

CHERUB

ADVISORY & CONSULTING
IT Sourcing for Maximum Value

Sourcing Management: What's the Problem?

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PREFACE

This paper is the first in a series of three Cherub white papers on the subject of Sourcing Management.

The three papers in the series are titled:

- Sourcing Management: What's the Problem
- Sourcing Management: Prepare for excellence
- Sourcing Management: Beyond Outsourcing

The series presents insights into Cherub thinking on the subject matter and précis our approach to helping our clients establish the mechanisms and disciplines necessary for effective management of sourced services.

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Introduction

The Australian market for outsourced IT services has grown significantly and matured since outsourcing gained wide-spread acceptance as an operational business tactic in the 1990's.

The pre-eminent IT industry research and advisory firm, Gartner, has forecast that the IT services outsourcing market (which represents the largest category of IT spending in Australia), is set to reach \$34.4 billion in 2019, an increase of 4.4 percent from 2018¹.

Outsourcing is also gaining increased acceptance in Australia for business functions beyond IT with Business Process Outsourcing forecast to expand significantly in the coming years.

In Australia, as in other countries, first generation IT outsourcing deals were mostly monolithic in nature. The contracts focussed on codifying what to do and how to do it. Typically, the deals were high dollar value, single vendor contracts for a range of bundled IT services over a long-term (5 years or more) contract period.

Dissatisfaction

These first generation deals often ran into problems over the life of the deal with the contracted work proving too inflexible to respond to changing business needs. The monolithic nature of the contract also made it difficult for individual service lines to be renegotiated or removed from the whole.

Those and other problems initially resulted in very high levels of dissatisfaction and disappointment with the outcomes of outsourcing.

In response to the problems and lessons learnt, a second generation of deals evolved.

Second Generation Sourcing Deals

These deals were outcomes focussed and began to move away from the constraints of the monolithic contract. Second generation deals no longer attempted to dictate what to do and how to do it to the provider. Instead, they focussed on specifying what was required in terms of service levels and performance outcomes, leaving it to the provider to determine how best to deliver to those requirements.

Enterprises also began to unbundle the service portfolio into discrete domains of service such as desktop services, service desk, applications development services, etc.; creating the option of awarding each to (potentially) different service providers. In addition, the contract period has in many cases been shortened to five years or less.

Unbundling the service portfolio allowed smaller, specialist service providers to bid for contracts; increasing price competition and providing an avenue for more tailored services to be sourced.

The multi-vendor approach has removed much of the inflexibility of the first generation deals. Shorter term contracts for individual service domains can be more readily renegotiated in response to changing business needs than can single-source long-term deals.

Too often however, enterprises found that second generation deals fell short of expectations. Providers often lacked incentive to innovate in ways that could grow the efficiency and effectiveness payback to the recipient enterprise if they could deliver the contracted levels of service without doing so.

In many instances problems emerged or were exacerbated as a result of service level requirements having been specified from an IT-centric perspective.

For example, service performance targets in relation to requirements for overall application server availability or first-call resolution of incidents by the service desk could be met but the business impacted adversely through an individual application server incurring excessive downtime or the root cause of incidents remaining unaddressed.

Third Generation Sourcing Deals

These and other lessons learnt have given rise to the current, third generation of deals.

Third generation deals remain outcomes focussed but provide mechanisms for the enterprise IS organisation to influence the way in which providers deliver services.

Outcomes are often expressed as a balance between the business and IT perspectives.

Business-centric service levels are supported by the more traditional IT-centric requirements.

Third generation deals are a hybrid of the preceding generations of deals and continue the unbundling of service portfolios and embracing multi-vendor scenarios that commenced with the second generation.

As a consequence of the second and third generation approaches, plus more mature and realistic expectations and objectives on the part of enterprises, satisfaction with service performance and deal outcomes has lifted.

Another contributor to this lift has been improved service delivery and client management processes on the part of service providers.

Despite this lift however, enterprises often believe they could achieve better results than

they have to date, and we at Cherub agree.

One contributing factor we see is that in a multi-vendor environment there is greater complexity in managing the relationship between the various external providers as well as between the providers and the internal service customers.

Service management is more complex and difficult by several orders of magnitude.

Enterprises have also realised that regardless of whether operating

with a single service provider or multiple providers, the contract alone is insufficient to ensure delivery of all desired outcomes and objectives. The contract must be supported through effective management of the sourcing arrangement on a holistic basis.

Ongoing Problem

However, our observations and experience tell us that to this day the scope of the sourcing management function is often not well understood by many enterprises.

All too often sourcing management is thought to be little more than some form of enhanced contract or management. Perhaps with a measure of vendor relationship management bolted on.

If enterprises do not fully appreciate the scope of the sourcing management function, chances are that they will do less than is required to fully manage their outsourcing deals.

At best, service users may be left dissatisfied with the services they receive. Worse still, deal-specific and sourcing strategic objectives may be put at risk and ultimately business strategic objectives compromised.

What do we mean by 'Sourcing Management'?

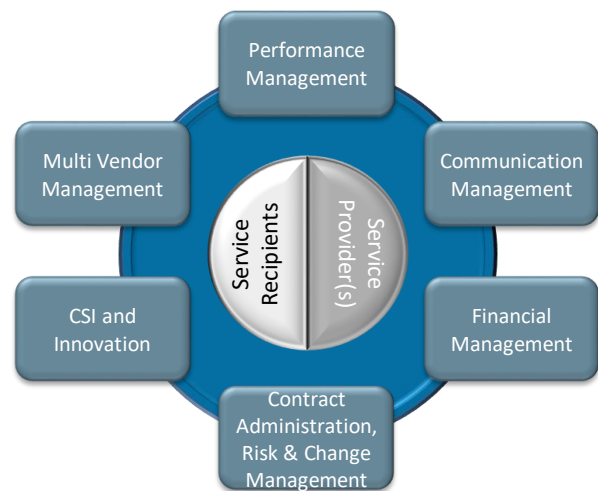
At Cherub we define sourcing management to be comprised of six primary capabilities:

- Performance Management;
- Communication Management;
- Financial Management;
- Contract Administration, Risk & Change Management; and
- Continual Service Improvement & Innovation; and
- Multi Vendor Management.

We believe the key to achieving excellent results from outsourcing deals and realising the enterprises sourcing strategy objectives is excellence in the discipline of sourcing management.

As Figure 1 illustrates, effective sourcing management interacts with and influences both the service recipient and the service provider.

Figure 1. Six Capabilities of Sourcing Management



We believe each of the six capabilities to be important and all must be present if enterprises are to succeed in realising maximum potential from outsourcing arrangements.

Unfortunately, a thorough discussion of each of the six capability domains is beyond the scope of this paper. As is detailing the full set of competencies, skills and levels of proficiency required for excellence in sourcing management. Nevertheless we do offer the following overviews of what we consider to be most important in each capability and some of the key competencies required. Please note that the lists of competencies are not intended to be exhaustive.

Performance Management

Performance Management is the process of actively monitoring, measuring, reporting and providing feedback on the quality, timeliness and levels of the contracted services.

Excellence in performance management requires a continuous and proactive approach. The goal is to promote service excellence from the provider.

It is not enough to rely solely on formal, periodic measurement and reporting of service levels in accordance with the metrics and reporting frequency laid out in the contract statement of works and service level agreements.

It is essential to remain balanced in the appraisal and to maintain awareness of the division of responsibilities between the enterprise and the service provider.

Key Competencies

- Investigative, analytical and interpretive competencies
- Numerical and statistical abilities
- Information and record keeping abilities
- Capacity for thoroughness and attention to detail
- Service domain knowledge – especially of IT service support and delivery process standards such as ITIL² and also of the IT systems deployed.
- Negotiation, mediation & conflict resolution
- Communication – aural, verbal and written
- Auditing abilities
- Constructive criticism – both giving and taking

Communication Management

The goal of excellent Communication Management is to foster and maintain a harmonious, collaborative and cooperative working culture between the enterprise's people and the service provider's people. The two sides, service provider and recipient, must be encouraged to come together and work as a single team.

An adversarial relationship is to be proactively guarded against and actively discouraged. History tells us that in the absence of highly competent communication management the two sides are likely to become increasingly adversarial over the life of the contract. A soured relationship will have unfavourable impacts on all aspects of the deal with direct cost to the enterprise.

The two distinct ways in which relationship management can influence the value equation is by creating value when the relationship is managed well, or by destroying value when the relationship is managed poorly. As found in a study by Vantage Partners et al³, at least 30% of the total outsourcing contract value is at risk if the deal is not well managed. In support of this finding, EquaTerra's 2007⁴ study found that organisations with more outsourcing experience tend to invest more in outsourcing governance, and these organisations are more satisfied with their outsourcing arrangements.

Key Competencies

- Emotional intelligence
 - Self-awareness
 - Self-management
 - Social awareness
- Leadership
- Negotiation, mediation and conflict Resolution
- Communication – especially aural and verbal

- Persuasion, influence and advocacy
- Facilitation
- Constructive criticism – both giving and taking

Financial Management

Financial Management is concerned with the ensuring the smooth and timely flow of quotations, statements, invoices, payments and remittance advices for services rendered by the provider.

In enterprises with a policy of recharging the business units for services they consume, the financial management function of sourcing management may also be responsible for supervision of that recharge process.

Awareness of, communication about and adherence to relevant policies and procedures is essential. So too is awareness, communication and adherence to the contracted requirements in respect of controlling the financial aspects of the agreement and of the respective parties responsibilities.

Excellence in financial management requires proactive monitoring of the processes concerned to ensure that queries or procedural delays emanating from either the enterprise or from the service provider are communicated immediately and resolved quickly.

Key Competencies

- Knowledge of financial accounting and accounting processes and procedures
- Numerical abilities
- Information and record keeping abilities
- Capacity for thoroughness and attention to detail

- Negotiation, mediation and conflict resolution
- Investigative, analytical and interpretive competencies
- Communication – aural, verbal and written
- Adherence to policies and procedures
- Auditing abilities

Contract Administration, Risk & Change Management

This capability deals with controlling and supervising the maintenance and execution of the agreement in accordance with the contract terms and conditions; including compliance monitoring and reporting.

The function also embraces negotiating, documenting and communicating any changes to contract sections such as statements of works, agreed service levels, financial arrangements, contract party responsibilities and general contract terms and conditions that may be required during the life of the agreement.

Excellence in contract administration, risk & change management is to avoid over-reliance on the codified content of the contract document.

An appropriate balance needs be found between reliance on and strict enforcement of the letter of contract on the one hand, and interpreting the spirit of the agreement on the other. It is more likely that allowing both parties sufficient but managed flexibility in keeping with the spirit of the agreement will result in the best possible outcomes than not doing so.

Excellence in the other four sourcing management capability domains is essential

to achieving excellence in contract administration and management.

Key Competencies

- Emotional intelligence
 - Self-awareness
 - Self-management
 - Social awareness
- Legal literacy and comprehension
- Knowledge of business and commercial practices
- Knowledge of applicable regulatory requirements and contract law
- Information and record keeping abilities
- Capacity for thoroughness and attention to detail
- Negotiation, Mediation and Conflict Resolution
- Communication – written, aural and verbal
- Adherence to policies and procedures
- Ability to identify risks and consider impact, likelihood and mitigation tactics
- Auditing abilities

Continual Service Improvement and Innovation

Nothing remains static. During the life of the outsource service agreement the business of the enterprise will change leading to changed service needs. Likewise, the service provider will change; new or more sophisticated tools and process will become available and component costs of systems and labour used to support and deliver the contracted services will change.

Continual Service Improvement and Innovation is about recognising and seizing opportunities for enhancing the efficiency and effectiveness of contracted services that changing circumstances may throw forth. It is

even more about encouraging and facilitating others, be they persons in the enterprise or persons from the service provider, to be continually on the lookout for such opportunities and to bring ideas to the table.

Key Competencies

- Emotional intelligence
 - Self-awareness
 - Self-management
 - Social awareness
- Leadership
- Lateral thinking
- Change catalyst - the ability to initiate, manage, and lead in a new direction
- Communication – aural, verbal and written
- Persuasion, influence and advocacy
- Facilitation
- Investigative, analytical and interpretive competencies
- Service domain knowledge
- Enterprise business value chain and process knowledge
- Negotiation, mediation & conflict Resolution
- Constructive criticism – both giving and taking

Multi Vendor Management

Most organisations will engage multiple service providers to deliver their IT services. The vendors may combine to deliver end-to-end services, or may be engaged to deliver separate, non related IT services.

Multi Vendor Management recognises the roles the vendors provide through to the organisation, and importantly, where there are relationships where vendors need to, from time-to-time, co-operate to deliver the services. In this instance, it is critical that the

vendors work together to deliver an effective service, rather than acting independent of each other, with the risk of service disruption caused by the actions of one vendor not being in synchronisation with the actions of another vendor.

Where related vendors exist, contractual obligations should be established between the Service Recipient and the Service Provider where there is an obligation on the Service Provider to co-operate with related Service Providers.

Additionally, the Service Providers should establish Operating Level Agreements (OLAs) between themselves where they identify and agree how they will interact for the common benefit of the Service Recipient.

Key Competencies

- Emotional intelligence
 - Self-awareness
 - Self-management
 - Social awareness
- Leadership
- Lateral thinking
- Communication – aural, verbal and written
- Persuasion, influence and advocacy
- Facilitation

Who's to be Managed?

We identify four stakeholder groups that the sourcing management function needs to actively consider and work with; two on the service recipient side and two on the provider side.

The four groups are:

- *Enterprise senior management* – the persons sponsoring and responsible for the sourcing strategy;
- *End user community* – the persons within the enterprise who actually use the contracted services on a day-to-day basis;
- *Senior management of the service provider* – the persons responsible for profitability of the deal at the vendor enterprise; and
- *Service delivery and support agents of the provider* – the persons responsible for the day-to-day operational supply of the contracted services.

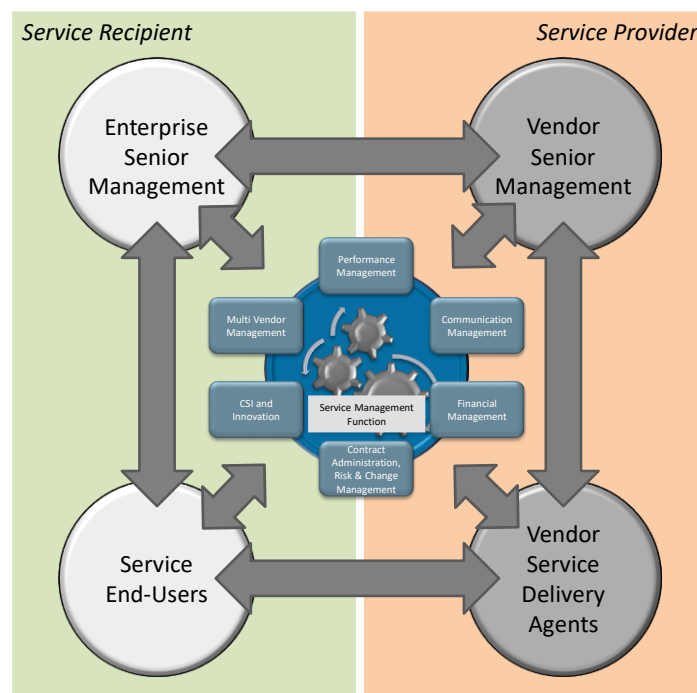
Figure 2 depicts the communication paths between the four groups and the sourcing management function. Sourcing management acts to foster, facilitate and channel open communication between the groups.

On the surface, each stakeholder group wants the same thing: “...the service deal to work to the satisfaction of all”. Below the surface however things get complicated.

The four groups' requirements and aims can and often do conflict. Particularly, and to no one's surprise, between the stakeholders on the recipient side versus those on the provider side. More subtle conflicts can and do exist between the stakeholder groups on each side of the recipient/provider divide.

There-in of course lays the challenge. It is the role of sourcing management to understand the competing requirements and aims, manage them, and drive the service provider to maximise their performance.

Figure 2. Four Stakeholder Groups to Manage



Critical Success Factors

We offer the following critical success factors as key takeaways in summation of the above material.

1. Understand the six capabilities that comprise the sourcing management discipline.
2. Recognise the importance of excellent sourcing management to realising expected service outcomes and enterprise objectives.
3. Recognise that no one person is likely to possess all of the competencies and skills required for excellence in sourcing management. Be prepared to provide the six capabilities through several persons.
4. Recognise the existence of the four stakeholder groups and be aware of their competing requirements and aims.
5. Proactively work with the members of all four groups in order to drive the desired outcomes from your specific outsourcing deals and realise your enterprise's sourcing strategy objectives.

Conclusion

As the use of outsourcing grows and broadens into business processes and other non-IT functions it will become increasingly important that the dollars invested contribute maximum economic benefit to the enterprise. That is, that the sourcing deals work and fully deliver to objectives.

Enterprises will not be able to concentrate fully on core, value-adding activities if they are being unnecessarily distracted, or worse still, hobbled by poor service performance and inadequate outcomes from those services they have chosen to source externally.

Our experience tells us that many enterprises fail to fully appreciate what is required to effectively manage sourced services. Too often sourcing management is thought of as little more than simply managing the vendor to the contract terms and conditions.

We define sourcing management to be comprised of six primary capabilities:

- Performance Management;
- Communication Management;
- Financial Management;
- Contract Administration, Risk & Change Management;
- Continual Service Improvement and Innovation; and
- Multi-Vendor Management.

Effective sourcing management requires all six capabilities to be present and for the sourcing management team to understand and proactively work with each of the four stakeholder groups we have identified:

- Enterprise senior management – the persons sponsoring and responsible for the sourcing strategy;
- End user community – the persons within your enterprise who actually use the contracted services on a day-to-day basis;
- Senior management of the service provider – the persons responsible for profitability of the deal at the vendor enterprise; and
- Service delivery and support agents of the provider – the persons responsible for the day-to-day operational supply of the contracted services.

In the second paper of this tri-part series on the subject of Sourcing Management we will explore the drivers and behaviours of the four stakeholder groups and provide our insights into how to influence and motivate all four groups, especially those on the service provider side to deliver excellent service outcomes.

Whilst business satisfaction with the outcomes from outsourcing non-core services has increased in recent years, greater satisfaction and better outcomes is sought and can be achieved.

The key is excellence in the discipline of sourcing management.

CHERUB

ADVISORY & CONSULTING

Cherub is a Sourcing Advisory and Consulting firm that specialises in providing practical and actionable insight and consulting spanning the entire sourcing lifecycle.

Our single-minded focus is on understanding the Australian IT Sourcing marketplace and leveraging our unrivalled practical experience and market perspective to provide our clients with pragmatic and actionable sourcing advice, solutions and consultancy and help you answer critical questions such as:

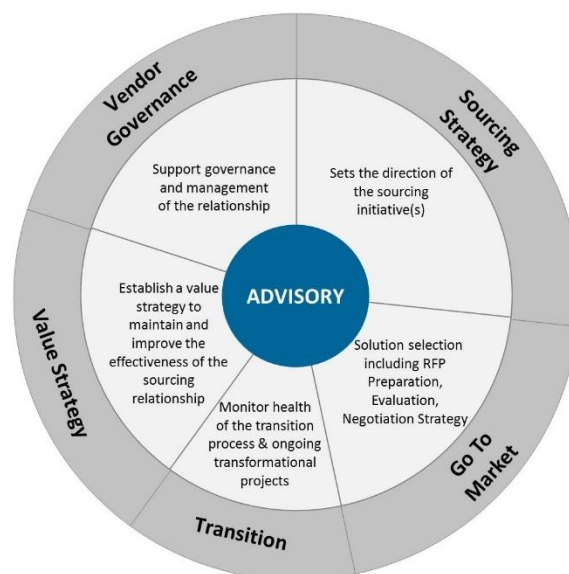
- Am I getting value for money today from my current deal?
- Is my strategy optimised to business needs?
- How can I get the right vendor, with the right services, backed by the right deal?
- How do I realise the goals and objectives of my strategy?
- What should I do to ensure success?

We know that the sourcing journey has many stages. Our Lifecycle Solutions Framework is pivotal in helping our clients to understand each stage of the journey and where their sourcing initiative fits into the overall sourcing journey.

It provides a platform from which clients can have a clear and informed view of the foundational activities and steps that have preceded the journey to date; as well as understanding what activities and steps need to follow to ensure success.

At the heart of our Lifecycle Solution Framework is Advisory Services which is the foundation of everything Cherub does and delivers. Our understanding and appreciation of both the 'hard' and 'soft' aspects of Advisory means that we are able to extend 'thinking' into 'doing' through the application of our best practice approaches, methods and tools.

Figure 3. Cherub's Lifecycle Solutions Framework



This is achieved through our Consulting Solutions that can be used to complement a client team's capacity or capability. Alternatively, a client may opt for a targeted sourcing consultancy where Cherub delivers an end-to-end solution. Such sourcing consultancies can focus on some or all aspects of the sourcing lifecycle, including:

- Sourcing Strategy to set the direction;
- Go To Market to select the solution;
- Price Benchmarking to evaluate the deal, set the price baseline and inform the business case;
- Transition to monitor the health of transition and ongoing transformational projects;
- Value Strategy to review, refine, and if necessary, undertake rectification of a service contract to help maintain and improve the effectiveness of the sourcing relationship between the customer and the supplier; and
- Vendor Governance to support excellence in governance and management of the relationship, including where required, the design and establishment of the vendor management office and toolsets.

We pride ourselves in our flexibility to either “roll our sleeves up” and work closely with clients; or to simply provide expert guidance in a more advisory role.

We believe it is our many years of real-world experience combined with our deep functional expertise that provides lasting value to our clients.

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¹ Gartner Research, 2018.

² IT Infrastructure Library - ITIL is best practice in IT Service Management, developed by the UK Office of Government Commerce and supported by publications, qualifications and an international user group. ITIL is the most widely accepted approach to IT service management in the world.

³ Study completed in 2010 by Vantage Partners and Outsourcing Institute, comprising approximately 250 outsourcing buyers, 350 outsource providers, influencers and attorneys at the leading firms advising buyers and providers in outsourcing deals.

⁴ EquaTerra, 2007, Outsourcing Management and Governance: Building a Foundation for Outsourcing Success.