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Outsourcing Service Levels in POS Maintenance Transactions

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With many demands on their time, consumers become impatient with delays when trying to make purchases at retail stores. A poorly operating point-of-sale system can result in long checkout lines, high levels of customer frustration and lost sales. Accordingly, uninterrupted, error-free operation of POS systems is extremely important to retail organizations.

An important factor impacting POS performance is the quality and timeliness of the installation, upgrade and maintenance of POS systems. Many retailers choose to contract with an external provider for such services rather than providing them internally. For retailers who contract for such services, a properly structured contract is critical to the quality and timeliness of the services they receive.

To some extent, retailers and their service providers have divergent interests: Retailers are interested in obtaining a high level of service at the lowest possible cost while service providers are interested in providing a satisfactory level of service at the highest possible margin. Use of the kinds of service levels and service-level credit structures used in outsourcing transactions, however, may well keep the parties' interests aligned and incent the service provider to provide high quality and timely services. This is especially difficult, however, where the retailer's stores are disbursed among urban, suburban and remote areas.

The threshold question that a retailer must confront when structuring service levels is which aspects of the POS services should be measured. The answer is simple: Measure those services that have the greatest impact on your business. For example, a key service-level measure for POS maintenance services is the time it takes the service provider to resolve problems. Assuming problems are reported through the service provider's help desk, other key measures might include the time the retail employee must wait in the queue to report a problem to the help desk and the number of service calls that are dropped by the help desk before the retail employee reaches a live person at the service provider. If the service provider is installing POS systems for the retailer, service levels that measure the extent to which installation and configuration activities take place when scheduled are also appropriate. An additional service level should also measure the percentage of new POS systems that experience problems within the first several days after installation.

Once you have identified the aspects of the services you want to measure, the second question that arises is how to structure measurement algorithms that in fact incent the service provider to perform. This can be more difficult than it seems. Consider, as an example, the problem resolution service level. Assume: (i) a retailer has 1,000 stores located throughout the United States with 800 in urban and suburban areas and 200 in remote areas; (ii) the urban and suburban stores have an average of 20 POS devices per store (1,600 aggregate devices in urban and suburban areas); (iii) the remote stores have an average of 10 POS devices per store (2,000 devices in remote areas); and (iv) on average there is one service call for 50 POS devices each month. In other words, assume the retailer has 360 trouble calls in the month, of which 320 are in urban and suburban areas and 40 are in remote areas.

This retailer and its service provider might agree upon a time to resolve service level that requires the service provider to resolve all problems in an average of four hours. The service provider could allocate resources to urban and suburban areas, resolving all 320 urban and suburban problems in an average of two and a half hours each and resolving 20 of the 40 remote problems in an average of five hours each. In such a case, the service provider could meet the service level even if it took 27 hours to resolve each of the remaining 20 remote problems. We see from this example that a service level which looks at performance across all stores may not incent performance at remote stores and may give the service provider great latitude to manage its costs at the expense of the retailer's service at remote stores.

Alternatively, the service provider and retailer might agree upon a service level that requires each call to be resolved within a specified period (*e.g.*, four hours), with the exception of a limited number of calls each month (*e.g.*, six) which might extend for a longer period (*e.g.*, eight hours) before the service provider can be considered to have failed to achieve the service level. However, such a service level would require the service provider to have resources on or near virtually each of the remote stores, which is likely to be very expensive.

Accordingly, when negotiating service levels, the geographically diverse retailer must make strategic decisions about the balance between cost and service and then reflect such decisions in carefully structured service levels. If consistent with its business needs this retailer might attempt to negotiate a structure in which the parties would measure time to resolve at two different classes of stores: remote stores and other stores. At the remote stores, the service provider would be required to achieve an average time to resolve of, say, 12 hours; provided that it would fail to meet the service level if an outage at any remote store with fewer than three functioning devices took longer than six hours to resolve. At the other stores (*i.e.*, those located in urban and suburban areas), the service provider would be required to achieve an average time to resolve of four hours. For this purpose, "remote" might be defined by reference to the distance between the store and the nearest of the major metropolitan areas listed on a schedule to the agreement.

Finally, a failure to achieve a service level should trigger a "service level credit." Service credits are refunds of portions of the service provider's charges paid by the service provider to the retailer upon the service provider's failure to achieve a service level. They are designed to incent the service provider to perform, not to fully compensate the retailer for its losses. Many POS service contracts do not provide for service level credits. Service levels are generally ineffective unless the service provider is required to pay a service credit upon its failure to meet a service level. Absent meaningful service level credits, the retailer has no remedy for the service provider's failure to meet the service levels other than termination, and a retailer is unlikely to terminate a service provider absent abysmal service because the retailer is unlikely to bear the cost and service risk associated with a termination. Accordingly, without service credits, the retailer has no effective mechanism to manage the service provider.

Use of service levels and service-level credit structures developed to improve vendor performance and client satisfaction in outsourcing transactions can help keep the parties' interests aligned and incent the service provider to provide high quality and timely POS services.

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