

Arc Horizon



An Arc Partners, Inc. Publication

Special points of interest:

- A Different View of Outsourcing
- The Sourcing Management Office
- Sourcing Management Lifecycle
- Valuable Sourcing Assets
- Feature for online readers*

* If you use Adobe Reader, you can now navigate the newsletter by clicking on entries from 'Inside this Issue', 'Continued on... Continued from...' notations, or 'Special Points' above.

*Sourcing...
places internal
operations in
direct competition
with external
vendors...*

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Featured Article

Changing the Outsourcing Concept

Several of our clients have requested that we evaluate the current state of their outsourcing practices versus industry best practices and help them answer a common question, one that has plagued companies since the inception of outsourcing: "Why are we not seeing the kind of returns we expected?"

Clients also ask us to help them achieve better results by applying our comprehensive sourcing methodology to improve the suc-

cess rate of their sourcing initiatives.

There is an important difference in the Arc Partners Sourcing Methodology, a difference that is reflected in its name... We do help clients understand which processes and services are good candidates for **outsourcing**, but we also help them objectively evaluate and identify the organization, **whether internal or external**, that can meet or exceed performance requirements in the most cost effective manner.



By performing such an evaluation, effective 'sourcing' rather than outsourcing, is the focus.

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Leaders' Notes

Special Edition: Sourcing

Over the past decade, six economic, business, and technology forces (see inset, this page) have converged to enable companies to realize extraordinary value from BPO and IT outsourcing initiatives.

The near-universal response to these forces by most business and technology leaders has been to enthusiastically seize upon the concept of outsourcing.

However, as the experience base around outsourcing matures, organizations are coming to realize that in many cases blind adherence

to an outsourcing credo leads to as many problems as solutions.

Yet, with all of its problems, outsourcing's core principles continue to hold true—there are still many valid reasons to outsource—and the rewards can be substantial for those who do it the right way.

In this Special Edition of Arc Horizon we focus on how we help our clients do it the right way.

Our **Featured Article**, *Changing the Outsourcing Concept*, discusses changing the conceptual basis of outsourcing by **allocating the per-**

formance of work to the entity best suited to do the job, whether internal or external. Arc Partners does this by applying a Sourcing Methodology which can help companies objectively evaluate the feasibility of BPO or IT services outsourcing based on strategic value and risk management factors. In this article we show how we accomplish this with many of our major clients.

The **Inside Story** *Managing the Sourcing Lifecycle*, highlights use of a relatively new management tool we call the Sourcing Management Office.

And finally, in **Consultant's Corner**, we reflect on the intrinsic value of a company's most essential sourcing asset—people.

We hope you enjoy the newsletter and benefit from the experience of our consultant/authors. As always, if you, like many of our clients, are facing some of these important issues, we're here to help.

— *Brendan O'Sullivan, Don Harder and John Marinelli are Managing Directors at Arc Partners*

Forces Driving Industry Towards Outsourcing

- ◆ **Trade globalization;** and more recently, globalization of trade in services.
- ◆ **Business-friendly climates;** countries are easing regulations, offering tax incentives, and trying to attract foreign investment.
- ◆ **Growth of the offshore labor pool;** the number of highly trained technical workers has surged.
- ◆ **Software commoditization;** the standardization of development practices and tools has turned development into a commodity, and made the transfer of development a feasible practice.
- ◆ **Drop in telecom costs;** Voice-Over-IP and other technical innovations caused communications costs to plummet, in some cases, by as much as 80-90%.
- ◆ **Wage differentials;** the level of economic development in many emerging economies enables firms to attract highly skilled employees at lower wages than is feasible in more developed countries.

Inside Story

Managing the Sourcing Life Cycle: The Sourcing Management Office

Origin and Purpose The Sourcing Management Office (SMO) concept resulted from the success of its older sibling, the Program Management Office. The two look and work very similarly, except that the SMO focuses its support on one core operational function—sourcing—as opposed to being instituted for the broader purposes of optimizing project performance and improving project management capability.

An SMO is often established with a relatively narrow organizational mandate, i.e., to manage BPO or IT-related outsourcing, but as the organization begins to realize benefits from an SMO it may eventually be extended to involve other kinds of sourcing; it can help an organization evaluate the effectiveness of its processes and functions and make recommendations for assigning the performance of work to the

organization best suited to do the work, whether internal or external.

When taken to its logical conclusion, an SMO can become a crucial element in a company's process improvement cycle. (E.g., a potential outsourcing opportunity is evaluated and a determination is reached that internal retention is preferred due to high-risk factors; but before the value of the internal solution can be achieved a sub-par process must be optimized. In this case, the SMO might hand-off the group and its broken process to the firm's internal process improvement facility for re-fitting.)

The SMO and Governance Governance is the single most important factor in successful sourcing. Sourcing governance provides structure, assigns decision-making authority and provides guidelines for the management of internal and

external resources. This is generally assured through the effective management of the Sourcing Lifecycle.

The Sourcing Lifecycle The SMO manages a five-stage sourcing methodology, containing processes, templates, and operating guidelines (see diagram on facing page). A key aspect of the methodology is the development and maintenance of a **Sourcing Strategy** which helps a company determine what its core processes are so that non-core processes can be definitely slated for external sourcing or internal optimization through the Sourcing Opportunity Initiation stage. The strategy clarifies management's rationale for sourcing, making decision-making faster and more efficient.

Sourcing Opportunity Initiation (Stage 1) provides an objective evaluation of the practicality of

sourcing a process, function or service. This stage also determines organizational and functional readiness for sourcing transition. Sourcing an IT service may be practical and desirable, but if the service cannot be accurately measured, an objective apples-to-apples comparison cannot be made, and the service is not ready to be outsourced at this point; there is no baseline with which to set Service Levels, so any decisions made are, at best, guesses, which is not a sound way to manage sourcing relationships.

Preliminary Financial Analysis (Stage 2) In many cases, financial analysis is the end-all-and-be-all of a firm's sourcing decision-making process; yet as important as financial considerations are, they cannot alone determine the likelihood of success in sourcing. The Arc Partners Sourcing Methodology provides a means for objective comparison of internal operational baseline cost with that of a potential vendor. The resulting financial analysis becomes an important part of the sourcing evaluation, but it is not the deciding factor. Arc Partner's rationale in developing its methodology this way

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Key Benefits of an SMO

- Enterprise-wide alignment of sourcing activities
- Increased management visibility and control over sourcing
- Provides clarity in roles and responsibilities for sourcing
- Provides well-defined procedures, guidelines, tools and templates and provides guidance to Project Managers and others executing sourcing-related activities

Consultant's Corner

Your Most Valuable Asset

"...only people have the ability to compensate for deficiencies in a firm's computer and technological systems..."

When considering a firm's most valuable assets, many companies only consider their brand or reputation, customer loyalty, or computer and technological systems. To do so is to err, for one ignores what may be the firm's most flexible and valuable 'system' — its human capital system.

Only a human capital system is capable of generating new ideas and thinking "outside the box." People create a firm's reputation, infuse its brand with value; and unlike any other asset, only people have the ability to compensate for deficiencies in a firm's computer and technological systems.

Organizations that fail to recognize the importance and potential of their human capital system potentially face a plethora of issues including low employee morale and lack of motivation. In engagements where outsourcing is the objective, this is one of the first things con-

sultants evaluate, because of its intrinsic importance to a successful result.

A consultant can tell upon beginning a new engagement whether a firm has a healthy attitude towards human capital or provides only lip-service to this valuable asset.

In an organization with an approach to human capital that is healthy, honest, and proactive, one can sense a feeling of dynamism, urgency, and excitement. There is a sense a dedication to task, a spirit of camaraderie, a feeling that goals can be achieved, and that competitors exist only to be conquered. This, obviously, is the best-case scenario for starting a sourcing engagement; however, even an environment such as this can be decimated by poorly-handled outsourcing decisions. Make no mistake, outsourcing can be extremely difficult and can tax a management team's business acumen and hu-

manity. No one looks forward to negatively impacting other people's jobs or lives. Perhaps this is why so many otherwise first-rate executives do it so poorly.

There are, however, steps that can be taken in an outsourcing scenario that can alleviate the stress, anxiety and pain:

1) Don't Allow Legal Concerns to Design any Reduction in Force.

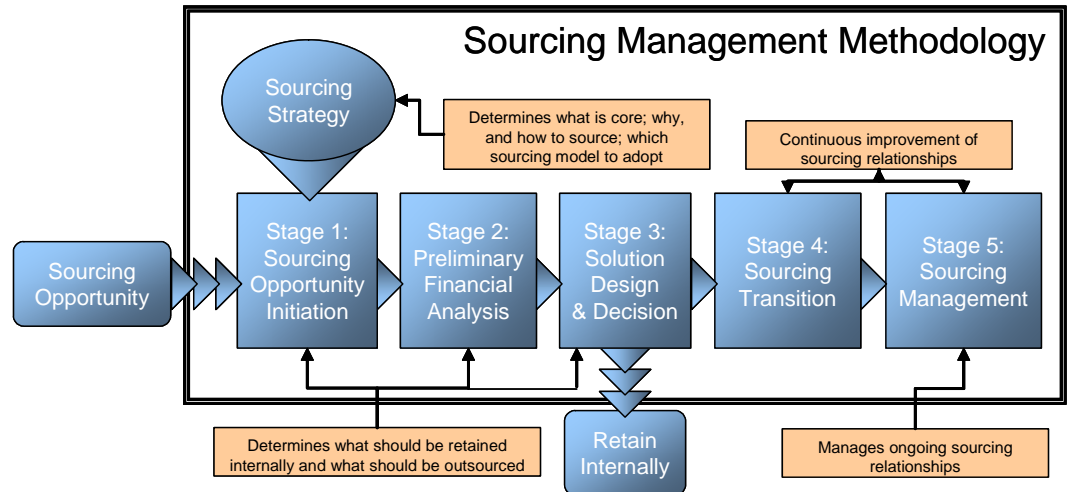
There are many ways to handle force reductions and outsourcing staff changes. These kinds of decisions should be based on an analysis of business needs, not on some ruthlessly expedient plan designed to keep the company out of court. The Legal Department should be included in the process, but should not be making the decisions.

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originated from our client's experiences when using only financial evaluation. In many cases, outsourcing failures were the result of non-financial causes that ultimately wiped out any potential financial benefit. So our methodology attempts to ensure that such factors are eliminated in the initial evaluation.

Solution Design & Decision (Stage 3) is where the rubber meets the road and decisions are made as to the future location of the work being evaluated. The decision-making process helps clients select from among four key alternatives; in-house or outsource, offshore or domestic. 'Outsource' says nothing about where the work should be located (except that someone else can do it more efficiently), and 'offshore' does not necessarily indicate an outsourced solution (many companies have captive resources in offshore sites). The solution design presents management with sufficient information to make an informed decision regarding internal or external source, and if external, provides recommendations on vendor selection and provides contracting/negotiation assistance. And as mentioned earlier, with maturity



the SMO can even become a key input into a company's Business Process Management capability by referring 'retain internally' decisions to BPM process improvement, where appropriate.

Sourcing Transition (Stage 4) Presuming an outsourcing vendor is selected in the previous stage, Stage 4 manages the processes surrounding transitioning the work to the selected vendor. It provides guidelines and templates to manage the transition as well as

guidelines for setting up a successful sourcing relationship.

Sourcing Management (Stage 5) provides guidelines for managing the sourcing relationship, dealing with service discrepancies and escalation procedures, improving processes, optimizing the outsourced function, and vendor evaluation. Finally, since all things must end, the methodology also deals with the issues of in-sourcing and/or bringing the vendor relationship to a close.

Conclusion The Arc Partners

Sourcing Methodology is a comprehensive sourcing lifecycle management tool that helps our clients finally achieve the results they had hoped for when they originally began their outsourcing journey. It is simple, flexible, and can be integrated with existing operations.

Its emphasis lies in placing work where it can best be performed, whether internal or external. This is the key that locks all other benefits in place. ☞

Changing the Outsourcing Concept—cont'd

(Continued from page 1)

Arc Partners conducts a structured interview and fact-finding process involving business and IT executives and managers to determine the current state of outsourcing practices, key business drivers, lessons learned from prior outsourcing initiatives, and which methodologies (if any) are currently in use. These interviews are documented and the root cause issues affecting sourcing success are identified.

Our findings are commonly indicative of situations that we observe with clients who have embraced outsourcing for both BPO and IT services;

- 1) Work is being outsourced without regard to whether initiatives are aligned with corporate strategies, and occasionally, to compound the oversight no outsourcing strategy exists. With no boundaries to guide their selection processes, every function becomes a potential outsourcing candidate — even core proprietary and mission-critical operations;
- 2) Evaluations are performed to determine **what to outsource**, without regard to **whether outsourcing is feasible** or even a good idea; e.g., little or no credence is given to determining whether, all things being equal, the job could be performed better internally or whether the risks involved in outsourcing a particular function are greater than commonly accepted risk parameters;
- 3) There is no clear process for making outsourcing decisions, little clarity around the roles and responsibilities involving outsourcing practices, and little guidance or support for those attempting to undertake this type of initiative;
- 4) Once transitioned, an outsourced function is treated like a foreign entity rather than a key part of ongoing business operations. Relationships with outsourcing

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"...what is really needed is not an outsourcing methodology, but a sourcing methodology. Outsourcing seeks to place work with a vendor, while sourcing seeks to place work, either internally or externally, with the organization that can meet or exceed performance requirements in the most cost effective manner."

Your Most Valuable Asset—cont'd

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2) Don't Wait Until the Last Minute to Talk to People.

Out of fear or guilt, many executives choose to give employees as little forewarning as possible. Many times they don't want to talk about possible outsourcing plans because they fear that good employees will begin to seek work elsewhere.

In reality, the opposite is true. People leave because they don't know what to expect, not because they have too much information. In the absence of information it is human nature for people to fill-in-the-blanks for themselves; usually inserting 'facts' that are much worse than the real facts.

3) Afterward, Act as if Nothing Has Happened.

Whether management talks about a difficult transition or not, employees will. And the more management tries to suppress these discussions the more subversive the discussions tend to become.

When management refuses to acknowledge what has obviously taken place, it appears emphatically heartless, usually leading to more filling-in-the-blanks... "After all, if management won't even talk about the obvious after the fact, what else

is it hiding?"

There is one important rule to keep in mind during outsourcing: *respect employee dignity*. No one enjoys outsourcing, but when it becomes inevitable, it can be accomplished in a way that minimizes problems and shows your people that they really are — your most valuable asset.

- Jim Longwell is a Senior Manager at Arc Partners. Opinions expressed in this article are entirely his own.

Changing the Outsourcing Concept—cont'd

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vendors are often strained, and more time is spent arguing over service agreements than improving operations.

These root causes frequently condemn a company's early outsourcing efforts to mediocrity, if not failure.

Most of our clients believe they need an outsourcing methodology and understand the benefits such a tool can bring. However, what is really needed is not an outsourcing methodology, but a **sourcing** methodology. The difference being, outsourcing seeks to place work with a **vendor**, while sourcing seeks to place work, **either internally or externally**, with the organization that can meet or exceed performance requirements in the most cost effective manner. This places internal operations in direct competition with external vendors. Over time, this service configuration will drive the optimization of well-managed internal operations and weed out weaker functions, while improving cost effectiveness and upgrading overall functional capability.

Creating an atmosphere of competition has additional benefits as well. In order to make an apples-to-apples comparison of internal vs. vendor operations, a company must be able to measure the effectiveness and cost of its internal operations. For many companies this kind of evaluation is die rigueur, however, many of our clients have emplaced only cursory measure-

ment capability, and use financial controls that tell them virtually nothing about the business value of operations.

Arc Partners has a structured, five stage sourcing methodology model which we can customize to effectively integrate with related client processes. The sourcing methodology includes two quantitative tools: a **sourcing opportunity evaluation scorecard** and a **financial analysis tool**. The scorecard enables the client to objectively evaluate the feasibility of sourcing any service or process based on strategic value and risk management factors. The financial analysis tool provides a cost comparison of the current internal baseline to a future-state sourced model, and accounts for planning and transition costs for external sources.

The sourcing methodology also provides clarity around the sourcing process, from identification of a sourcing candidate, through the decision and selection processes, into transition (or retention and operational improvement), and finally, it provides tools, templates, techniques, and guidelines for effectively managing the sourcing relationship.

To implement and optimize the sourcing methodology, Arc Partners usually recommends the creation of a Sourcing Management Office (SMO.) The SMO is responsible for the adoption and use of the sourcing methodology and provides governance and structure around sourcing decisions. The SMO also

provides ongoing training and expertise to assist managers with sourcing decisions and processes. (See *Inside Story* starting on page 2 for more information about the Sourcing Management Office.)

After we help our clients implement the Sourcing Methodology, they have a clearly defined framework with which to objectively evaluate the sourcing of processes and services. Client managers seem to readily understand the five stage sourcing methodology (processes and tools) and are effectively positioned to apply the methodology which will help them determine whether services should remain in-house or be outsourced.

Using the sourcing methodology, clients are able to align their sourcing initiatives with corporate

strategies and reduce risk by objectively evaluating sourcing feasibility.

Clients can further mitigate risk by establishing the Sourcing Management Office which will provide governance around sourcing decisions and ongoing sourcing operations management.

To learn more about how you can increase the success of your sourcing initiatives and improve your overall results, contact Arc Partners at (212) 370-9460, or e-mail us at:

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Rules for Successful Sourcing

- ◆ **You must have a sourcing strategy**
The complexity of sourcing and the pace of business change will whipsaw an organization without a comprehensive sourcing strategy, aligned with business and IT strategies.
- ◆ **You must have visible and transparent processes**
Sourcing has moved beyond discrete functions and tasks and into processes. If you lack a clear understanding of what your processes are, what they cost, who performs the work, how outputs are measured, etc., you will likely not be able to effectively source them elsewhere, nor will you be able to improve them internally.
- ◆ **Governance is the single most important factor in determining success**
Without sourcing governance in place to implement your strategy, enforce it, change it, and adjust it to market conditions, any strategy will be worthless.
- ◆ **Sourcing is built on a network of relationships, not transactions**
Success requires that you understand that you are entering a series of long-term, ongoing relationships with service providers that will be partnering with you to deliver business outcomes.
- ◆ **Sourcing requires creating metrics that matter**
Many service relationships flounder, not because of lack of metrics, but because of a lack of meaningful metrics.



"Transforming vision into profitable reality"

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Arc Partners was founded during a time of unprecedented business and technology change in the financial services industry. Our goal is to assist financial services companies in improving business performance through better management and application of technology.

We are a high performance management consulting firm that works with clients to ensure key business process and technology initiatives succeed. We don't do projects to our clients. Our combination of industry expertise and consultative skills allows us to creatively analyze fast-changing environments and recommend best-fit solutions.

Arc Partners has earned a reputation for high quality, value-added service. We perform multiple engagements for over 90% of our clients, reflecting their satisfaction with their service. We continue to expand, but pace our growth to ensure continued excellence in the quality of our work.

Arc Horizon is published quarterly by Arc Partners, Inc.. Special editions may be published intermittently as circumstances require.

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