7**	**$.8**	**$4.8**	**$15.3**
Dual Running/Employee Backfill Costs		1.0	1.0		2.5	
Employee Severance		1.1	1.1			
Existing Supplier Contract Termination					2.1	
Supplier Transition Fee		0.2	0.3	0.8		
Project Management Costs, Travel, Training		0.9	0.3			
Application Packaging		1.0				
Messaging Implementation		0.3	0.3			
Software License Fees	0.5					
Other, e.g. Maintenance		1.0	0.7		0.2	

Table 3
Project Savings

Savings
As a result of the Client Services outsourcing agreement, total End User Services (EUS) costs will be reduced by $3 million in 2006. Expected savings over the three-year life of the contract is $12.6 million and is primarily a result of the supplier's lower operational cost per seat, including a complete replacement of the existing services solution and a 50% EUS full time equivalent head count reduction.

Following is a table outlining the key components of the program savings:

$ Millions		**2006**	**2007**	**2008**	**2009**	**Total**
Current Service Model:	Employee related costs	6.0	6.2	6.3	6.5	25.0
	Telecommunications and related costs	4.0	4.1	4.2	4.3	16.6
	Lab to script applications to run in					
Unilever's environment	1.0	1.0	1.1	1.1	4.2	
	Total Costs	**11.0**	**11.3**	**11.6**	**11.9**	**45.8**
Service Provider Costs Per Seat:*		8.0	8.2	8.4	8.6	33.2
Savings:		**3.0**	**3.1**	**3.2**	**3.3**	**12.6**

*The pricing is based on an agreed upon seat price per quarter. The agreement allows for some flexibility in number of seats with no change in pricing structure. The seat count will be reviewed on a quarterly basis.

3. Did the finance team consider all costs when outsourcing to a third party or can you identify any costs that may have been missed?
4. What can Unilever do to ensure the savings realized in the early years of outsourcing will continue in the future?
5. Can you identify any other approaches to outsourcing that Unilever may have considered when examining the transfer of services in one region of a global organization to a third-party supplier?

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Exhibit 1
Unilever Company Profile

UNILEVER STRUCTURE:
Unilever is the operating arm of Netherlands-based Unilever N.V. and UK-based Unilever PLC.

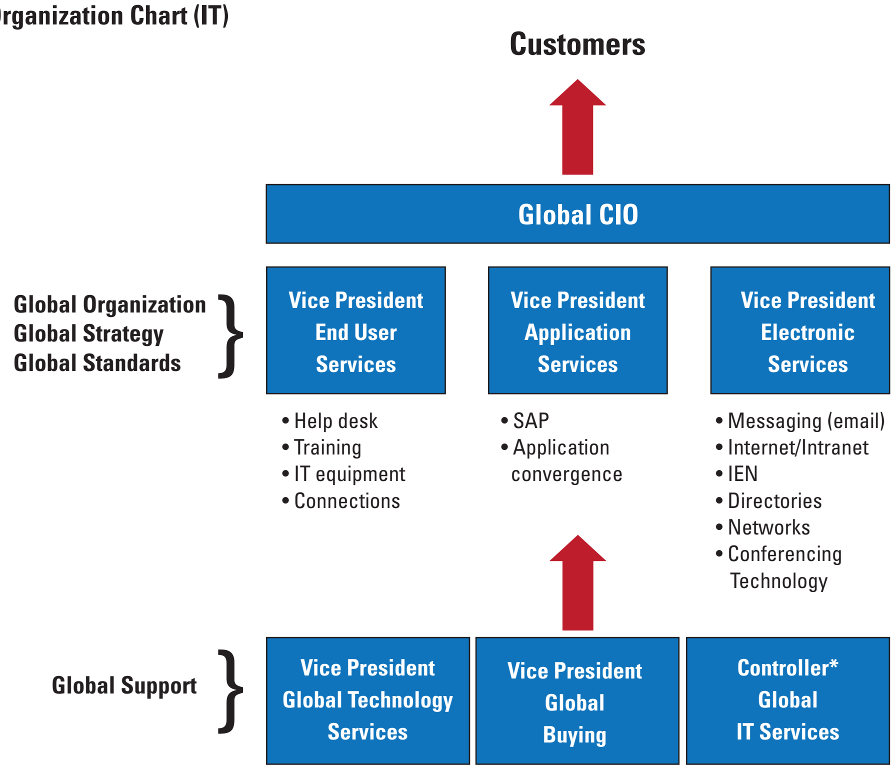
KEY EXCECUTIVES:
Chairman: Michael Treschow; CEO and Director: Paul Polman

BACKGROUND:
A top maker of packaged consumer goods worldwide, Unilever products are sold in more than 180 countries throughout Africa, Asia, Latin America, the Middle East, North America, and Western Europe. The company's offerings span 11 categories, including skin care and deodorant. Best-selling brands include *Hellmann's* (mayonnaise), *Knorr* (soups), *Lipton* (tea), *Dove* and *Lux* (soaps), and *Sunsilk* (hair care).

TOP COMPETITORS:
- The Procter & Gamble Company
- Nestlé
- Reckitt Benckiser Group

Selected Financial Data (USD $ in millions, translated from EUR €)
Revenues: $58.7 billion
Net Profit: $5.6 billion
Net Profit Margin: 9.59%
Number of Employees: 165,000

Exhibit 2
Unilever Organization Chart (IT)



* Dotted Line to Global CFO

Exhibit 3
Glossary of IT Terms

Applications An IT application is the term used for software that a business would use to assist the organization in solving problems. When the word "enterprise" is combined with "application," it usually refers to a software platform that is used for large, complex organizations.

Desktop Support The organization that provides assistance to users of technology.

End User Services (EUS) In an IT organization, "end users" are those employees actually using computer equipment.

Integrated Enterprise Network (IEN) An integrated network is the management of telecommunications and distributed computing systems within the same framework.

Infrastructure Services IT infrastructure consists of the equipment, systems, software, and services used in common across an organization.

ITIL ITIL is a widely adopted approach for IT service management. It provides a practical framework for identifying, planning, delivering, and supporting IT services to the business.

Messaging is the storage, exchange, and management of text, images, voice, telex, fax, e-mail, paging, and Electronic Data Interchange (EDI) over a communications network.

Network a group of computers set up to communicate with one another. Your network can be a small system that's physically connected by cables (a LAN), or you can connect separate networks together to form larger networks (called WANs).

SAP SAP is a global company that provides software, solutions, and services to manage business processes.