

Virginia Is For Outsourcing

The state hopes an outsourcing deal will modernize its IT infrastructure, save jobs, and spur development. All this, and the work stays local.

By Paul McDougall, [InformationWeek](#)

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State CIOs are in a jam. Like their private-sector counterparts, most are trying to deliver new applications and services and modernize aging IT infrastructures on no-frills budgets. Yet, political considerations rule out a cost-cutting tactic widely employed elsewhere: offshore outsourcing.

Virginia says it has an answer, one that could serve as a model for other states. Virginia last week became the first state to hand over the bulk of its IT operations to one vendor through a 10-year outsourcing agreement that will pay defense contractor Northrop Grumman Corp. more than \$2 billion. The deal, if approved by state legislators, is designed to save the state \$200 million, upgrade its IT systems, spur economic development and IT education, and save state tech workers' jobs.



It's a calculated move to hand off a state's entire IT operations to a single vendor. Some businesses, such as Procter & Gamble Co., have taken similar steps ("[Selling Soap, Razors-- And Collaboration](#)," Nov. 14, p. 49), while others, such as General Motors Corp., use multiple IT suppliers for redundancy and to encourage price competition. But Virginia's leaders tried to forge a please-all-parties agreement, which could make success more difficult.

"This partnership will provide high-tech jobs with good salaries," Gov. Mark Warner said at a news conference in Lebanon, Va., last week. A possible candidate for president in 2008, the outgoing Democratic governor needed to find an approach that would solve many of the state's biggest IT problems without sending tech jobs overseas.

Technology Secretary Huang says "the appetite just wasn't there" for increased IT spending.

And the problems are extensive. Virginia's IT services are delivered piecemeal to departments, rather than statewide. Many of its IT workers are approaching retirement age, and its infrastructure is creaky. "Our data center is over 20 years old and is a security risk," Secretary of Technology Eugene Huang says. He contends that Virginia's \$220 million

annual IT budget isn't keeping pace with its needs. "We tried to get increased funding for IT projects, but the appetite just wasn't there," Huang says.

In a bidding process that involved well-known IT outsourcing specialists, including EDS and IBM, Northrop Grumman, best known for its work for the military, was the surprise choice. "They not only are going to manage operations within our current budget, but they're providing us with new and improved infrastructure," Huang says. Northrop Grumman will operate and maintain Virginia's mainframe, server, desktop, and network operations. The state also is set to tap CGI-AMS to roll out new applications designed to modernize the delivery of numerous services to Virginia residents. Northrop Grumman is partnering with Hewlett-Packard and Gateway in the implementation.

Northrop Grumman appears to have won the deal in part because it's planning to use the Virginia operations as a base for growing its outsourcing business. It agreed to build data centers in underdeveloped areas of the state, earmarking more than \$55 million to build a 130,000-square-foot data center in Lebanon and a 167,000-square-foot operations center in a

long-vacant technology park in Chesterfield County. Yet only 20% of the seats at the Lebanon center will be devoted to Virginia state government work--the rest will be filled by contracts that Northrop Grumman hopes to bring in by attracting more IT outsourcing work from businesses and other governments. "This is a new model for economic development," Huang says. The state expects the initiative will add more than 1,000 private-sector IT jobs. The contractor also will fund IT-education programs at the University of Virginia.

With no offshore component, the agreement also defuses a political bomb that has brought down other state outsourcing deals: More than 900 state IT workers will be offered jobs at Northrop Grumman with 4% salary increases and signing bonuses. The company must retain the workers for at least a year.

Other states have tripped up as they've tried to navigate the political sensitivities of outsourcing. New Jersey and Indiana have drawn opposition over plans to use low-wage IT contractors in India. Connecticut in 1999 scuttled what was supposed to have been a comprehensive deal with EDS worth up to \$1.5 billion. Protests from labor, combined with intense public scrutiny, ultimately killed it.

Virginia officials courted employees before proceeding with the Northrop Grumman contract, a strategy that seems to have paid off. "Taking care of employees is both the morally right thing to do and the smart business thing to do," says Bryan Drake, a state IT employee and member of the Virginia Governmental Employees Association.

Outside Interest

The deal has attracted the attention of other state CIOs. "Virginia is an interesting experiment we're all watching very closely," New York CIO Jim Dillon says. "We face an aging workforce, many of whom are ready to retire, and rapidly changing skill needs. Legacy systems combined with an aging staff are increasingly making us look to outsourcing to satisfy those needs and skills."

Virginia's Big Deal

The 10-year outsourcing pact calls for Northrop Grumman to:

- Receive more than \$2 billion along with partners HP and Gateway
- Take over the state's mainframe, server, desktop, voice, and data networks
- Spend more than \$55 million building two data centers
- Fund IT education at the University of Virginia
- Provide state IT employees with 4% raises and signing bonuses upon transferring to the company
- Retain transferred employees for at least a year

But many remain wary of outsourcing. Michigan consolidated 20 data centers into three and launched a number of other efficiency programs designed to save about \$100 million. "We're doing an effective infrastructure consolidation with our own state employees," CIO Teri Takai says.

Yet Takai acknowledges there's constant pressure to deliver more. "Citizens are demanding online involvement more than they ever have," she says. "In order to provide that service, we really have to address some issues around statewide broadband, security, and ways to reach those citizens." While Michigan may never turn to outsourcing, Takai says Virginia's move might generate new approaches for IT management, efficiency, and keeping people happy.

Some argue that the only lesson here is that Virginia taxpayers will end up paying more than they should because certain choices--specifically offshore outsourcing--weren't considered. States could save "astronomical amounts of money" by placing their IT work offshore, says Andy Keyser, who heads the state government practice for India's largest outsourcing vendor, Tata Consultancy Services Ltd. Yet, because of political sensitivities, virtually all of Tata's state government work is performed in the United States, Keyser says.

Virginia has plenty of reasons to keep the work under domestic control. The state is home to sensitive federal-government institutions, including the Central Intelligence Agency, and few contractors can match Northrop Grumman's experience working in

such environments. Also, offshoring wouldn't have provided the state with the kind of economic benefits it was looking for. "We have rural areas where the work can be done for significantly less money than in the metropolitan area," Huang



Virginia Gov. Warner contends the deal "will provide high-tech jobs with good salaries."

Photo by Andre Teague/Bristol Herald Courier/AP

says. "We don't need to go offshore."

It's No IBM

For Northrop Grumman, which has a small but growing nonmilitary outsourcing business, the challenge is to win enough additional work for its new data and operations centers from other customers to justify the cost of the inherited state IT workers, with their raises and bonuses. The company, which didn't return calls to discuss the deal, provides IT services to state and federal agencies and a number of other nonmilitary customers. It's no IBM, however. The company's Information Technology unit posted sales of \$4.75 billion in the most recent fiscal year, up 12% from the previous year but still only about 10% of what IBM rakes in from IT services.

The deal "has the added benefit of being financially sound," Huang says, noting that the project, while needing legislative approval, won't require new funding.

Still, large government IT projects have a spotty track record, and managing outsourced suppliers is trickier than dealing with in-house IT employees. So it remains to be seen whether Virginia will realize all the sought-after benefits: a revamped IT infrastructure, new services for state workers and residents, private-sector jobs, and a boost in tax revenue.

And, even if Virginia succeeds, it's uncertain that a similar deal could be replicated elsewhere. Virginia, with its proximity to Washington, D.C., can attract a company like Northrop Grumman more easily than most other states. "It's going to be very interesting for us to watch what Virginia is doing," Michigan's Takai says. "We're all going to learn from it."



"We're all going to learn" from Virginia, Michigan CIO Takai says.