2011 Sourcing Drivers: Realigning Business for the new normal

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Organizations are pursuing outsourcing today to gain more than just cost savings. If implemented right, outsourcing can provide agility and competitive advantage that can help organizations cope with the challenges of the new world. But will the same old sourcing strategies be relevant in a world where the economy is in constant turbulence? Organizations seeking long term value from outsourcing even in challenging market conditions need to recalibrate their sourcing strategy and priorities. In this note we take a look at the Top 5 Sourcing Drivers for 2011 that we believe will help unlock greater value for your organization and form the basis of more sustainable sourcing practices.

Introduction

Over the last decade, organizations have realized that outsourcing delivers more than cost savings –if implemented right; it can lead to agile and competitive businesses that can take on new market challenges. There are many organizations that have used outsourcing effectively and created significant long term value for themselves. But as another year rolls by and with the economy still running on half throttle, it is clear that the changed business and market conditions will become the new normal. On the supplier side, the landscape has undergone significant shifts, with the rise of new and maturing destinations, rapid vendor consolidation, evolution of cloud based services and proliferation of more transformative sourcing models. Companies have to recalibrate their sourcing strategy and priorities to adapt to these operating conditions and market changes. As executives grapple with a myriad of priorities, we take a look at the Top 5 Sourcing Drivers for 2011 that we believe will help unlock greater value for your organization and form the basis of more sustainable sourcing practices.

Balance your sourcing portfolio

Services Globalization has been in a constant state of evolution, resulting in ever-changing opportunities and challenges for organizations. The elements of a sourcing strategy created few years ago may continue to be valid but the order of importance of each element may no longer be as pertinent. For instance, late 2010 saw Philippines overtake India as the largest provider nation of voice based services due to superior quality of service and competitive costs. While India continued to face labor tightening and rising salaries, the Philippines has strengthened its position due to an inherent affinity towards voice based services and lower wage inflation. Organizations that revamp or reassess their global strategy every few years could latch on to the trend by moving their customer support to the Philippines, thereby gaining significant competitive advantage. Today services globalization can be a lever for access to high end skill sets, market expansion and sustainable competitive advantage. Organizations that keep an eye on the shifting market forces and take the necessary action can derive significant value over the long term. However change in sourcing strategy is only possible if it is accompanied by a managed discipline akin to a portfolio investment model–a Balanced Sourcing Portfolio approach.

The first vector of the sourcing portfolio is Process Ownership. With the shifting business climate, rationale for keeping many of the processes hitherto kept in-house may no longer apply. Case in point is Mortgage lenders who had normally managed Loan-modification processes internally since the volume and the associated savings weren't large enough to justify outsourcing. However, with the primary mortgage market nose-diving, home values dropping and refinancing lending rates at historical lows, the transaction volume in loan modification has sky-rocketed. This has changed the dynamics for Mortgage firms and many have had no choice but to outsource these processes. With the economic forecast still uncertain, more and more companies are realizing that outsourcing ultimately provides them a key advantage – an ability to react to market changes rapidly, without making significant capital investment and the flexibility to shift business models without risking existing revenue streams.

The second vector of the sourcing portfolio is Location Blending - allocation of assets between different geographies to match the right skills to the right location. In recent years many new regions have emerged that are now following the maturity curve of India and the Philippines. Some of these geographies offer not just cost savings and quality of service but also address some of the gaps of mature locations such as language availability, time zone requirements, near shore capability, investment incentives and so on. Alternative choices run the gamut from near-shore locations in Latin America and Caribbean to mid-shore ones in Egypt, Morocco, Ghana, Jordan and far-shore ones in Vietnam and Indonesia. With more mature options available today than ever before, the single shore strategy is being replaced by a multi-regional sourcing portfolio. Achieving the optimal Blend of Onshore/Near shore/Offshore can ensure the right balance between Skills, Costs, Quality and Risks. The key is to keep your pulse on the global palette of different destinations and their respective specialties. Eventually when the time is right, your organization can tap into these opportunities by selectively diversifying into locations that offer a better and more sustainable advantage.

Focus on governance

While many organizations spend significant amount of time and effort on the vendor sourcing phase, very few devote the necessary time and management attention towards governance. The fact is that poor governance can cause even the best of vendors to perform below par, thus inducing a significant drop in projected outsourcing savings and lower customer satisfaction. In extreme cases, lack of effective governance has even resulted in broken relationships between the buyer and the service provider. By some estimates, the way contracts and relationships are managed (or mis-managed) can account for a delta of up to 30% of annual contract value. A well-managed relationship can provide a 15% upswing in baseline value in the form of better response time, delivery quality, resource efficiency and team and customer satisfaction levels. On the other hand, up to 15% in contract value can be siphoned away by poorly performing contracts, over-invoicing, excess management overheads (such as unnecessary conflict escalation that saps executive time) and overlapping effort because no one knows what others are doing. There is no doubt that healthy governance practices can result in a positive reinforcing effect while badly managed contracts and relationships can have a negative cascading effect.

Based on our interaction with many mature service buyers we believe organizations should invest atleast 3% to 7% of their annual contract value on governance to capture this variable value. Organizations that do not have effective governance practices in place should consider making further investments in establishing a structure and putting a role based team in place to pro-actively manage all aspects of outsourcing delivery. A suitable Governance framework pays for itself by preventing value leakage and enhancing sourcing outcomes. Incidentally, automation of routine processes, better analytics and monitoring tools by specialized Contract and Vendor Management systems are making the task of governance easier.

Time for a Sourcing Healthcheck™

All aspects of global sourcing have witnessed rapid transformation in a span of few years. From newer engagement models to advanced technologies to more innovative service providers – recent developments have changed the game significantly. The transformation has happened at both the macro as well as micro environment level. Some geography have saturated while newer locations have emerged. Service providers have been on a consolidation spree (Igate acquiring Patni; Xerox acquiring ACS; Dell acquiring Perot Systems, Atos Origin acquiring Siemens IT Services, etc) resulting in new supplier market dynamics. Pricing models have evolved from simpler concepts such as Time &Material to more buyer friendly models such as Outcome-based pricing and Gain-sharing. Increased adoption of delivery models such as Platform-as-a-Service and Infrastructure-as-a-Service are also impacting how companies outsource. Overall this means that sourcing strategies adopted a few years ago may be out of alignment with the current environment and sub-optimal. A mid-stream analysis in the form of a Sourcing Healthcheck™ can help organizations evaluate their current state with respect to industry peers and prevailing best practices – giving them a report card of their existing programs, gaps and recommend steps to improve ROI.

Such an assessment can enable sourcing executives to tweak their program strategy to continue to accrete value from their sourcing initiatives.

Uncloak your Cloud Strategy

2011 is considered to be the year when organizations would finally start giving cloud computing the respect it deserves. Though we do not expect that cloud will replace traditional IT anytime soon, we strongly believe that organizations will start seriously evaluating cloud as a part of their service delivery options. However this could come with some serious ramifications, especially when hype meets reality and end-users find themselves at the wrong end of that spectrum.

The promise of cloud based business services is like a double edged sword. It can be a ray of sunshine for cash-strapped businesses wishing to scale their infrastructure and reduce reliance on expensive CAPEX and professional services. Yet, if not done right or for the wrong reasons, this can literally cloud an IT organization's future. The enticing pot of savings at the end of the rainbow that can be achieved by paying for IT services -- including infrastructure, software and even collaboration platforms -- on a subscription basis, can be elusive if a proper evaluation exercise is not done.As organizations evaluate cloud based solutions, factors such as customer usability, security, uptime, response time and scalability will become the main determinants for decision making. While most cloud service providers pitch their utopian vision of plug-n-play and homogeneity, each organization will have to look at cloud based solutions contextually and develop an adoption roadmap to suit their organizational DNA and objectives. However, whatever the ultimate decision, it is imperative in this new normal that each organization develop an appropriate strategy to adopt (or not adopt) cloud in the near to mid-term future. Else history teaches us what happens when everybody suddenly wants to board a juggernaut run amok – the dot com era is littered with carcasses of organizations that hastily crafted internet strategies to "not be left behind".

Doing More with Less

This sounds simple enough. Just renegotiate your service contracts, slash your discretionary spend on non-strategic IT and squeeze your vendors to provide more freebies. But the catch is that all of these tactics eventually come back to haunt you and don't really reduce TCO. The pricing burden is shifted elsewhere and also shows up in the form of poorer quality, lesser value-added functionality and sometimes can even raise your overall costs. What's required is a more holistic review of what the organization really needs in this new operating environment and then a realignment of the incumbent IT and Services strategy to match those needs. Doing more with less actually has more to do with re-prioritized spend than re-negotiated contracts. As the economy comes out of a prolonged slumber, it is essential that organizations revisit their existing contracts, licenses and other alliances and examine them in the context of the current organizational goals. What this essentially means is that organizations should look closely at their contracts and see if they are generating sufficient value. Contracts should only be renegotiated where organizations believe there exist too many redundancies and opportunities to increase efficiencies and cost – not because they believe they can get a better price point through a competitive re-bid. This process can be expensive and often does not result in significant savings to justify the extra effort.

However the same is not the case with software license contracts because the software industry has gone through significant price and business model shifts, justifying a complete review of existing contracts that are more than 3 years old. Software agreements that come up for renewal should be examined in the wake of current realities, effects of current reorganization initiatives, planned usage and technology impact. For instance, it may be worthwhile considering the latest cloud based offering for existing app's and in many cases there are better alternatives to the traditionally entrenched approach of License + Professional services + Annual Maintenance Contracts. Organizations should not hesitate to re-negotiate in order to derive maximum immediate value from their existing vendors.

Conclusions

To recap, we believe that 2011 is a major inflexion point and not just because we are entering a new decade. A perfect confluence of various factors from economic rejuvenation to emergence of new sourcing alternatives and destinations as well as the willingness for vendors to provide more transformative deals is ushering a new era. For those who re-prioritize, streamline and realign based on this new business reality, there will be a significant payoff. For others that continue with business as usual, there is likely to be an erosion of sourcing value and dissatisfaction. The choices organizations make in 2011 on how they adapt to the new sourcing drivers, will determine to a large extent, their ongoing success in the new "relentless" economy.

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About Avasant

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