Choosing The Right Sourcing Strategy

Getting the basics right to optimise outsourcing outcomes
Contents

Introduction 3

Determining Your Sourcing Strategy 4

1. Why Outsource? 5

2. What Functions to Outsource? 6

3. What is the Future Service Delivery Model? 7

4. How To Select a Supplier? 13

Conclusion 15
Commonly accepted best practice indicates that successful outsourcing deals are often achieved by organisations that recognise the importance of defining their sourcing strategies before engaging and then contracting with the supply market. An ill-defined or ineffective strategy is often the reason some of the largest deals fail to achieve their objectives.

This paper provides a guide for organisations on how to define their sourcing strategies based on their specific circumstances, thus laying the strong foundations for a successful deal outcome.

To start off, the paper attempts to de-mystify sourcing strategies by defining them in simple terms and demonstrating that there are four key considerations to be addressed when creating a sourcing strategy, each requiring a series of critical business decisions to be made, and identifying the mistakes to be avoided.

Of these four key considerations, this paper will focus primarily on the future service delivery model, because this is the most complex part of the process, which deals with multiple aspects of a company’s strategy at the same time.
Determining Your Sourcing Strategy

What is a Sourcing Strategy?
A sourcing strategy clearly articulates the vision and way forward for a particular area under consideration for sourcing. An effective strategy needs to take into account the following four key considerations, which are undertaken in a series of steps as below:

1. Why Outsource?
   At the heart of an organisation’s sourcing strategy, the firm must understand its motivation for outsourcing and what it would like to achieve. A high level business case, to be further refined once the outsourcing scope has been clarified, is developed to support the rationale for outsourcing. A solid high level business case and clear outsourcing principles will help to achieve stakeholder buy-in and organisational consensus, which are critical to help green-light and implement the deal.

2. What Functions to Outsource?
   Having demonstrated the overall benefits and motivation for outsourcing, the next step will be to understand the specific functions to be outsourced versus retained. When this decision has been made, organisations can clearly articulate to suppliers the scope, size, location and service levels they anticipate from the outsourced area. The outsource vs. retain decision should be an outcome of a wider Operating Model exercise.

3. What is the Future Service Delivery Model?
   After determining the specific functions to be outsourced, organisations will need to decide their service delivery model. This is driven by a complex interplay of business decisions, which include: the level of service bundling; the location of the service delivery; the level of resource sharing with other organisations; and the degree of asset ownership. As a result of this complexity, this key consideration will be the main focus of this paper.

4. How to Select a Supplier?
   Finally, when the organisation is ready to implement the deal, it must decide how it intends to select its vendor, or vendors. The choice of vendor selection approach can range from an RFP, which is an open, competitive selection process between a number of suppliers, to commencing negotiations with one preferred supplier, or a hybrid between the two differing options.
1. Why Outsource?

To help clarify and support the motivation for outsourcing, this paper has identified the following outputs undertaken as part of the process:

1. A clear **high-level business case for change** is a priority to help organisations achieve consensus and prioritisation on the sourcing strategy. This high-level business case will be refined once the detailed outsourcing scope has been understood. Large companies will usually spend an average of 10 weeks on developing a formal case for outsourcing, including identification of issues, opportunities, benefits and risks of inaction.

2. An early definition and prioritisation of the **sourcing objectives** must also provide guiding principles for the entire supplier engagement process. Questions companies need to ask themselves include: Will suppliers be selected purely on cost competitiveness? How important is service improvement or long-term transformation? What will be the impact on the ultimate end users of the service? Specifically, for customer-facing services, and services that directly impact front office functions, brand reputation and customer experience are vital considerations. Intangibles such as these, although harder to quantify, are in many cases no less important than cost arbitrage motivations.

3. Defining the **sourcing constraints** is equally important, including any scope exclusions and non-acceptable commercial and/or operating models. As companies face increasing regulatory and customer-related pressures to minimise offshoring as a delivery solution, these sourcing constraints must be identified early in the process to avoid wasted resource and efforts.

**Useful Insider Tips**

- It is vital to first achieve internal buy-in and broad-based consensus on the way forward within the organisation.
- Organisations should ensure sourcing principles are comprehensive and state absolute deal-breakers.
- Linking outsourcing objectives to business strategy objectives, including those of the internal customers (e.g. IT outsourcing objectives linked to Marketing department’s objectives), can help demonstrate the real success of the deal.
- Organisations should ensure objectives are measurable and tangible to unequivocally assess the achievements of the outsourcing contract.
- Asking end users what they want to achieve can help determine the right outsourcing objectives.
2. What Functions to Outsource?

Few would contest the importance of clearly defining what should be outsourced, including precise articulation of the scope, baseline and service levels, before entering into a binding contract. However, surprisingly and all too often, large deals fall through or the predicted benefits fail to materialise due to incorrect scope, baseline or other data having been provided to suppliers during the sourcing process.

To avoid such pitfalls, organisations must aim to achieve agreement on the following:

- The **sourcing scope**, which includes setting out the areas, processes, services, technologies, people and costs to be addressed in the potential deal, and which areas will be retained in-house.

- A robust **baseline profile** reflecting the current state of in-scope areas and how these have evolved over the last 2-3 years. Typical data collated would include volumes of work and drivers, budgets, contractual commitments and staff numbers.

- The **current and required future service levels** to be delivered by any potential third party supplier. For example, does an organisation expect a 24/7 or a 5 days a week service level from suppliers bidding for a help desk outsourced contract? The commercial quotes and delivery models for each of these options are likely to be substantially different. A clear Transition Plan must be developed to assess the people impact and to ensure that service levels are maintained during this critical period.

**Case Study – Getting the Basics Right**

Providing the correct scope and associated baseline data to suppliers is critical and needs to be closely managed.

In a recent large IT Desktop outsourcing deal, a global bank awarded a large contract to a single provider only to realise that actual volumes of work were 30% higher than the original baseline which they had provided to suppliers. As a result, predicted savings largely disappeared as the supplier sought compensation for this unplanned supposedly ‘new’ volume.

**Useful Insider Tips**

- Accurate baselining is imperative, but remember to apply the 80/20 rule.

- During due diligence, consider asking suppliers what data they need upfront to avoid wasting time on non-important data or missing crucial requirements.

- Organisations should first map out their current and future processes to define which functions (and therefore competencies) need to be retained or outsourced. Decisions on roles, people and retained resources should all flow out of this objective analysis.

- Companies must be careful not to compromise their competitive advantage by outsourcing certain core or strategic capabilities, IP or patents.
3. What is the Future Service Delivery Model?

Defining the optimal future outsourcing delivery model for a service is undoubtedly the most complex of all the four key considerations. This section guides organisations on how to define their future delivery model and delineates the business decisions they need to make at this stage, as outlined in Figure 1 below. Each of the business decisions present a range of strategic options available to the organisation.

The following pages will explore a framework for dealing with each of these decisions, demonstrating the level of complexities and considerations to take into account to avoid some of the common pitfalls.

There are differing schools of thought on whether companies should clearly define and articulate their future delivery model to suppliers prior to commencing negotiations, or if they should seek to use negotiations as an opportunity to explore options with suppliers before finalising their future implementation model and associated commercials. In fact, both approaches have their own merits and will be further explored in the next section when we investigate the various approaches to market engagement.

Figure 1: Elix-IRR’s Sourcing Strategy Framework

<table>
<thead>
<tr>
<th>Business Decision Required</th>
<th>Strategic Options</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Level of Service Bundling</td>
<td>Multiple 3rd party suppliers, ‘Guardian’ manages multiple 3rd party suppliers, Single Source/Prime Supplier</td>
</tr>
<tr>
<td>2. Location of Service Delivery</td>
<td>Client Onshore locations, Supplier Onshore locations, Supplier Near-shore locations, Offshore</td>
</tr>
<tr>
<td>3. Resource Sharing with Other Firms</td>
<td>Captive, Dedicated Supplier Centre, Shared</td>
</tr>
<tr>
<td>4. Ownership of Assets</td>
<td>Client-owned, Assets joint ownership e.g. via Joint Venture, Supplier-owned</td>
</tr>
</tbody>
</table>
Business Decision 1: Level of Service Bundling

Description
- Organisations need to robustly analyse options and then select the most appropriate service bundling strategy.
- Consider whether one vendor should deliver all services, and sub-contract to other companies as required, or should the organisation manage multiple vendor relationships?

Considerations
- Selecting one model over the other will have far-reaching implications and may dictate how best to approach the supply market, the future sourcing deal structure and the size and shape of the retained organisation.
- E.g. If a company decides to split their in-scope service area into multiple contracts, it may then decide to initiate multiple RFP engagements (or otherwise equivalent approaches), possibly phased over some time.
- Choosing a multi-source option will also affect the size and mix of the retained organisation – the rule is generally that managing multiple contracts and relationships will require a larger, more specialist organisation to be retained.

Recent Trends
- There is a rising global trend towards a multi-sourcing bundling approach, with companies tending to sign smaller and shorter deals with more suppliers.
- Multi-sourcing strategies are increasingly used by organisations to mitigate perceived risks associated with reliance upon a single supplier or ‘putting your eggs in one basket’.
- The above also shows that as organisations become more experienced in managing the initial wave of outsourcing arrangements, they are now feeling more confident in managing multiple relationships with ‘niche’ expert suppliers.
- In the retail industry, retailers tend to rely more on “Best-of-Breed” multi-sourcing. The seasonal and ‘zero order book’ nature of the retail sector means that retailers are more reluctant to commit to long-term deals and therefore prefer to spread their sourcing activities through shorter-term multiple suppliers.

Case Study: Getting your Service Bundling Decision Right
Deciding an appropriate level of service bundling before engaging the supply market is critical. Getting it wrong can prove detrimental in terms of costs, time and brand reputation. In a recent example, a large global mining corporation entered into a costly and lengthy negotiations process with several IT Infrastructure providers aiming to contract out the entire area to a single supplier. During negotiations, however, it became apparent that not one single provider had the capability to adequately deliver the required bundled service. The mining company subsequently had to put the negotiations process on hold, split out the original tender into manageable modules and re-issue multiple tenders to a new set of ‘niche’ suppliers. This resulted in a significant time delay as well as cost implications.
Selecting the Future Service Delivery Model

Once the decision to outsource has been taken, and scope defined, there are a variety of future service delivery models which the organisation can decide to pursue.

**Single Sourcing Approach**

The outsourcing of a service or group of services to a single service provider (all services outsourced to the same service provider)

**Multi Sourcing Approach**

The outsourcing of services to multiple service providers – enabling the company to benefit from the key strengths of the different service providers

**Prime Contracting**

Single contractor appointed with full responsibility for the outsourced contract. Services might be subcontracted to other suppliers – but remain under the prime contractor

**Service Partner as Service Aggregator**

Single service provider appointed to manage the service delivery (end to end) on behalf of the customer. However, the contract for the different services is directly with the different suppliers

**Consortium**

Group of service providers contracted to deliver outsourcing services. Each consortium member remains independent in its operations and has no contractual influence over other consortium members

**Client as Service Aggregator**

Multiple service providers are contracted to deliver outsourcing services. The providers may have zero interaction with one another; hence, management of each partnership falls wholly upon the client

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**Useful Insider Tips**

- It is important to look at the impact on the retained organisation when making a sourcing strategy decision – it is often more simple to handle a single provider than 20+ different suppliers.
- Organisations need to have pros and cons of each operational model in mind – for example, with a single provider, it may be faster and easier to get contracts expanded or new contracts signed.
What is the Future Service Delivery Model?
(continued)

### Business Decision 2: Location of Service Delivery

<table>
<thead>
<tr>
<th>Description</th>
<th>Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Organisations need to decide on whether a particular service would be best delivered within organisation-owned or occupied locations or from supplier-owned and/or managed locations.</td>
<td>• The most effective location largely depends on the type of commodity or service under consideration and its relevant characteristics.</td>
</tr>
<tr>
<td></td>
<td>• Some services, such as Facilities Management, typically require frequent and face-to-face interactions with many other internal functions as part of governance and delivery. Therefore co-locating within the organisation's premises would make real sense.</td>
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<tr>
<td></td>
<td>• Conversely, highly commoditised technology areas, such as Data Centres, enabled by remote management technologies can be more cost-effectively managed from supplier locations, and are often offshored.</td>
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<tr>
<td></td>
<td>• Jurisdiction is also an important consideration (i.e. locating service delivery centrally in the country where a multinational company is headquartered versus using multiple service delivery centres in each of the countries where the company operates, or a compromise between the models through regional hubs). This determines the regulations that come into play. For companies operating in multiple countries, sourcing decisions can be influenced by differing tax regimes, restrictions on data transfer and client data as well as the movement of funds across international borders.</td>
</tr>
<tr>
<td></td>
<td>• India remains a large offshore destination although labour arbitrage benefits there are not as marked as they once were. China is also widely used, offering reliable infrastructure and technical skills, and with improvements in the quality of spoken English which was initially an issue. However security concerns present a difficulty here, and also in South Africa, which otherwise enjoys popularity from UK companies due to excellent English language skills, cultural affinity and convenient time-zone compatibility.</td>
</tr>
<tr>
<td></td>
<td>• Unlike Financial Services, companies within the retail sector do not tend to do much offshoring directly themselves via captives (although there is some activity via third party suppliers). Their model relies more on various local structures and is often built on legacy systems which are bespoke for the different locations and varying distribution centres.</td>
</tr>
</tbody>
</table>
What is the Future Service Delivery Model? (continued)

<table>
<thead>
<tr>
<th>Business Decision 3: Sharing of Resources e.g. Operations, People and Technology</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description</strong></td>
</tr>
<tr>
<td>• The extent to which the organisation is willing to share resources, including operations, people and technology, with other companies.</td>
</tr>
<tr>
<td><strong>Considerations</strong></td>
</tr>
<tr>
<td>• Most suppliers would prefer a deal structure whereby the client’s resources are shared with other organisations, enabling suppliers to maximise their control over utilisation of resources and assets.</td>
</tr>
<tr>
<td>• This option can be most appealing (provided that these optimisation benefits are handed back to the client), particularly to small/medium-sized organisations with relatively limited access to industry best practice tools and facilities.</td>
</tr>
<tr>
<td>• Conversely, larger organisations may have prohibitive concerns around potential loss of resources dedicated to their specific needs and requirements.</td>
</tr>
<tr>
<td>• Potential security risks associated with shared resource pools (e.g. public cloud technology) may also be a key concern.</td>
</tr>
<tr>
<td>• Organisations should weigh up the benefits of resource sharing with the increased difficulties of switching suppliers when resources are shared and there is significant integration, making it more complex to disentangle from one another when there is desire to do so.</td>
</tr>
<tr>
<td><strong>Recent Trends</strong></td>
</tr>
<tr>
<td>• Recently there has been rising interest in shared services relative to traditional outsourcing, particularly within BPO.</td>
</tr>
<tr>
<td>• This is perhaps due to the economic climate encouraging businesses to look for cost-saving measures, with some pulling work back onshore into shared services as a result.</td>
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<tr>
<td>• Top Tier retailers tend to be less likely to share their resource (e.g. by maintaining their own dedicated data centres). Tier 2 retailers will be more open to sharing their resources (e.g. through shared data centres). Unlike Financial Services firms, retailers have traditionally appeared less sensitive on data issues.</td>
</tr>
</tbody>
</table>
What is the Future Service Delivery Model?
(continued)

### Business Decision 4: Ownership of Assets

| Description | • Organisations need to decide whether the assets in scope of sourcing should be retained or migrated to the vendor over time.
|             | • This is particularly relevant to asset-rich ‘depreciation-heavy’ areas such as technology and property management, where selling off these assets can deliver relatively quick cash and other benefits.
|             | • Data centres are a common example, whereby cloud-based and Remote Infrastructure Monitoring (RIMO) type technologies are increasingly enabling organisations to use supplier-owned assets to meet their data management and storage requirements.
| Considerations | • During negotiations suppliers can propose significant cost and resource savings to companies who agree to sell or transfer the ownership of their assets to the supplier.
|             | • This can be particularly appealing for organisations using outsourcing to deliver a significant cash injection or trying to change their current cost structure from fixed, and at times, uncontrollable (i.e. as a result of depreciation), to a variable consumption-based model.
|             | • Other organisations see the potential risks (e.g. loss of control, business continuity, supplier ‘lock in’) as outweighing the potential gains and prefer to keep ownership of their assets.
| Recent Trends | • With the increase of consumption-based service models, more organisations are migrating their data and technology onto supplier-owned assets. A prominent example of this is the Cloud for provision of computing resources.
|             | • As a result of a high level of direct contact with ever-changing consumer trends and behaviour, retailers are at the forefront of innovation in multi-channel strategies, such as e-commerce. This includes being increasingly open to software-as-a-service products and capabilities that will allow them greater flexibility and agility to embrace change.
|             | • In the Telecom industry, driven by the fast pace of technological change (from 2G to 4G and LTE-advanced within a few years), operators are increasingly turning to infrastructure outsourcing to avoid the cost of building networks that might quickly become obsolete. This often means reduced asset ownership.
|             | • The growing popularity of this ‘utility pricing’ form of operation is linked to the sharing of services discussed in Decision 3 (previous page) and reflects a more flexible approach to business processes.
4. How To Select a Supplier?

This fourth and final key consideration pertains to the vendor selection process. There are two key approaches typically used, namely, an open competition (known as an RFP) or a non-competitive approach involving one or more carefully selected suppliers.

There is debate as to the merits of each approach and this is explored in a recent Elix-IRR white paper ‘RFP or not to RFP. That is the Question’. This paper outlines that under the correct circumstances, the RFP option can be a valuable approach; however, in some cases, performing an RFP can become unnecessarily time-consuming and costly, potentially resulting in the selection of a partner for the wrong reasons.

**Case Study: Collaborative Solutioning**

Elix-IRR has been working with a leading retailer, which faces great pressure for change from the rise of digital channels and competition from purely online retailers. Technology is at the centre of their business transformation programme, and Elix-IRR was engaged to support them in their selection of the right partner organisation to help the business transformation and deliver many of their core IT services.

Given the requirement to move quickly, Elix-IRR developed an accelerated selection procedure as an alternative to the traditional RFP process. This ‘Collaborative Solutioning’ approach brought the client and potential partners together through a series of structured workshops, evaluation and feedback sessions.

It helped to define appropriate selection criteria that reflected the client’s objectives and coordinated the engagement in conjunction with stakeholders within the organisation.

This iterative approach facilitated the production of two compelling and viable proposals from which the client was able to down-select a preferred partner.
A second emerging debate revolves around the most appropriate RFP process, namely ‘conventional’ versus ‘collaborative solutioning’. In the former, suppliers will typically be provided with a clearly defined scope and detailed baseline to which they respond with a comparable quote. In a more ‘collaborative’ approach, suppliers are initially given less information on the current and desired future model, which is then jointly developed with the organisation during the RFP process. Both options are examined in a recent Elix-IRR blog ‘Supplier collaboration, the Key to Unlocking Greater Value From the RFP Process’.

It is argued that a ‘conventional’ RFP is most suitable for relatively well-defined, commoditised functions often motivated mainly by cost arbitrage benefits. Conversely, in other less well-defined circumstances, a collaborative approach towards negotiations and contracting may be the most appropriate route.

For example, if an organisation desires a large and/ or complex transformation, using the supplier engagement process to get innovative ideas and best practice solutions from suppliers can be highly effective. ‘Collaborative Solutioning’ has a number of advantages including facilitating a partnership and information-sharing environment from the outset, reducing the likelihood of deal collapse at a later point in time. Furthermore, Collaborative Solutioning tends to be more flexible which can result in a shorter timescale than the traditional RFP approach, helping to save time and resources.

**Useful Insider Tips**

- An RFP may be the most appropriate method, especially for smaller, more structured deals, but be mindful of its relative inflexibility and resource costs and ensure that it is not employed simply as a matter of course.

- If a collaborative sourcing approach is chosen, senior buy-in and commitment from all parties are essential – the process is highly interactive and relies on face-to-face meetings and structured workshops rather than the production of lengthy documents.

- Large organisations must be able to retain flexibility. For example, large companies that rigidly stipulate that all tenders must include a certain number of bidders can create problems further down the line as they prevent the company from taking individual approaches to each outsourcing process.
Conclusion

Designing an effective sourcing strategy to make the most of any outsourcing arrangement involves a set of complex and time-consuming decisions. At the outset, establishing a robust framework and set of key sourcing considerations can help organisations to avoid a potentially costly journey that ends up damaging not only their core competencies but also their employee morale and brand reputation.

At the heart of this white paper is the recognition that every organisation is unique and its sourcing strategy must be formulated based on a clear understanding of its specific situational factors. To achieve an effective and sustainable deal outcome, it is pivotal that the organisation addresses the four key considerations with respect to their individual circumstances (Figure 3, below).

*Why Outsource?* is driven by internal motivations of the outsourcing deal, the organisation’s sourcing objectives and constraints as well as a need to build a clear and solid business case to support the sourcing decision.

*What Function to Outsource?* is determined by establishing a clearly defined scope of the functions, processes, technology, assets and people that will be outsourced versus retained within the organisation. This is achieved by outlining an Operating Model for the outsourced versus retained scope as part of best practice in sourcing methodology.

In the meantime, *What is the Future Service Delivery Model?* sets out not only the sourcing delivery model but also the commercial structure by deciding where the organisation aspires to sit along a spectrum of the four interlinked business decisional factors: the level of service bundling; locating of service delivery; sharing of resources; and asset ownership.

Finally, having decided upon a sourcing model, *How to Select a Supplier?* determines the approach for selecting the service provider, which may be through a formal competitive RFP tender route or a more collaborative engagement with the down-selected vendor towards negotiation and contracting.

After the contract has been signed, the organisation must next turn its focus toward ongoing management and monitoring of the relationship and service levels of the outsourcing partner. This will require internal changes to be made within the organisation, potentially including the creation of an in-house function to oversee the entire outsourced portfolio.

In the face of a myriad of possible sourcing options, getting the basics right from the start by addressing the key sourcing considerations against each organisation’s own unique and specific decision drivers will be key to ensuring the long-term benefits and success of the deal.

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*Figure 3: Four Fundamental Questions To Be Answered*
About Elix-IRR:

Elix-IRR is a strategic advisory firm, offering bespoke, differentiated advice to plan and execute achievable transformation that creates demonstrable business value. We provide inspiration and drive at every step of the process, from defining business strategy, through operating model design and strategic sourcing, to the alignment of major change initiatives. Our team is comprised of senior professionals from top-tier consulting and services firms, as well as experienced practitioners from industry.

We provide insightful, practical and pragmatic advice that leads to real results.

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