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WHAT TO LET GO, WHAT TO HOLD ON TO

Defining and Managing an Optimal Sourcing Mix

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ISG WHITE PAPER

INTRODUCTION

Executives responsible for IT and business process sourcing decisions face a wide range of options. The most basic consideration is whether to outsource a process or function, or whether to manage it with internal resources. Once a decision to outsource has been made, additional choices present themselves, such as onsite versus remote service delivery, or near-shore versus offshore. Subsequently, businesses must make more granular decisions regarding the role of their retained functions in managing the provider. Finally, in multi-sourced environments, decisions must be made regarding roles and responsibilities and how multiple providers interact with each other and with the client.

Each layer of the process involves a variety of considerations. How do businesses ensure they are evaluating the right criteria, asking the right questions and making informed choices?

This ISG white paper examines different types of sourcing strategy and implementation decisions, and defines criteria to consider when formulating a plan and managing a program.

SOURCE Vs. RETAIN

Sourcing can be defined as the optimal placement of work, internal or external to a company, to best meet business goals and objectives. Work components can be performed solely by external suppliers, exclusively by internal "retained" organizations, or (in most instances) by combinations of both.

Organizations have multiple reasons to source work externally, including but not limited to:

1. Accessing new capabilities, skills or technologies.
2. Reducing time-to-market.
3. Facilitating innovation or business transformation.
4. Reducing owned asset base.
5. Improving tools or processes.
6. Repurposing resources to higher value work.

Similarly, multiple reasons exist to source work internally, such as:

1. Gaining a competitive advantage.
2. Focusing on core competencies.
3. Maintaining control over critical areas and integration points.
4. Ensuring retention of key process knowledge.
5. Assuring career paths necessary to attract and retain staff.
6. Controlling innovation or new product development.

Outsource versus retain decisions have a lasting impact and must be well thought out. The decision-making process must be both robust and carefully managed. Fundamental considerations include:

1. Customer intimacy.
2. Technology marketplace.
3. Economies of scale.

4. Business and regulatory environment.

5. Human resource impacts.

6. Risk management.

These six areas form the basis for prudent decision making. The following section covers each area in greater detail, outlining key questions that client organizations need address to determine whether outsourcing or insourcing is appropriate.

Customer Intimacy: This is not the "voice of IT" to the internal customer, but rather the core business process knowledge that cannot be purchased "off the street," such as insight into how proprietary technology is used in manufacturing processes. Outsourcing such service elements is likely to result in failure. An organization that uses IT to competitive advantage in creating products and delivering services must retain all the components necessary to continue and build upon that success. The key question: *Is core business process knowledge necessary to successfully perform this work?*

Sourcing strategies must be planned in the context of the long-term horizon.

Technology Marketplace: In today's rapidly changing technology marketplace, sourcing strategies must be planned in the context of the long-term horizon. As cutting edge technologies mature and become commoditized sourcing externally is often beneficial. For example, Boeing once owned one of the world's largest telecom networks. At the time, enabling significant reductions in communications costs amongst manufacturing facilities represented a competitive advantage. As telecom technologies matured and prices dropped substantially, divesting those functions made more sense. Later, as Voice over IP protocols developed, leveraging the company's internal data network became advantageous, so the service was once again re-sourced internally. As components of the service became commoditized once more, the cycle repeated and a supplier was again tasked with much of the work. The key question: *How does the technology lifecycle impact the ability to in- or outsource?*

Economies of Scale: Before going to the marketplace to purchase a solution, businesses need to consider the providers' perspectives and assess whether or not the scale of the opportunity is sufficient to interest bidders. A related consideration is whether a sufficient supply base of prospective providers exists to ensure adequate competition for a given organization's size, scope and complexity. While sole-sourcing is sometimes necessary, a lack of competition severely reduces leverage, perhaps not on the initial buy, but certainly when an entrenched incumbent faces little competition at renewal. The key question: *Will a potential provider be able to leverage economies of scale to make a profit, while delivering equivalent service at a lower price point than could be acquired internally?*

Business and Regulatory Environment: As a manufacturing technology leader and government contractor, Boeing is heavily regulated as well as a prime target for a wide variety of advanced persistent threats. As such, public cloud solutions—while offering significant benefits for many businesses—are largely off the table due to data protection and privacy concerns, export controls and other issues. Regulatory requirements affect other industries as well. The financial crisis of 2008 led regulators to tighten compliance standards, placing the onus on client organizations to maintain oversight of their end-to-end service delivery chains. By raising concerns around where work is done and by whom (e.g., which sub-contractors and third parties), these regulations have a significant impact on a financial services firm's decisions on whether or not to outsource, which providers to select, and how to structure and manage the supplier mix. (For more information, download the ISG white paper "The 'Uh Oh' Moment"). Healthcare organizations face heavy regulatory burdens as well, as do most companies to a greater or lesser degree. The key question: *How do current and anticipated regulations constrain sourcing decision-making?*

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Human Resources Strategies: Employees should be aware of knowledge, skill and ability requirements for a viable career path within their company, or, conversely, avenues to pursue to move to an external service provider. Forethought can avoid adverse impact on both the buyer and the seller. Service providers often wish to acquire key personnel to mitigate transition risks, whereas buyer organizations need talent to oversee contracts and perform retained work. For example, while Boeing used to build and maintain its own PCs, the decision to purchase equipment from OEMs led to a more maintainable and cost-effective solution. Over a period of several years, break/fix, service desk, add/move/change and other associated end-user support activities were outsourced as well. Employees who wished to remain desktop support experts had the opportunity to move to provider organizations, whereas those who wanted to remain with the company had to acquire other skills. The key question: *Where sourcing decisions impact company personnel, what is the best way to mitigate any adverse impact?*

Risk Management: Enterprises must have the ability to assess and manage operational, technical and business risks for work given to outside suppliers. Even when "fully outsourced," certain retained functions such as security, supplier oversight, or enterprise architecture are typically necessary to keep providers focused on client interests, ensure that change proposals can be adequately vetted, and facilitate cooperation amongst suppliers in multi-sourced environments. A robust governance process is essential for transitioning to new suppliers or contracts, refreshing and sun-setting technology, vetting and implementing changes, assuring innovation and addressing the myriad tasks necessary for smooth operations. The key question: *What governance is necessary to moderate sourcing risks?*

HOW AND WHERE TO SOURCE

Business objectives and required service delivery locations are paramount in the decision-making process. While insourcing decisions can be fairly self-evident, outsourcing decisions have far more tentacles that can move in more directions than anticipated. Additional considerations arise when determining whether the outsourcing initiative involves buying something relatively straightforward like hardware or contingent labor, versus acquiring a complex service. In general, the greater the expected business outcome, the more complex the relationship between buyer and seller is likely to be. This complexity must be reflected in the contract and managed accordingly.

Business objectives range from buying commodities or support labor as inexpensively as possible (commonly referred to as utility deals) to driving transformational change that can make or break a business. The former might include purchasing IT hardware or infrastructure services, whereas the latter might be moving from brick and mortar banking to ATM machines and web services. Clearly, expectations, Terms & Conditions, pricing structures, Statements of Work and Service Levels will vary significantly. True innovation should not be expected from a utility deal, but is an iron-clad requirement of a transformational one. The potential supply base is impacted as well, as service providers who excel at utility deals are rarely the best at transformational initiatives, and vice versa.

Once business objectives are clear, decide where the work will be performed.

Once the business objectives are clear, a decision must be made regarding where the work will be performed. Choices may be restricted by regulation, but more often than not control, cultural compatibility and communication are the determining factors for what aspects of the work can be done remotely versus on the client site. Issues such as tax policy and public relations impacts can also influence where work is performed; specifically, whether rural sourcing, near-shoring or offshoring could be viable options. If offshoring is pursued, site considerations include location (whether a follow-the-sun model is important), culture and language compatibility, economic and political stability, legal climate and intellectual property laws, security and a host of other issues. Whatever offshore location is selected, contingency plans and risk mitigation strategies must be developed accordingly. For example, Boeing used to source airplane parts from a Yugoslavian company, but the supply chain was disrupted during the civil war when the factory was bombed. Without contingencies in place, a significant impact to production could have occurred.

Approaches to contracting are similarly varied. A transformational initiative typically requires longer term contracting with outcome-based incentives whereas utility deals are often multi-sourced, frequently rebid or safeguarded with a benchmark clause to assure ongoing competiveness. Transition and termination terms require careful consideration. Generally speaking, the more control a service provider has over tools and processes, the more problematic a change becomes. For example, if a service provider owns the desktop

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environment, including hardware, bringing in a new supplier will have a direct impact on the user community. A "big bang" transition would increase disruption risks. Contract strategies must anticipate potential termination scenarios and put contingencies in place to assure minimal end-user impact.

WHAT TO MANAGE WHEN OUTSOURCED

When functions or processes are outsourced, client organizations still need to retain certain responsibilities. Consider desktops: while businesses generally outsource desktop services, many retain control over architecture, integration and security.

Defining an appropriate role for the retained function requires proactive planning and a structured framework sufficiently granular to address the unanticipated challenges that inevitably arise in an enterprise environment. The Information Technology Infrastructure Library (ITIL) framework, for example, can enhance process maturity, mitigate risk and identify drivers of performance issues.

MANAGING MULTIPLE PROVIDERS

The final piece of the puzzle involves developing a strategy to manage multiple suppliers. This requires addressing not just the touch points and interfaces between the client and vendor teams, but between different vendors.

Setting expectations early allows providers to build that understanding into offers.

Key success factors for managing a multi-vendor environment include a contracting process that builds in an understanding of what the post-contract environment should look like in terms of vendor collaboration. By setting expectations early, clients can allow providers to build that understanding into best and final offers.

Contractual language and shared service levels can be used to require service-based interactions between providers and participation in collaborative activities and mechanisms. Once the relationship starts, cross-provider process integration workshops and governance forums involving the provider team should be instituted to oversee strategic objectives, as well as address the detailed operational interactions and touch points that occur between different providers and between providers and the client team. Ongoing process performance evaluation that produces a scorecard for each provider can incent the team members to work toward shared goals. (For more information, download the ISG white paper, "Play Nice").

SUMMARY

An effective sourcing decision-making strategy is characterized by the following elements:

1. A holistic approach that examines each and every work element in a structured model such as ITIL to determine what elements to buy, what elements to retain, and how to assure that all the parts and pieces work together seamlessly.

2. Evaluation of customer intimacy, technology marketplace, economies of scale, business and regulatory environment, human resource impacts and risk management in the context of determining insource/outsource decisions. Understanding that this cannot be a onetime exercise.

3. Continuous monitoring, evaluation and reevaluation to stay abreast of changes in company strategy, business environment, technology innovation and provider marketplace.

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