

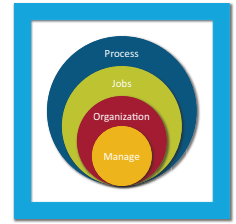
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White Paper

Avoiding Outsourcing Failure by Understanding the Retained Operation

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White Paper “Avoiding Outsourcing Failure by Understanding the Retained Operation”

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Introduction

According to studies of the industry, roughly 50% of outsourcing relationships fail. So what causes a transaction entered into with so much hope and promise to fail? A 2004 survey¹ identified the following (in order of priority):

1. The buyer’s unclear expectations up front as to its objectives
2. The parties’ interests are aligned up front but become misaligned as the buyer’s business environment or needs change
3. The provider’s poor performance against service level agreements
4. The parties do not consider each other’s interests to ensure their relationship is mutually beneficial
5. Poor governance structure for managing the ongoing relationship
6. Poor cultural fit compatibility of the parties
7. Poor communication; the parties do not proactively share necessary information with each other
8. Challenges arising because of the buyer’s multi-supplier environment

Excluding #3, every one of these has to do with the relationship between the customer and the supplier outside of the outsourcing contract, and all but #3 and #8 would fall into the category of “irreconcilable differences” for getting a divorce (#3 would be failing to live up to your wedding vows, and #8 isn’t really applicable to most marriages).

The purpose of this white paper is to provide some explanation for why the relationship between customers and suppliers goes wrong and to propose a solution that will increase the parties’ understanding of the customer’s operational needs and improve the relationship. Part I of the paper discusses issues associated with the establishment and operation of the outsourcing relationship and flaws in the approach taken by customers (and suppliers). Part II describes a tool and analytical structure for:

¹ Kathleen Goolsby, F. Keaton Whitlow “Studies Reveal Eight Buyer-Provider Disconnect Areas Likely to Cause Outsourcing Failures” (2004) (available at <http://www.outsourcing-center.com/2004-08-studies-reveal-eight-buyer-provider-disconnect-areas-likely-to-cause-outsourcing-failures-white-paper-39089.html>).

- ⤴ Understanding the allocation of responsibilities between the parties in an outsourcing relationship – particularly those retained by the customer
- ⤴ Designing the jobs customer personnel will perform in the post-transaction environment
- ⤴ Assembling those jobs into a retained organization, and
- ⤴ Using that retained organization to manage the provision of services in the post-transaction world.

Part I – The Problem

Outsourcing as a Marriage

Like many marriages, outsourcing relationships result from a courtship period of blissful happiness and excited expectations, where the outsourcing contract is the “pre-nup.” Like most pre-nups, outsourcing contracts are very specific about things like ownership rights, responsibilities, and what happens when the relationship is over, but very light on how the relationship will be managed.

When discussing this with engaged or newly married couples, you frequently hear things like, “As long as we love each other, we’ll work it out,” and a host of other clichés that do not actually provide much guidance for the day-to-day handling of the minor and not-so-minor issues that come up. All newlyweds have their own ways of operating from when they were single and bring to the relationship their own concepts of what a marriage is like and how things should be done. Few newlyweds have experience in dealing with the issues and stresses of marriage, and even less have any training in doing so.

When it comes to handling an outsourcing relationship, all of the problems of the newlywed couple come into play –

- ⤴ Each company operates their business in a particular way before the transition and has their own concept of what an outsourcing relationship is
- ⤴ The stresses and issues associated with the relationship are different from those that existed when the customer was providing the services for itself, and
- ⤴ The people who are responsible for the relationship have little, if any, experience or training in how to analyze and resolve the issues that inevitably come up.

The only difference is that the outsourcing contract says that all of those issues will be handled via something called “governance.”

So What Is “Governance”?

You’re not alone if you think the idea of governance, as it pertains to customer-supplier relationships, is more than a little opaque. In reading about governance you’ll be presented with a baffling array of concepts that range from decision-making methodologies to the need to motivate and terrify suppliers only when absolutely necessary to categorical statements of outsourcing not being business as usual. Importantly, each member of each side in the outsourcing relationship has their own idea of what governance means. Like the newlyweds, we’re long on platitudes and short on understanding.

If governance is such a poorly understood term, how did it come to be the industry standard description for the stuff that makes the relationship work? Part of the appeal of the term, particularly for suppliers, is that it implies a partnership of equals (which most marriages in the Western world are). An outsourcing relationship, however, is, at its most basic, a supplier providing goods and services to a customer. So why not use a term for the relationship between a supplier and a customer that is already well-established and proven, like “management”? Doing so transforms the concept from something requiring a divining rod and magic to one of routine blocking and tackling. If *governance* is an obscure and amorphous cloud, then *management* seems like a very useful and familiar tool.

“Management” and the Outsourcing Relationship

The concept of management promotes the notion of accountability – not necessarily in the sense of somehow paying for one’s mistakes, but through the allocation of defined responsibilities to discrete entities (people, departments, business units, suppliers, etc.). While there are those who have been successful with highly matrixed management or laissez-faire decision-making, the vast majority of companies practice the more plain vanilla form of hierarchical-based management and decision-making.

Possibly because such standard management is so ingrained in our culture – or maybe because the other models are not so well defined or understood – the grand experiment of attempting to manage large-scale outsourced operations with forms of management other than the plain vanilla one does not seem to have generated wide-ranging success. The typical governance structure, which manages through committees where potentially volatile mixtures of internal and external personnel with disparate personality types (passive-aggressives, Type As, alpha males, introverts, touchy-feelies, etc.) are called together at designated, but infrequent points in time to govern, has resulted in a failure rate for outsourcing relationships that rivals the divorce rate in the US.

Managing Operations in the Outsourced World

To continue the marriage analogy, prior to the marriage each spouse performed (or chose not to perform) all of the functions required by life – laundry, cleaning, bill paying, shopping, working, etc. Each spouse developed and evolved their “operations” organically as new requirements surfaced, based on their personality, capabilities and priorities and, in most cases, without any specific expertise or understanding of best practices. Each came to the marriage with their own ideas of how such tasks should be allocated and performed in the relationship, informed by a variety of sources – their own parents’ relationship, TV, prior (obviously failed) relationships, etc. When the spouses come together, each begins to perform some of the tasks the couple needs done. In some cases, they perform the tasks based on what they prefer to do, and in others they do what they believe is appropriate based on their assumptions and experience about who does what in a relationship. In some cases, this is discussed openly, but in others it just happens. Each spouse notices when (1) something isn’t being done by the other spouse as well as they would like it done, and (2) the tasks one spouse assumed that the other would perform are not getting done. What they rarely examine is the list of tasks they still do and how those relate to the tasks being performed by the other spouse, because they had to do them all before the marriage.

In an outsourcing relationship, the contract frequently specifies in excruciating detail what the supplier will do – which provides an advantage over most newlyweds, because they’ve at least thought about what one side will do. However, the general premise of most outsourcing contracts is that they specify what the supplier will do, and the customer remains responsible for that unspecified box that is everything else. Customers rarely look at the broad scope of work they are retaining because they already do it – they are focused on the things the supplier is going to do for them (and how well), as if “scope” somehow belongs to suppliers, and the customer’s share of the overall operation is somehow different. But this approach assumes that customers understand all of the tasks that need to be done, even though the way the customer performs those tasks has evolved organically within the organization, rather than being designed according to best practices.

This is one of the major reasons why the #1 cause of outsourcing failure is the buyer’s unclear expectations up front as to its objectives. If the customer only focuses on what the supplier will do, without adequately understanding what it currently does and how that will relate to what the supplier will do, then there are almost certain to be gaps/overlaps in scope, hidden costs, inefficiencies and sacred cows that sit waiting like land mines in the relationship.

Continuing the theme, while most sourcing customers clearly understand the value of a *supplier’s* solution describing how, when, where and at what price the supplier will deliver the stated objectives within the boundaries of a defined scope, those same customers typically do not see a similar need to develop solutions for how *they* will do the same for their retained scope. As such, it’s not surprising that while sourcing customers are well-versed in requesting, analyzing and negotiating solutions proposed by suppliers, they have historically not been similarly energized to do so for their retained operations.

To truly manage their operations, customers should develop a comprehensive list of all of the processes being performed both by the customer (including the customer’s other suppliers) AND the new supplier. The list should describe not just the activities that come easily to mind about the functional area being outsourced, but also the business practices associated with functions that indirectly enable that functional area. The collection of processes should include those that are:

- ^ Technical (e.g., architecture, engineering, monitoring, repairing, testing)
- ^ Non-Technical (e.g., client relationship management, program management, service catalog management), and
- ^ Support-Based (e.g., compliance, sourcing, commercial, financial control, HR).

By including all of the processes in the list, the identification of the business unit, department, person or supplier that is to be responsible for the performance of each can be safely engineered without fear of creating gaps or overlaps in such responsibility. Stated differently, the allocation of responsibility plotted on a list of processes can be used to help understand the statement of work associated with each of the delivery actors in the environment – both internal and external.

Who Should Do the Managing?

Despite decades of evidence to the contrary, there remains a strong belief by sourcing customers that good technical managers (i.e., those in charge of managing the resources to

perform internally provided IT services) should manage the supplier that takes over such services on an outsourced basis. This philosophy is, in part, an artifact of the traditional outsourced services sales process where a supplier tells a customer executive, “We can do the same thing your people do, just better, faster and cheaper.” The logical leap that most customers make at this point is to equate managing the functions currently performed by internal resources, which requires a certain set of skills, with managing the performance of an outsourced service provider, which requires a different set of skills. It is common to find organizations that have chosen, following an outsourcing, to take the retained technical personnel and move them into a new function (let’s call it a “supplier management organization”) that is simply bolted onto the customer’s existing structure, rather than use those people in a manner consistent with their skills and experience and re-design the customer’s core operations as necessary to adapt to the new circumstances.

While it is *always* a good idea to retain some technical knowledge, it is also important for sourcing customers to consider the broader impact of an outsourcing and:

- ⤴ Redesign their operation by taking into account the functions that will be retained, as opposed to what they performed prior to an outsourcing
- ⤴ Staff their new organization with resources who possess the skills applicable to the retained functions, and
- ⤴ Transfer, based on the supplier’s solution, some of their best technical resources of all levels to the supplier as a way of increasing the overall probability of the supplier’s success (oftentimes referred to as “key personnel” in outsourcing parlance).

The remainder of this white paper addresses how IT sourcing customers might go about developing solutions for their retained operations (albeit, the same principles can be used for other entities like F&A, HR, Procurement and Real Estate that choose to implement outsourcing in their operations). While there are many compelling reasons why such solution development should occur before and during the formation of the outsourcing transaction, nothing is inherently wrong with or misguided about applying the same methods after the fact or even long after the fact – in other words, it’s never too late to fix the problem.

Part II - The Recipe for the Solution

In Part I we discussed:

- ⤴ How companies focus on the tasks to be performed by an outsourcing supplier without really considering the tasks that need to be performed by the retained organization
- ⤴ How companies assign the same functional managers to manage the outsourcing supplier, even though managing a services provider requires very different skills
- ⤴ How companies frequently create/bolt-on “supplier management” organizations without focusing on how the suppliers and those organizations will interact with the rest of the retained organization, and
- ⤴ The many interpretations of the term “governance” and how the concepts and skills normally applied to corporate management might be more appropriate for handling the relationship between customer and supplier.

So, if companies aren't thinking about the things they still need to do, and if the people a company is using to manage an outsourcing supplier have the wrong skills, and if they're being put into the wrong place, and the governance processes advocated by many suppliers and a lot of consultants are the wrong processes, how should it be done? In Part II we'll discuss:

- ⤴ A methodology for identifying the processes to be performed by a retained organization
- ⤴ How to use those processes to identify and build up descriptions of the jobs to be performed by retained personnel
- ⤴ How to collect those jobs into an organization, and
- ⤴ How to manage the whole thing.

The overall process is broken down into a series of 4 work components that build-upon one another to produce an integrated and cohesive result: Process, Jobs, Organization and Management.



The Recipe

Process

Process is about developing an operation that, on an integrated basis, is capable of performing the full spectrum of its retained functions at the desired level of maturity.

As an organizing tool, it's hard to beat the use of a value chain. Value chains have been the process reengineering tool of choice for the last 20 years. Why? Because, when looking at an operation as a monolithic whole, the value inherent in the discrete functions used in designing, producing, marketing, delivering and supporting its services are lost in a background of homogeneity.

Governance and Leadership	Service Management and Integration	Service Delivery
IT Management Client Relations Enterprise Architecture Delivery Strategy Sourcing Strategy	Actor Management Portfolio Management Domain Architecture Process Architecture Standards Solution Requirements Service Management Security Management Program Management Solution Formation	Infrastructure Engineering Software Engineering Quality Assurance Client Support Acquire Deploy Maintenance Software Maintenance Operations Service Support Security Logistics Project Management

Although a value chain is not a silver bullet that can guarantee the desired results of an outsourcing, it can depict the resulting combined organization more accurately as the sum total of a collection of processes, rather than as a single, uniform construct. Its beauty is its ability to:

- ⤴ Express business processes at whatever level of granularity is appropriate, and
- ⤴ Expose all functions involved in the making of the service, including those that are central to IT (the direct processes) or ancillary and enabling (the indirect processes).

This recipe exploits such features not only in its construction (an all-inclusive listing of direct and indirect processes), but also by recording which delivery actor will be responsible for the performance of each process. For example, if architecture and engineering are to be retained

by the customer, but acquisition, configuration and deployment are to be sourced to one or more suppliers, then the names of such delivery actors would be associated with those processes. Likewise, the delivery actors responsible for approving invoices, managing contracts and reviewing service level reports would also be recorded.

So, if sourcing customers typically don't have their retained functions documented, how can they be identified? Easy, by recording the contractually committed scope of work assigned to a supplier that is to operate in the relevant space (e.g., centralized compute, LAN, desktop). Those processes listed on the value chain that have not been delegated to the supplier can be assumed to either be performed by the customer or by another supplier courtesy of some other sourcing transaction. After exhausting the processes that are assigned to all such suppliers, the scope of work retained by the customer will be exposed. The result is a delivery model that describes the allocation of process responsibility across the breadth of the value chain to all delivery actors – external and internal.

Supplier Scope Per Contract: (sample)

Governance and Leadership			Service Management and Integration						Service Delivery																			
IT Management	Client Relations	Enterprise Architecture	Delivery Strategy	Sourcing Strategy	IT Finance	Actor Management	Portfolio Management	Domain Architecture	Process Architecture	Standards	Solution Requirements	Service Management	Security Management	Program Management	Solution Formation	Infrastructure Engineering	Software Engineering	Quality Assurance	Client Support	Acquire	Deploy	Maintenance	Software Maintenance	Operations	Service Support	Security	Logistics	Project Management

Customer Retained Scope By Implication: (sample)

Governance and Leadership			Service Management and Integration						Service Delivery																			
IT Management	Client Relations	Enterprise Architecture	Delivery Strategy	Sourcing Strategy	IT Finance	Actor Management	Portfolio Management	Domain Architecture	Process Architecture	Standards	Solution Requirements	Service Management	Security Management	Program Management	Solution Formation	Infrastructure Engineering	Software Engineering	Quality Assurance	Client Support	Acquire	Deploy	Maintenance	Software Maintenance	Operations	Service Support	Security	Logistics	Project Management

As the focus here is on the customer's operation, the delivery model can be improved by being more specific about the various internal groups that are actually going to perform the processes. So instead of a process owner being described as a single whole customer, the specific business units, departments or other groups can be identified to describe more accurately either the existing As-Is configuration or the preferred future To-Be configuration.

Once the processes the retained organization must perform and the individual functional entities within the organization that are responsible for doing so are identified, the next step is to determine which of the retained processes need to be developed/revised. We can map each retained process based on its importance and its current level of maturity. Low importance processes are unlikely to need modification regardless of their level of maturity, and processes

that are most mature also need no modification. That leaves the medium- to high-importance processes that are low- to medium-maturity as the targets for improvement:

Improvement Priority	H	H/L	H/M	H/H
	M	M/L	M/M	M/H
	L	L/L	L/M	L/H
		L	M	H
		Process Maturity		

Again, a value chain can be useful, as it can be used to record an assessment of the operation's ability to perform each process at the level of maturity believed necessary under the circumstances. The result is a maturity model that expresses, for each process, both the current level of maturity and, to the extent it is believed inadequate for the new world, the speed at which the shortfall is to be overcome.

With the delivery and maturity models in hand, it is now possible to identify the:

- ⤴ Scope of work associated with the retained operation
- ⤴ Specific internal delivery actor responsible for performing each retained process, and
- ⤴ Retained processes that require a boost in maturity level and the desired speed of doing so.

Such information can then be used to prioritize the development/revision of how the retained processes are to be performed. While some value chains provide detail regarding the activities associated with each process (to avoid ambiguity and eliminate gaps/overlaps), they typically don't provide the level of detail necessary for personnel to understand *how* to perform the process. For example, the process of preparing fruit may include the activities of washing and slicing, but how each of these activities is to be performed is not defined. Is the washing to be done with warm or cold water and with or without some kind of cleansing product? Is the slicing to be done with an appliance that performs many cuts on an automated basis or manually with a certain type of knife?

Typically, policies and procedures describe *how* the work is to be performed. The need, as it pertains to the retained functions, is no different. Similarly, to the extent that tools like templates, spreadsheets, forms or even applications are needed to help enable the processes, they too must be taken into account and developed, purchased, revised and implemented as necessary.

Finally, to ensure a solid understanding of how the processes are to be performed, training material to impart the necessary information will need to be developed and rolled-out. As usual, the training should take into consideration the capabilities of the personnel who are to perform the functions, as well as provide the context for the use of the new processes.

Jobs

Jobs is about developing the job groups and/or individual jobs associated with the functions to be retained, the number of personnel, the location of work and the manner of job change.

So now we know what needs to be done and which functional entities within the company will do them, but, ultimately, individual tasks need to be performed by people. The next step is to break the activities contained in the processes into jobs to be performed by individuals.

Informed by the delivery and maturity models, the underlying work associated with the retained processes needs to be allocated into the discrete job groups and/or jobs designed to optimize the performance and management of such work, as well as to ensure there is accountability and that checks and balances are built into the overall system.

Both an enumerated list of the activities that comprise each process and the method of how the processes are to be performed are invaluable for understanding the retained processes. Based on such information, the activities of a process or group of complementary processes can be separated or aggregated as necessary to achieve the desired outcomes. By recording the processes associated with each group/job on a value chain, a jobs model is created that can be used to ensure there are no gaps or overlaps of duties.

The heavy lifting of documenting the activities associated with each group/job can be reduced by leveraging the descriptions of the activities associated with each process. The job activity descriptions can be transformed into position descriptions by appending the relevant attributes (e.g., skills, education, and work experience) required to perform the jobs, based on the manner in which the processes are expected to be performed. So our fruit preparing process might be modified to be part of a job description for a *sous* chef by including other relevant food preparation processes (vegetable preparation, meat preparation, etc.) and descriptions of required skills, degrees or levels of work experience.

For each job group, it is also important to determine the primary work drivers. For example, if the job group pertains to the management of IT's relations with its clients, then knowing the number of business units and their locations would certainly drive the amount of work the group will need to perform. By coupling the work drivers with the work locations, the customer's design standards for managerial/supervisory loading can be applied and estimates made of the number of FTEs required for the retained operation. As more precise views of how the processes are to be performed are developed, the estimates can be refined into more accurate numbers.

With a known target of groups/jobs, the customer can assess its applicable personnel to determine:

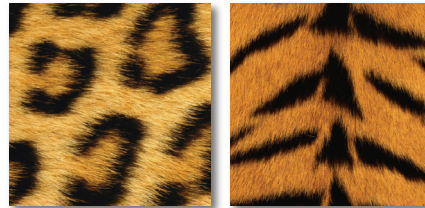
- ⤴ The extent to which the jobs can be filled from among the existing personnel – both with and without additional skills training
- ⤴ The jobs that will have to be filled via recruiting efforts, and
- ⤴ Whether an excess of personnel will exist following an outsourcing and how that will be handled (e.g., transferred to a supplier via an in-flight transaction, redeployed elsewhere in the enterprise or severed).

Although anything may be possible when it comes to human behavior, most businesses are aware of the complexities of implementing change that is highly personal to its employees (i.e.,

change is always hard, but change of a person's skills, outlook and purpose is like no other). Despite such knowledge, a large percentage of sourcing customers still insist that the best way to remain in control of outsourced work is to retain the former managers of such work and refocus their role to one of *managing* the supplier. One supposes that doing so is with the best of intentions to mitigate the risks (real or perceived) of an outsourcing, but the outcome is nearly universal – those who managed the personnel who used to perform the work can't help but continue trying to do so. So much so that it's one of the top complaints of suppliers, who describe the negative consequences of a retained organization constantly looking over their shoulders, telling them how to do their job or, worse, building shadow organizations to perform the same functions that have been outsourced.

The expression that leopards can't change their spots couldn't be more apt. Although almost everyone can adapt to *small* changes, there appears to be some force of nature at play that causes otherwise rational people to act contrary to their new role when the change is *large*, including those who have undergone training and formal job change. Whatever the reason, the former managers of outsourced work can't seem to let go. In some ways, it's just like the ex-manager of a group that offers to stay around for awhile to *help* his or her replacement with the transition. The replacement manager soon learns that the benefits are, at best, slim and not worth the trouble it causes in gaining their employees' or peers' trust, confidence and allegiance.

While anything is possible, the shift from managing internal resources to an external outsourcing supplier is enormous. At root is the underlying skill sets which are *vastly* different from one another. The best quarterbacks rarely make great coaches and it would be difficult, if not impossible, for a skilled cricket player to successfully manage an American baseball team even though the players are using the same basic skills of pitching/bowling, batting and fielding. By remaining either sympathetic or unrealistic regarding those who possess skills that are not appropriate for managing suppliers, the historical result of asking such personnel to trade in their spots for stripes is usually disastrous for all involved. As such, we recommend either moving such personnel to jobs/groups that require their skills or ensuring they are moved far from the outsourcing.



In any case, based on the results of the personnel assessment, training material can be developed and implemented for the additional skills that will be required to redeploy some of the existing personnel to the new jobs.

Organization

Organization is about developing an organizational structure that enables the retained job groups and describes both the allocation of responsibility to the internal actors and to the key interfaces with the external delivery actors.

After identifying the retained processes and structuring the jobs to be performed by the personnel in the retained organization, the next step is to design the retained organization itself.

Informed by the relevant factors (e.g., existing structure of the IT domain, existing allocation of responsibility to other domains, new delivery model, leadership's preferences, number of retained resources, number of suppliers), a target organization structure can be developed by traditional design methods, coupled with the best practices found among sourcing customers who have successfully made the transition from managing internally delivered IT services to managing external service providers.

Setting aside the numerous possibilities for assembling the retained functions in ways that will enhance the overall effectiveness of the IT organization, much of the discussion, and oftentimes heated debate, will revolve around how to handle those functions that are in support of IT, yet not typically considered IT (e.g., supplier relationship management, commercial management, budgeting, forecasting, invoice handling, HR management, compliance management).

Most of these support functions exist, to some degree, even when IT is performed exclusively in-house. However, the introduction of an outsourcing raises the level of complexity among such support functions significantly. Even for a modest outsourcing, say desktop and associated user services, there is a considerable difference between how these support processes are performed in the "before" and "after" scenarios. Take, for example, the invoice handling function for desktop purchases in an in-house operation versus an outsourced operation. The review and processing of invoices for desktop purchases in the in-house operation is relatively simple and straight-forward:

- ⤴ The number of units purchased multiplied by the unit price of each item, plus
- ⤴ The fees for configuration and installation services, if applicable, plus
- ⤴ Any warranty or support charges, if applicable, plus
- ⤴ Shipping, handling and taxes.

This function becomes substantially more complex when performed in the context of an outsourced desktop services operation. That's because the charges for the desktop purchases are oftentimes a subset of the supplier's monthly charges and to be separately identified must be disentangled from the supplier's charges for other outsourced desktop services. It is likely that the outsourcing agreement's pricing schedule contains numerous (possibly dozens of) pricing elements and formulae, not to mention separate fixed and variable components, categories of pass-through expenses, COLA adjustment mechanisms, service level credit and earn-back mechanisms, and a rate card for out-of-scope work. The bottom line here is that the performance of even a relatively simple support function is made significantly more complicated when those functions are carried out as part of a complex outsourced services arrangement. The more complex the outsourcing arrangement, the more complex the support function will be.

The reality is that the traditional methods used for the support processes of an in-house operation do not translate well to what is required for an outsourced operation. Yes, the support functions are likely all there today, but not in a sufficiently robust form to support a targeted outsourcing service, much less a complex multi-sourcing or large-scale, multi-tower sourcing to an integrator.

The solution, of course, is to adapt the processes and skills of those performing such support functions to the degree required. The question then becomes how to implement the results organizationally:

- ⤴ Should they fully reside within IT as they pertain to IT? If so, should they also reside within other domains to the extent they too choose to outsource?
- ⤴ Should they reside within IT, but report directly to other domains that have more relevant expertise (i.e., dotted line to IT and solid lines to other domains)?
- ⤴ Should a new domain be developed to house the support functions (e.g., a center of excellence)?

The answer, of course, is that it depends on the circumstances and preferences of the stakeholders – and that means the politics will need to be considered and weighed in the final organization design.

While the overall structure of the organization is a key design element, it is also important to address the features of the various groups it is to house. Obvious, but hidden in plain sight, is the truism that most operations, including IT, are organized around the various things (nouns) they are charged with designing, building, operating, maintaining, etc. That's why we end up with groups with names like Network Data Operations, Mobility Services and Unix Server Operations. Although not perfect, this type of organizational design has adequately served those that have kept IT in-house. In short, *specialization* through narrow focus.

In organizational design terms, the use of noun-based slices is considered a *vertical* orientation and while it can work quite effectively when the output of a group is largely self-contained (i.e., limited inputs and outputs to other groups), it can create drag and inefficiencies when the number and importance of its interactions with other groups increase – so much so that the term “silo” was coined to describe its detrimental effects.

It is both interesting and ironic that the IT outsourcing industry has used *towers* of service as an organizing mechanism. While it may be useful as a method for aligning the supplier's service proposals with the customer's internal organizations, it has an unfortunate side effect on the customer's retained operations, which typically are more process-oriented than technology platform-oriented.

If the functions retained by the customer are more process-oriented than technology or platform oriented, then it behooves the customer to reorganize its retained organization to reflect more of a process orientation. If, instead, the customer's retained organization is organized around technologies or platforms, its operation will be inefficient (due to the duplication associated with replicating the same process expertise and resources in multiple organizational units). Problems are also likely to occur as the same process is performed differently in the different technology or platform organization units. If the same supplier is responsible for providing the services across these different service towers, the lack of process consistency and standardization among the towers will create integration challenges for the supplier and adversely affect the supplier's performance.

A revised organization structure can help mitigate some of the risks, in particular, by recognizing and taking into account the shift from a technology focus (nouns) to a process focus (verbs). As silly as this may seem, it is powerful notion that can help drive home the point of what the retained organization is tasked with doing and assist with its transition. As such, the organizational design effort should not only consider the larger buckets of work in which the various job groups reside, but their names and charters as well.

As the major outcome of this work is a new organizational design, the scope must also include the corresponding organizational change. In general, the change work will involve the development of a communication plan for the various groups of personnel that will be impacted, directly or indirectly, by the various changes (i.e., process, job, organization), as well as the overall coordination of the implementation of such changes.

Manage

Manage is about orchestrating the manner in which the customer's operation interacts with and manages its suppliers.

So now we've reached the point where we know what the retained organization needs to do, the jobs that are involved and how the retained organization will be structured. That means we're finally ready to look at how the re-designed retained organization will manage the provision of IT services in the outsourced environment – those provided by the suppliers and those provided by the retained organization.

Absent this component of work:

- ⤴ New ways to perform the retained processes will be developed by the Process component
- ⤴ New job groups and/or jobs will be defined by the Job component, and
- ⤴ A new organization structure will be developed by the Organization component.

But still missing would be the solution or strategy for how to best use the new processes, jobs and structure to manage a supplier. It would be just like a professional football team where each player knew their assigned role and possessed the requisite skills, but there weren't any pre-set plays. Sure, the players might align themselves in the right positions, but once the ball was snapped, each player would do what he thought was best given the circumstances and the result would be something less than desired. The same is true for most businesses. Employees don't perform all of their assigned activities on a continuous basis, they perform them at a time and in a manner consistent with what others in the organization are doing so they can optimize and coordinate the overall outcomes.

The same should be true for that part of a customer's operation that is focused on interacting with an outsourcing supplier. The underlying policies, procedures, tools and systems could all be in place, but absent a solution for how, where and when such features are to be used, the management of the supplier would likely be less than optimal. By analogy, it would be like a supplier's response to a customer's set of service delivery objectives consisting of nothing more than the continuation of what the customer was already doing. Customers, more often than not, want their suppliers to bring solutions that solve problems and improve things, not just perpetuate the past. So, just as an on-the-ball supplier would develop solutions that change the way the various levers of IT produce and deliver the customer's desired objectives, customers need to develop solutions for how to perform their collective retained functions – technical, non-technical and support-based.

In the context of an IT operation comprised of internal and external delivery actors, it would be both difficult and ill-advised to segregate the functions so as to suggest that only one set of actors or another is responsible for *all* of the desired outcomes (this is not to imply that suppliers should not be held accountable for *some* desired outcomes). In this regard, a partially

sourced operation is no different than one that is fully internal – all of the pieces must be present and working in synch with one another. So while the natural inclination of customers is simply to add a supplier management organization into the mix, unless that organization is appropriately linked into the rest of the operation, doing so would effectively create a mini-silo within the organization.

Conventional wisdom suggests that the best interactions with suppliers are those that mimic the interactions with the personnel who performed the functions on a pre-sourced basis. “But,” you say, “that’s why customers use the subject-matter experts who were responsible for managing those functions before the outsourcing. I thought you said those people didn’t have the right skills?” And we did.

So let’s look at how such personnel were *actually* managed before the outsourcing. Interestingly, such management is quite diverse:

- ✦ The employee’s immediate supervisor and manager – who traditionally cover the technical aspect of their work (i.e., the product or service)
- ✦ HR – who manages how the employee is to be measured and compensated
- ✦ Finance – who manages how the employee’s out of pocket expenses are reimbursed
- ✦ Procurement – who manages how the employee obtains items required to perform their work
- ✦ Security – who manages how the employee gains access to their place of work
- ✦ Unions/Works Councils – who might manage aspects of how, when and where the employee performs their work and at what rate of pay
- ✦ And the list continues...

No wonder the technical subject-matter experts get overwhelmed – their relationship between all of those other “management” functions and the supplier is either gone or has been radically restructured by the outsourcing.

On top of that, while the nature of a commercial relationship is different than one with employees, the management required is no less diverse. There’s still management of technical work, management of performance, management of compensation, management of procurement, management of security, management of the commercial terms, etc. The difference is that the level of complexity of how the management is performed is far greater, as there is neither a catch-all condition like “...and other duties as assigned” or the doctrine of “employment at-will” that can be relied upon to quickly produce the desired outcomes.

The good news is that a fully developed IT value chain will not only identify the processes that collectively form such management, but also the underlying work activities for each process, including those appropriate for the handling of external actors. As the Process component deals with how such activities will be performed, the Manage component describes how the retained processes will *interact* with the service provider’s processes.

As we discussed in Part I, customer-supplier interactions are frequently collectively called “governance” and governance has not been terribly effective at accomplishing its goals. Why? Because it’s generally defined too broadly and considered more art than science. As such, governance has been implemented and practiced with a less than enthusiastic spirit. So why does it perpetuate? Some suggest it’s because nothing better has come along. Cynics say it’s

because suppliers would rather be governed than managed. Still others say it's because that's the way it has always been done. It's amusing to note that, while "management" is a well-defined, well-understood, multi-pronged activity when it comes to internal resources, somehow "governance" – an ill-defined, ambiguous term – is all the rage for dealing with external, outsourcing-based services.

Regardless of the rationale for what has occurred historically, the question becomes what to use going forward. If employers the world over have been using a comprehensive set of techniques to perform the management required of their operations and such management processes were roughly similar to the management processes required for external entities, wouldn't leveraging the former for the latter be appropriate?

In reviewing the basic techniques used to produce and manage the work of employees or, maybe more importantly, the internal business units, cost centers or other groups in which employees are present, one would typically find 4 levels of activity consisting of:

- ✧ Discrete Activities – The specific work actions (e.g., engineering, coding, monitoring, repairing) that result in the goods or services that are the main output of a job or group
- ✧ Process Interactions – Where process owners interact with one another in the normal day-to-day operational sense
- ✧ Meetings – Where multiple process owners and other stakeholders meet routinely or on an ad hoc basis to review prior results, discuss issues/problems, document agreed-to changes, plan for upcoming changes, etc., and
- ✧ Committees – Where selected individuals participate in pre-defined groups that perform oversight, establish new strategies and address matters that cannot be handled by the process interactions or meetings.

Although the vast majority of the work occurs at the discrete activity level, management (and major headaches) occurs among the other levels. At these levels we find that some of the processes performed by an operation will pair naturally with other processes. As a result of such interactions, various information, preferences, requirements, mandates, problems, solutions, etc. will be shared and the manner of how/when the underlying work will be performed becomes identified and established. The owners of the paired processes, including others with a vested interest in the subjects, will meet on some recurring (monthly, quarterly, etc.) basis to recap the results of the prior period and possibly make adjustments to how things get done. Decisions or issues that can't get made/resolved by the paired process owners are typically escalated to other groups for review and resolution. Such other groups also meet routinely to review the results of the operation and determine what changes they would like to see implemented. In short, management.

In contrast, the governance structure typically implemented by the contractual mechanisms underlying outsourcings, calls for a series of committees (e.g., senior leadership committee, executive steering committee, technology architecture committee) that, based on a schedule of meetings, list of participants and charter of activities, are to guide all aspects of the customer-supplier relationship (technology, change, financials, commercials, etc.) over a multi-year timeframe – a lifetime when measured in IT terms.

What seems to be missing from the traditional outsourcing "governance" model is the recognition of how work and its management occur in typical corporate settings. Borrowing

from the 4-tier model described above, the work, as it pertains to outsourcing, would be described as follows:

What	Who	How
Discrete Activities	Individuals or Departments	Separately by customer and supplier
Process Interactions	Process Leads	Together by customer and supplier
Meetings	Process Owners	Together by customer and supplier
Committees	Select Individuals	Together by customer and supplier

The model above describes the collection of work as being spread out and performed by various individuals for different purposes. Simply constructing committees to sit atop and “govern” neither recognizes how work gets done nor how it is managed. Likening the sole use of committees to a football team’s exclusive use of zone coverage, what becomes instantly obvious is the benefit of man-to-man coverage, as well as the contributions required at the individual level.

Here too, a value chain can be of real benefit. In addition to allocating responsibility for performing each process to the applicable delivery actor, a value chain can identify the natural process pairings that will form the key interactions between the customer and its supplier, as well as the requirements (e.g., where, how often) for such interactions. Examples of the pairings include:



The recurring meetings necessary to establish and maintain the relationship in concrete terms as it pertains to topics or events that are the lifeblood of an outsourcing, along with the relevant descriptions, attributes, agendas, inputs, outputs and decision-making to be used in such meetings, can be identified and documented. Examples of such meetings include:



	Customer	Supplier	Comments
Oversee	Business Meeting		Financial and commercial review/change
	Performance Meeting		Performance review/change
	Service Delivery Meeting		Service delivery review/change
	Pipeline Meeting		Review of T&T, BAU and new requirements across the lifecycle of change

Similarly, committees with charters to appropriately review and advise regarding the core operations, resolve disputes that cannot be worked out within the core or infuse the core with new strategies, directions and methods, can be identified and documented. Examples of the committees include:



	Customer	Supplier	Comments
Resolve	Dispute Resolution		The formal process described in the services agreement
	Actor Disagreement & Dispute Forum		The informal operational process of hashing out concerns
	Escalation Committee		Makes decisions when others can't
Direct	Mission/Vision/Innovation Committee		Tops-down infusion
	Technology/Services Committee		Bottoms-up review, consideration and approval of process-driven change

While there is no guarantee of success, using the appropriate mix of “man-to-man” and “zone coverage” when designing how work will be performed and managed in an outsourced environment brings the framework, methods and practices of what is already well established and successful to the party.



About Pillsbury

ValueChain

Pillsbury began using value chains for outsourcing transactions in 2002 when we crafted our first statement of work describing the supplier's (and customer's) responsibilities in the form of a series of intersections comprised of the relevant processes and technologies underlying the outsourcing. As our system of using a value chain and a technology tree structure was new and innovative, Pillsbury applied for and was granted a patent for the business method known as ValueChain (U.S. Patent No. 7,308,414).

Over the ensuing years, we have enhanced our value chain approach to take into account the strong acceptance of ITIL and other standards bodies (e.g., ITGI, PMI, SEI) by the IT community, as well as our customers' need for the development of IT delivery strategies and solutions for their retained operations that are responsive to their complex environments.

Currently, Pillsbury's IT value chain contains 104 processes that are organized in a 3-tier model describing the service delivery, service management & integration, and governance & leadership functions. Each of the processes is fully defined using language that is not only contract-ready, but accepted by the world's leading outsourcing suppliers.



PGS

Pillsbury Global Sourcing (PGS) pioneered the earliest IT outsourcing transactions over 20 years ago, and since then has expanded its practice to help clients determine how to best deliver, and if applicable, source their back-office horizontal functions (information technology, finance and accounting, human resources, real estate, supply chain and procurement). The group has performed over 500 transactions collectively valued at over \$450 billion.