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THE NEW FACE OF GOVERNANCE:

How to Coactively Manage the New Sourcing Relationship

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ISG WHITE PAPER

INTRODUCTION

This is why we propose a new way to govern services relationships. This new way shares strategy and responsibility between the client and provider equally and allows an innovation environment to flourish.

When outsourcing began to gain acceptance among large companies, the technique for managing new sourced services evolved from traditional procurement methods. Initially, a procurement-style vendor management approach was adequate, but as these services moved closer to the heart of business operations, and as the work of multiple providers began to affect each other, a new style of sourcing management that emphasized service integration emerged. This new management technique looked more broadly at service delivery approaches and more deeply engaged the technical operational roles in provider service management – engagement that took time for most internal company staff to accept.

Increasingly, enterprises accepted sourcing as a way of doing business, and the growing complexity of their sourced environments meant they needed to introduce more and more governance and service integration processes into the conduct of the relationship. Ideas about how to govern these services have evolved at pace, especially as companies increasingly adopt more-deeply integrated digitally transformed products and services, Agile development and DevOps, methodologies that make it clear that process alone cannot bridge the gaps in relationship and integration required to optimize sourcing's potential. This is why we propose a new way to govern services relationships. This new way shares strategy and responsibility between the client and provider equally and allows an innovation environment to flourish. We are calling this Coactive Governance.

Figure 1 The continuum of service management styles from process focused to collaboration focused

This ISG white paper explores the evolution of governance approaches, highlights limitations in current governance and introduces the concept of Coactive Governance as a way forward.

The Beginning: IT Vendor Management

At the beginning of the 2000s, IT vendor management organizations (IT VMO) began managing services provided by third-party providers. At that time, IT organizations were typically the largest internal procurement groups and had to develop the capability to manage a growing number of purchases, including software licenses, hardware, phones and laptops. Though many of the people in IT VMO had a procurement background and expertise in the specific products they were purchasing, the outsourced IT services did not blend smoothly with this group because – despite having specific contracts for sourced services – the VMO was generally ill-equipped to manage ongoing services, and the IT organization was unprepared to be the service delivery manager. By the early 2000s, enterprises were looking for new ways of managing their sourced services.

Setting sourcing strategy in an IT bubble will introduce division between the business and the operations groups.

Sourcing Management and Service Integration and Management

By 2003, services management organizations began to use specific support techniques and operating model structures to help them cope with industry changes. One significant change came out of the realization that IT operations needed to hold the reins on service delivery management; it was simply impossible for a VMO, which lacked specialized operational IT knowledge, to be on the front lines of services and manage the daily events of those services at the same time. Most IT operations initially resisted the change to making service delivery managers oversee providers. Between the stigma that came along with sourcing providers replacing employees and the lack of understanding of the management technique required under a contractual relationship, services management of third-party providers floundered, frequently devolving into management by emotion rather than by data and results.

Early efforts by ISG and other management consulting firms to create the appropriate processes and operating models were somewhat effective, though the hoped-for sourcing management maturity proved elusive. Neither the buyer nor the service provider delivery teams prioritized ongoing services management over contract terms. It wasn't unusual for buy-side IT service delivery teams to become hypercritical as they micromanaged the provider teams. Needless to say, this approach was counterproductive, and integrated service capability did not prove easily achievable under these circumstances.

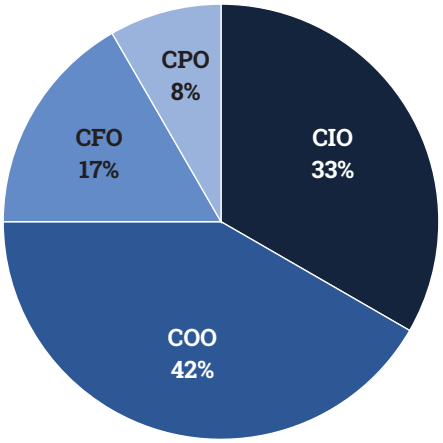
In the meantime, sourced services scaled up and became more common in non-IT business operations. Providers rolled out services for Finance and Accounting, Customer Service, Transaction Processing and other functions across the enterprise, but many enterprises lacked the corporate structure to manage sourcing effectively. Corporate procurement got involved in areas of significant spend, but the closer services were to business operations, the more often service managers – who had no background in sourcing – were left to figure things out for themselves. In business process outsourcing, many client teams felt frustrated and defeated.

Centers of Excellence Emerge and Evolve Quickly

In 2007, ISG developed enterprise sourcing offices, which we called Sourcing Centers of Excellence, or Sourcing CoEs, where enterprises could consolidate their learnings, policies and processes for procuring and managing multiple large ITO and BPO sourcing contracts, which could then be shared with teams across the enterprise to improve their skills and mindset. The potential was high for this management approach, especially for its ability to create a balanced scorecard for specific sourcing engagements and for enterprise services as a whole.

The stratification of services in the market today profoundly affects the relationship with the provider and the business.

Figure 2 Executive Sponsorship of Sourcing CoEs in 2010



Source: ISG Research, 2010

As we implemented and studied Sourcing COEs, we found they worked best as organizations separate from procurement. Indeed most enterprises had kept the Sourcing Center of Excellence out of Procurement, which was a source of friction between business operations and corporate procurement. When ISG Research looked at established Sourcing CoE groups in a study in 2010, we found they all reported to C-level executives, but the function had no clear organizational owner.

Figure 2 illustrates our findings that show Sourcing CoEs generally reported to C-level executives, though largely not within the procurement organization. We also found that the reporting executive was inconsistent and the Sourcing CoE frequently changed with half of the Sourcing CoEs having moved from one executive area to another in the previous 18 months. This further validated the view that, while organizations acknowledged the need for the capability of a Sourcing CoE, no one was quite sure where it should be located.

From today's vantage point – because all sourcing questions are driven by either "make" or "buy" business decisions with an increasing emphasis on "buy" to get the newest digital capabilities – a Sourcing CoE should be a strategic function. The rapid digitalization and

technological disruption in the business value chain complicate today's sourcing options, especially in IT and in areas enabled by IT. Setting sourcing strategy in an IT bubble will introduce division between the business and the operations groups. A Sourcing CoE can mitigate this risk by driving the enterprise service acquisition strategy as a holistic process.

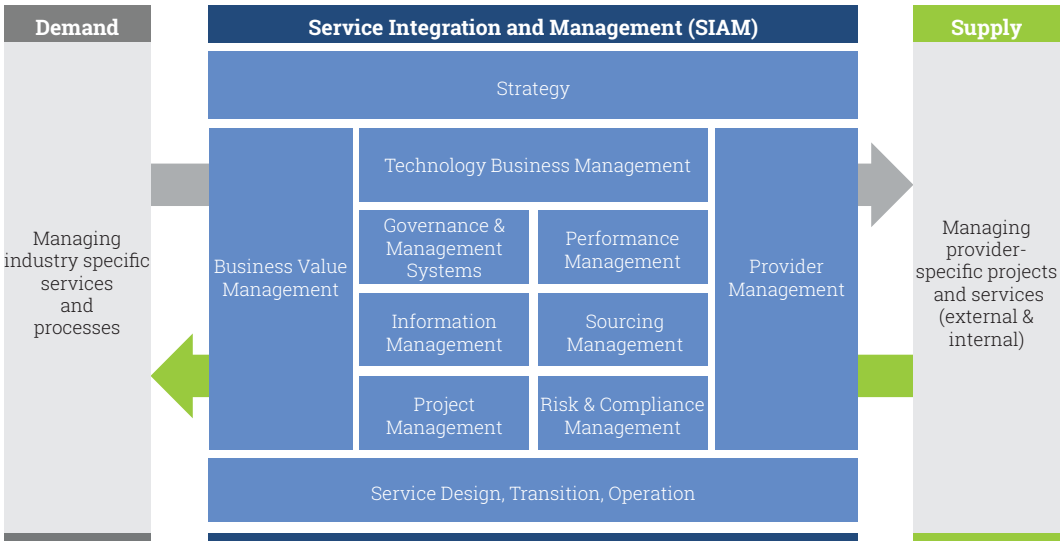
Sourcing CoEs provide training, transition support, process models, policy and sourcing strategy to their enterprises. The Sourcing CoE staff we have studied work hard at creating comparative indicators based on service provider performance and analytics data. When the Sourcing CoE is able to manage the data and perform the analytics, the enterprise benefits from savings and improved quality – and better relationships. However, as organizations have tried to mature and deliver value over time, cost-conscious executives have chafed at the cost of maintaining the Sourcing CoE and its data. Some Sourcing CoEs have survived, but by 2013 most had been absorbed into the procurement organization or evolved into Service Integration and Management (SIAM) functions.

Typical as-a-service contracts have "take it or leave it" terms. Consequently, attempts at management can exert only limited control over these services, opening the possibility that poor performance could negatively impact the business.

SIAM Gains Popularity as Multi-sourcing Grows

The SIAM approach helped organizations fully integrate the growing number of providers – and retained IT functions – from both an IT operations perspective and a sourcing management perspective. SIAM processes and governance relies on an ITIL-based software solution – a new development for this period. While the intent was to improve the overall supply and demand for services, the operational focus was on integrating internal and external service providers as a means to deliver uninterrupted performance. As depicted in Figure 3 below, the SIAM approach provides processes around strategy, IT governance, risk management and provider management – and for those enterprise that used it, SIAM conclusively institutionalized provider governance into existing and defined IT governance for the first time.

Figure 3 ISG's SIAM blueprint



The overwhelming complexity of dozens or more service providers in a company's environment made the SIAM management construct essential for IT operations. Such an integrated approach made sense for an enterprise, but in most cases it was applied only in IT and tangentially in BPO services expressed in the IT world.

With the adoption of SIAM, organizations – and in particular its employees – began to accept the fact that providers were here to stay; IT business operations in Fortune 1000 companies had grown too complex to be provided for solely by internal groups. Digitizing the SIAM process model through the service desk software also drove compliance. While SIAM did not draw out potential innovation in the management construct, it provided the foundation for integrating and automating processes as seen today in robotic process automation (RPA). SIAM also heralded further changes, including the ability to prove that measuring and managing services were critical to success for both the client and the provider.

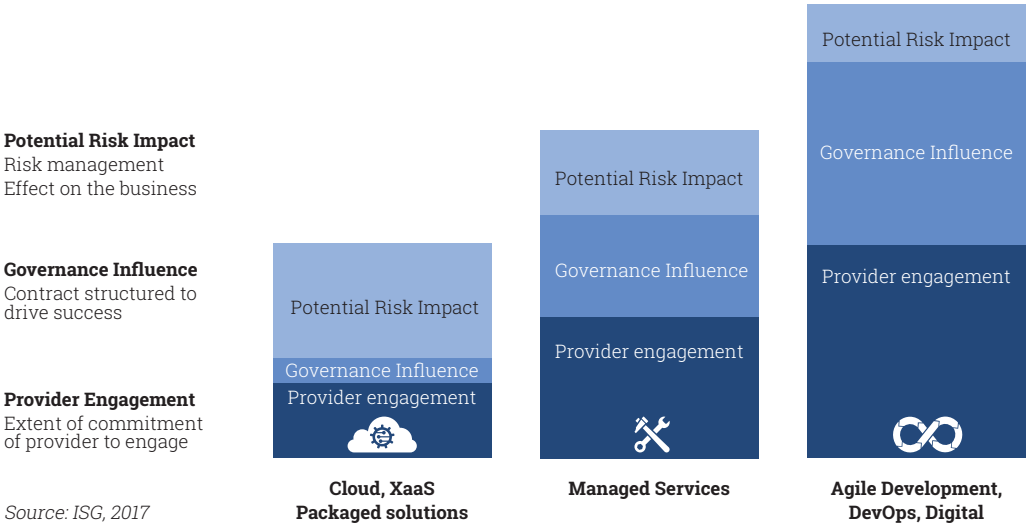
The "us versus them" mentality pervasive in managed services before 2017 simply cannot work in an assimilated model where the success of both the client and the provider depend on an environment of true collaboration and trust.

The Impact of As-a-Service

In the last couple of years, sourced services began to evolve dramatically. Managed services separated first into two and then three distinct types as illustrated in Figure 4 below, each of which had very different attributes for contracting and managing relationships. Today, managed services requires systematic involvement by subject-matter experts and structured governance, whether that be SIAM or vendor management processes; it is not possible to limp along with a suboptimal management technique.

The stratification of services in the market today profoundly affects the relationship with the provider and the business. Figure 4 breaks services into three elements: 1) Potential risk impact – including risk management and potential effect on the business; 2) Governance influence – including a contract structured to drive success; and 3) Provider engagement – including the extent of the provider's commitment to engage in the service delivery process.

Figure 4 Stratification of services today



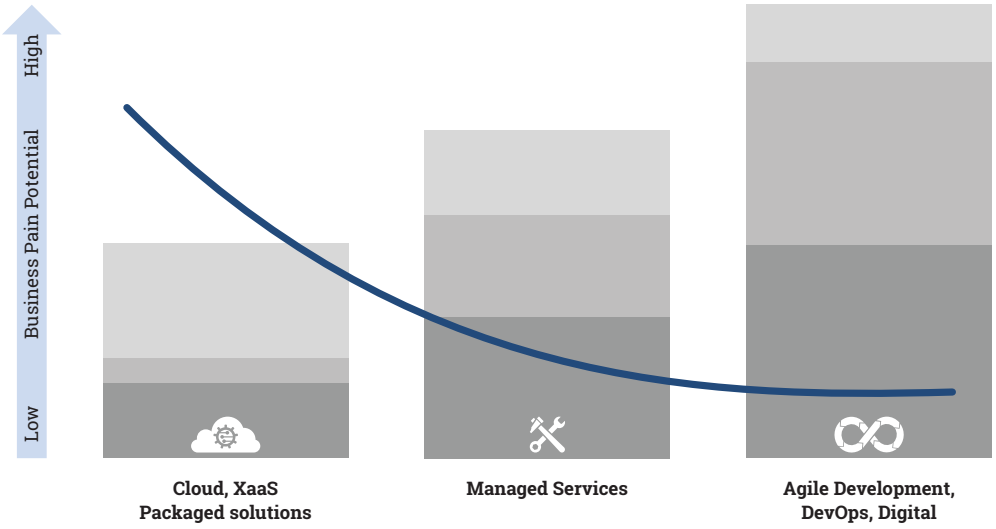
Source: ISG, 2017

A new form of managed service powered by the "as a service" model appeared quickly and took over significant swaths of tasks formerly performed by in-house or outsourced providers. Rather than tailoring services to a client's needs, providers were developing data center operations, storage services and business applications with a common set of largely non-negotiable capabilities. While their low price made these as-a-service solutions irresistible for companies, they also required a greater need for architecture development to anticipate service issues. When a contract is not customized, there is little to administer; typical as-a-service contracts have "take it or leave it" terms. Consequently, attempts at management can exert only limited control over these services, opening the possibility that poor performance could negatively impact the business.

Coactive Governance is the state of an integrated relationship between the client and provider teams – a state reliant on trust, common interest and a sense of achievement that forms the basis of the services relationship.

Figure 5 below illustrates the potential inverse relationship between the business experience of sourced services and the control an enterprise can drive through the contract. In other words, the impact curve creates governance challenges. As the services fragment, larger providers deliver services to larger direct groups of business users who may experience a problem as a massive impact, unlike the diminishing risk of disruption in managed services and Agile/DevOps/digital services.

Figure 5 The impact curve creates governance challenges



Source: ISG, 2017

The recent recurring failures of one of Amazon's cloud data centers is a prime example of the dynamic illustrated on the far left of Figure 5. When the user app for the cycling business Strava was put out of commission by an outage, Strava published a message stating "This function is not available due to an outage by Amazon Web services." Strava also blamed Amazon on its online support site.

At the other extreme, as illustrated in the figure above, digital services and Agile and DevOps development techniques come with complex and customized contracts – and the need for a much more assimilated model of service delivery than the kind standard managed services has used. The "us versus them" mentality pervasive in managed services before 2017 simply cannot work in an assimilated model where the success of both the client and the provider depend on an environment of true collaboration and trust.

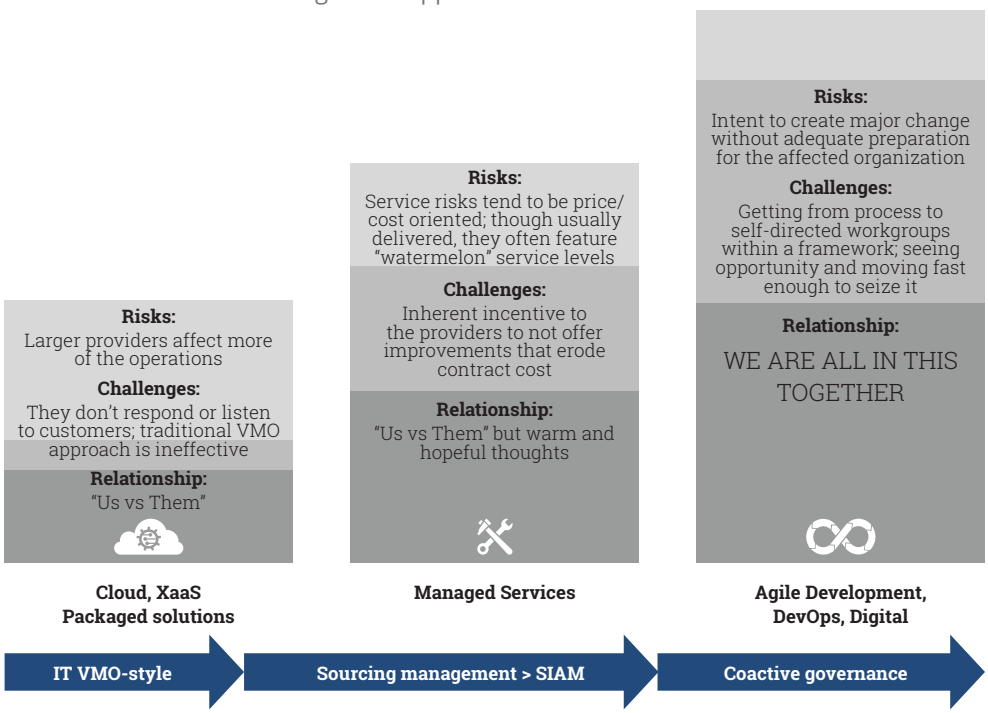
Organizations that want to take advantage of emerging digital technologies and development techniques need to change how they contract with service providers and how they describe service levels.

This new way of working must begin at the strategy level – where clients have typically excluded managed services providers – and inform the product/service development lifecycle, including deployment, particularly in the digital and DevOps models. Implementing collaborative models in enterprise environments requires organizational readiness – that is, willingness – to adopt a different working attitude that accepts change as a condition, rather than an event. A company that has some existing capability in this area will find it can help lead the entire organization toward necessary change, extending the ideals into corporate culture as well as service management and governance.

Managing Service Stratification

The three levels of services pictured in Figure 5 above (cloud/XaaS, managed services and Agile/DevOps/Digital) exhibit a curious parallel to the evolution of services management. As-a-service options, which give enterprises little ability to negotiate service levels, leave little to be "managed." The focus of an IT VMO is on performing rudimentary service management. It wants to know: Is the service available? Is it performing as expected? Are customers happy (enough)? In contrast, as-a-service providers typically do not want a relationship and will not give service-level credits for performance misses, as is typical of a managed service.

Figure 6 The evolution of management approaches



The skills and processes in sourcing management and SIAM continue to be appropriate for managed services. These contract-intensive, service level-driven relationships depend on client service delivery managers who interact with and handle individual providers and the integration approach. Service desk software and data are critical here, and the provider is a stakeholder in the relationship as is named personnel to support the specific enterprise.

Digitizing governance can address the issues of poor reporting by taking advantage of RPA and advanced analytics to gather data into a common platform and visualize it in new ways.

However, these management approaches generally keep the teams from reaching the level of integration required by advanced software development. While developing, testing and deploying digital, Agile and DevOps projects has the potential to make a tremendous impact on the business, the successful deployment of such a deep and wide change requires an organic and fluid integration that will be uncomfortable for managers used to the managed services approach; moreover, the organization at large will need to be prepared to engage in an ever-changing set of services that improve incrementally over time. It is these services that require the new management model Coactive Governance.

Coactive Governance

Coactive Governance is the state of an integrated relationship between the client and provider teams – a state reliant on trust, common interest and a sense of achievement that forms the basis of the services relationship. This requirement dramatically changes the nature of services relationships – from being based on service level metrics to being based on mutual business objectives. As the Agile Manifesto articulates the principles of trust and collaboration espoused by the Agile development methodology, metrics in deeply integrated services like Agile and DevOps, while performance-based, also must be designed to promote genuine collaboration. Performance objectives that underpin the service levels in Agile and DevOps are defined with concepts such as business value, customer satisfaction and product quality – objectives that have been difficult to articulate or measure in managed services relationships to date.

Service managers used to an "us versus them" mentality may feel uncomfortable with provider teams collaborating and integrating so closely with development-and-release work, especially in high-profile business applications. ISG has encountered situations in which the vendor manager was harsh to the service provider's Agile team, causing it to chafe under the constant criticism and unable to improve the relationship by its own efforts. Consequently, the services – and ultimately user satisfaction with the services – suffered.

Organizations that want to take advantage of emerging digital technologies and development techniques need to change how they contract with service providers and how they describe service levels. They need to redefine traditional "service levels" to something closer to "service levers" that allow them to focus on collaboration, integration and innovation.

An enterprise's inability to embrace a truly collaborative management approach will seriously hamper the success of Coactive Governance. Technology provides some pathways to support this new governance paradigm within organizations, but the driving force toward value-add services in today's sourcing marketplace must be people, followed by process and then technology.

Digitizing Governance

When creating a service relationship – whether it is based on SIAM, a Sourcing CoE, Sourcing Management or, to some extent, VMO – standardizing processes has helped. But it can't completely transform the relationship needed for Coactive Governance to succeed. Focusing on standardizing processes also has fallen short in creating a way to interact with the end consumers of the services – a gap caused in part by poor reporting, which often measures service metrics irrelevant to the direct experience of the services. The philosophical disconnect also is caused by an underlying break-fix philosophy that fails to see a break as a defect. An important distinction between ITIL service management, which relies on severity to determine defect status, and Coactive Governance, which relies on corrections applied before a defect is formally detected, as discussed below.

Coactive Governance requires human change driven by leadership in a new ecosystem, motivated by whole-hearted engagement and shared responsibility for the outcomes and services to the user community.

The IT4IT approach is starting to address this aspect of service-level management with the detect-to-correct concept, which removes judgment from an occurrence and instead views it as a feedback loop toward improvement. Incidents point to what must change in the environment to solve the problem. The goal: solve the problem before users perceive it.

Digitizing governance can address the issues of poor reporting by taking advantage of RPA and advanced analytics to gather data into a common platform and visualize it in new ways. The ability to create real-time reports without human involvement makes room for a philosophy shift that allows teams to repair causes of incidents before they generate defects. Mastering the mechanics of digital governance on the way to Coactive Governance facilitates a new kind of relationship between providers and end users that is fundamentally collaborative; the emphasis shifts from defects and break-fixes to continuous service. Automating data and analytics on actual performance in real time frees humans to focus on more important tasks – and eliminates the many voices – from the VMO and external stakeholders, for example – that have muddled governance activities in the past.

Many in the industry are re-examining service levels in this context. Moving from the idea of "service level" to "service lever" is just one possibility. For example, the Xperience Level Agreements (XLAs) introduced by consulting firm Giarte focus on redefining service levels by measuring empathy and connection to the user experience. The service-providing team – consisting of many internal and external providers – can only do this with a higher degree of integration, harmony and cohesion than we have seen in the past. XLAs must be married to SLAs to triangulate on a meaningful and valid measure of end-user experience. This construct serves as a step toward a "service lever" approach.

The New Face of Governance

In the new world of Coactive Governance, leadership by explanation and example may be more important than training. Process alone won't get us there. Coactive Governance requires human change driven by leadership in a new ecosystem, motivated by whole-hearted engagement and shared responsibility for the outcomes and services to the user community. It also requires preparing the user community for ongoing change.

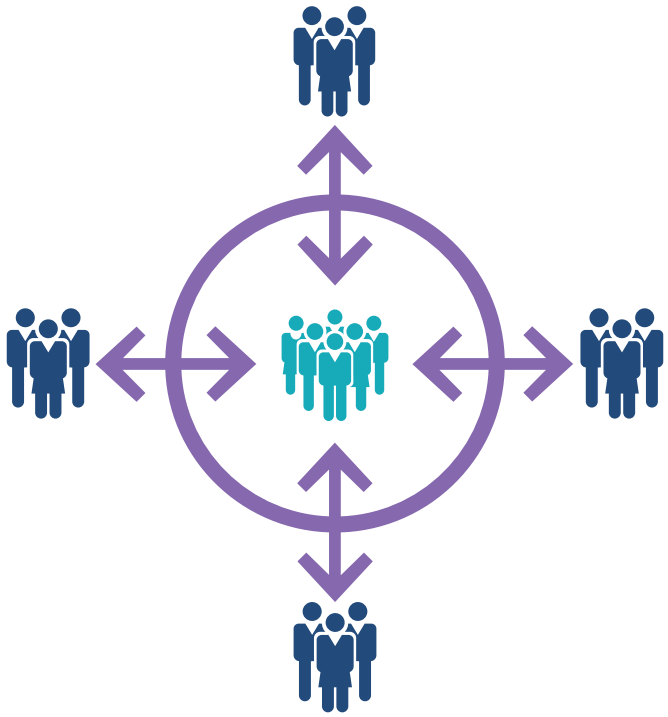
When ISG created the SIAM process blueprint (Figure 3), our philosophy was "change from the middle." By creating a new pathway through standardized processes – and preventing teams from reverting to the "old way" – we prescribed processes that would drive new behavior and require less of a leadership example. This worked in SIAM environments, but it didn't succeed in changing the underlying philosophy and intent of both provider and client teams. In many cases, an "us versus them" mentality prevailed.

Innovation cannot happen in an "us versus them" environment.

This mentality is due in part to the contracting structure itself; a contract that is punitive to only one participant creates an imbalance of power that undermines full and trusting integration. In the SIAM world, leadership could afford to look at reporting in arrears and address incidents in the ITIL manner. Today, we need to move forward to a model that provides more inherent integration and trust.

In many ways, the contract has allowed service providers to avoid accountability for changing the way they relate to their clients. As the delivery provider in the contractual relationship, service providers have had an inherent disadvantage in changing the way clients work with them. Providers know how to deliver services, but the clients don't know how to receive them. Thus, clients continue to manage by service levels, preventing the very innovation and deep collaboration they frequently say they want. Innovation cannot happen in an "us versus them" environment.

Figure 7 ISG FutureSource™ helps enterprises look inward at their own needs and outward at the provider marketplace



As ISG has considered these challenges, we have developed methods to open the client and provider relationships very early in the services acquisition process. **ISG FutureSource™ is our answer for starting this process**. We are working to drive a holistic relationship between clients and providers – to grow awareness of the need to look inward at an enterprise's business requirements and capability to accept change and to look outward to the marketplace for providers who can deliver the innovative change they need and who are ready for a truly collaborative relationship.

"Service levers" must drive results that speak to the user's experience – beyond the business "service levels" aspired to in the past.

In a recent set of workshops with IT leaders in Latin America, we asked two questions, and participants answered both similarly.

- Do you agree that the same contract strategy and content we use today will work for Coactive Governance? How important is that to your function?
- Do you agree that your service delivery teams are technically and psychologically prepared for the state of Coactive Governance? How important is that?

Three-quarters of the participants felt that today's contracts would inadequately address the new state of services and that, while preparation was important, their teams are ill-prepared.

The philosophical change needed to succeed with Coactive Governance – in which enterprise buyers and providers act as truly integrated, equal partners – requires strong leadership on both sides. Contracts must become more reciprocal, sharing accountability for service delivery across both parties. And "service levers" must drive results that speak to the user's experience – beyond the business "service levels" aspired to in the past.

These "service levers" link an enterprise's values directly to a competitive advantage in the marketplace, measuring the financial performance of a company to make its stakeholders happy. Coactive Governance focuses on how an external customer experiences a company's products, on how the enterprise receives the service products internally and how intuitively an enterprise deals with its external and internal customers. Accomplishing this degree of connection between the value chain of services and the consumers of the services has as much to do with soft facts – like perception of services – as hard facts – like service-level performance. However, failure to recognize these connections can have a tremendous – even catastrophic – impact on enterprises that may be facing immediate disruption from start-ups.

Everything touches everything in the new world of digital services, and it all touches the end consumer. Providers all along the supply and value chain of services, both internal and external to the enterprise, must make a commitment to collaboration and to connecting to the user experience. A successful company practicing Coactive Governance has leaders who embrace and are willing to bring about this philosophical change.

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THE NEW FACE OF GOVERNANCE: How to Coactively Manage the New Sourcing Relationship

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Cynthia Batty brings 25 years of experience helping clients develop their sourcing governance and service management design. Having worked with more than 50 organizations to improve business management and service management processes in both single-provider and multi-provider environments, Cynthia has become a recognized expert in sourcing governance, vendor and contract management. She currently serves as the architect for ISG's service methodology and global integrator of its products and services. Cynthia works to leverage ISG's accumulated intellectual property resources to help enterprises create effective transformation and governance capability, and maintains a continuing role in the Strategy and Organizational Change Enablement practice.

ABOUT ISG

ISG (Information Services Group) (NASDAQ: III) is a leading global technology research and advisory firm. A trusted business partner to more than 700 clients, including 75 of the top 100 enterprises in the world, ISG is committed to helping corporations, public sector organizations, and service and technology providers achieve operational excellence and faster growth. The firm specializes in digital transformation services, including automation, cloud and data analytics; sourcing advisory; managed governance and risk services; network carrier services; technology strategy and operations design; change management; market intelligence and technology research and analysis. Founded in 2006, and based in Stamford, Conn., ISG employs more than 1,300 professionals operating in more than 20 countries—a global team known for its innovative thinking, market influence, deep industry and technology expertise, and world-class research and analytical capabilities based on the industry's most comprehensive marketplace data. For more information, visit www.isg-one.com.

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