

Strategic Sourcing and Technology Business Management

Alex-Paul Manders, ISG TBM Practice Lead, Americas, and Paul Schmidt, Partner, ISG Americas



INTRODUCTION

The business model of the 1950s and '60s, in which companies did as much for themselves as possible, is as obsolete as the heavy, black rotary phones and clunky typewriters that served as the primary tools for managing all those many tasks. The Internet, cloud computing, digital consumerization and new tactics for connectivity, such as unified communications, have changed all that. Today, a company with ten employees can do more than a company with a thousand employees might have accomplished fifty years ago. This is due not only to increased levels of automation and computerization but to a shift away from the “let’s-do-it-all-ourselves” model to one of “lean” operations and strategic sourcing.

The cloud-computing model and the ease of use and relatively low cost of “as-a-service” offerings have created a new imperative that calls for greater focus on strategic sourcing of essential IT services. As this trend continues, a shift in employment practices often puts the most qualified IT specialists in the offices of service providers rather than in those of the buy-side enterprises, making outsourcing even more compelling.

A sourcing strategy that relies on third-party service providers, as-a-service software and infrastructure and remote IT job shops may usher in a new era of bottom-line savings that delight stockholders—but only if it is done right. Many enterprises undertake sourcing without a centralized strategy. Corporate executives assume efficiency and cost savings are the logical products of such a strategy without proving it or monitoring it over time. A company that doesn’t ensure the financial transparency of each arrangement, centralized management and continuous and automated benchmarking of results risks losing significant potential benefits.

Technology Business Management (TBM) delivers visibility into sourcing and other business processes by offering insight into the comprehensive business value of IT spending. The financial transparency that is often lacking in a sourcing environment is delivered as a key component of TBM, revealing the true costs and value of technology services – whether sourced or in-house. These data inform day-to-day operations and are easily shared between IT, the business and even the service provider to power a mutual quest for continuous improvement. This white paper explores the effective use of TBM as a way to gain the full value of outsourcing arrangements.

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TODAY'S IT LANDSCAPE

Cost transparency is the foundation of sound IT sourcing, particularly as outsourcing contracts multiply, become shorter and more agile and less dependent on a front-loaded payment schedule. For the company looking for services, Technology Business Management (TBM) answers the question: "Is this sourcing arrangement going to benefit us today and in the future?" For the service provider, TBM answers the question, "What do I need to know to submit a competitive request for proposal (RFP) and provide services that meet expectations over time?"

Of the IT services that enterprises source from third-party providers today, many come in the form of a subscription to an "as-a-service" platform. These services have won favor because they are simple to install and implement, they are easier to manage than on-premises applications, they offer significant cost savings and they give business-line managers the ability to acquire a service without having to go through the IT department. However, sourcing services in this way creates a fundamental conflict — or at least the appearance of a conflict.

This conflict, whether perceived or not, sets up a zero-sum game scenario with a winner and a loser. Enterprise buyers are looking for the shortest contract duration possible with little or no front-loaded payment, while service providers are looking to maximize profits and obtain the longest-term commitment they can. A more effective model, which can be built on the visibility and control afforded by TBM, would be one in which both parties come out ahead.

MORE CONTRACTS, MORE MANAGEMENT

One of the most influential trends in today's IT sourcing environment is the steady decrease in contract duration. Traditional IT contracts, until recently, tended to be between five and seven years, but today's typical contract is closer to three years. In the past, service providers often purchased assets directly from the client and wrote them off over time. To make the deal financially viable, the contract had to allow for this write-off. Changes in accounting rules brought about by the Sarbanes-Oxley Act make this arrangement less rewarding. In addition, most cloud-based service providers today are working on a multi-tenant model, allocating capital expense across multiple clients. The result is that the service provider has lower capital requirements per client and is offering shorter deals so it can deliver more advanced and more affordable technologies.

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More frequent contract renewals call for more rigorous management and oversight of contracts and greater due diligence in sourcing and renewals. As contracts come up for renewal, the continuing cost visibility afforded by TBM give executives the data they need to make more informed renewal decisions.

Traditionally, achieving IT cost-transparency has been a challenging process. Aligning the many different components of how a company manages the business end of IT grows even more difficult as the number of third-party vendors grows. Many enterprises still spend a great deal of time collecting, aggregating and aligning data to a specific taxonomy. As multiple sourcing contracts become an even bigger part of the sourcing ecosphere, enterprises need to (1) manage and integrate those services, (2) gain greater and more centralized end-to-end visibility of IT services no matter how they are delivered, and (3) ensure the promised return on investment (ROI) spelled out in the contracts continues to be delivered.

EVOLVING SOURCING STRATEGIES

Cloud computing, digitalization, big data and enhanced collaboration tools have enabled companies to create a much larger sourcing ecosystem than was previously possible. Even small-to-midsize organizations today are building large sourcing ecosystems, which, when managed properly with a sound strategy, allow a company to obtain the best services, software, and infrastructure possible—and, in many cases, gain access to services and talent that would not otherwise be available to them.

However, a large sourcing ecosystem comprised of perhaps dozens of business-critical service providers sourced from multiple business-line managers outside the purview of IT can cause confusion and a higher incidence of “shadow IT.” In itself, shadow IT is not necessarily negative, but when it is allowed to proliferate without oversight or unified management, it can completely negate the potential benefits of sourcing. A by-product of a large sourcing ecosystem and shadow IT is often a decentralized IT organization that leaves sourcing, management and due diligence to individual business-line managers. The result can be subpar or duplicated services throughout the enterprise.

Many argue a fully centralized model is not the ideal solution either. The traditional centralization of IT is unidirectional, with IT often lacking the input and financial information from the lines of business that it needs to make informed sourcing decisions. A hybrid approach

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that leverages TBM's continuous visibility, benchmarking and collaborative model can lead to a new environment that benefits all stakeholders. In this hybrid model, the individual line managers may still retain authority to source services, but the IT department serves as a broker, guarding against redundancies, ensuring the best deal and benchmarking over time to ensure the services continue to be delivered as promised.

TECHNOLOGY BUSINESS MANAGEMENT: THE KEY TO STRATEGIC SOURCING

TBM offers a standardized framework and taxonomy developed by the TBM Council and leverages specific vendor technologies, such as the TBM Unified Model, that align with that taxonomy. When applied as part of a multi-dimensional framework, TBM technology and process go well beyond traditional point-in-time snapshots to deliver a dynamic and continuous approach to managing IT costs over the long term. Implementing TBM as a multi-dimensional framework creates a foundation for building real-time, ongoing benchmarking capabilities and analysis that brings a level of insight into the sourcing process that has not previously existed.

Key benefits of TBM in a sourcing environment include:

- 1.** The ability to automate data collection and alignment to the TBM Unified Model for cost transparency, which accelerates the process and simplifies management of the relationship throughout the term of the contract.
- 2.** The ability to automate the collection of data on an ongoing basis and compare it with benchmarks found during the initial base case, which creates greater clarity throughout the contract cycle and a way to track the benefits stipulated in the sourcing agreement.
- 3.** A consistent and ongoing "system of record" as a baseline for costing discussions, both internally and with service providers.

In addition, using the TBM Unified Model standardizes both operational and financial information and aligns benchmarking data to a standard taxonomy. This simplifies historical trending and analysis, provides an ongoing comparison of infrastructure IT costs against industry peers and emphasizes data analytics so empirical information can be more effectively applied to developing strategy and transforming the IT organization.



STARTING WITH THE RFP

A sourcing ecosystem in which both the buyer and the service provider benefit is built with four key elements: information, well-validated data, benchmarking and visibility. The process starts at the very beginning with the RFP. If the RFP does not include adequate information and data or a provision for continuous monitoring and benchmarking, a service provider will find it difficult to create an accurate bid, and the initial lack of visibility may result in unexpected cost overruns. In addition, a well-prepared and validated cost basis (or base case) can significantly lower the risk premiums service providers assume in determining their price.

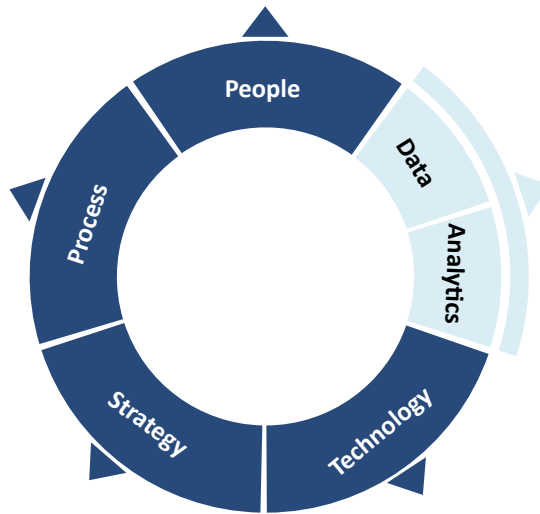
The goal of an RFP is to (1) allow the buyer to get the best deal, and (2) allow the service provider to make a realistic bid and realize a reasonable profit. To do this, the service provider needs detailed information, a base case for comparison and benchmarking, complete data and full transparency. Cost transparency and TBM set the stage for a better sourcing process from the very beginning, with improved visibility into both internal and external costs.

A MULTI-DIMENSIONAL APPROACH

An enterprise that gains full financial visibility into its IT investment and then is able to benchmark continuously over the life of its contracts can be more agile while enjoying a higher level of success in its sourcing arrangements. Creating a standard data taxonomy means data refreshes can be automated, which reduces the time and expense required of a traditional benchmark and enables ongoing benchmarking based on real IT costs and operational data. Using a TBM program in this way drives a shift towards a variable-expense model. The fact is most sourcing arrangements are not—or at least should not—be based on a point-in-time analysis. Instead, they should be based on an automated, multi-dimensional solution that allows the enterprise to achieve its sourcing goals faster and measure the results of the contract throughout its lifecycle.

ISG's multi-dimensional approach to TBM takes both strategy and data into account, backs it up with automation, and forges a closer alliance between an enterprise's IT organization and its core business. As illustrated in Figure 1 below, TBM includes six dimensions—people, process, technology, strategy, data and analytics—that come together to provide a thorough understanding and clear visibility into the current and comprehensive costs to provide business services.

ISG's Multi-Dimensional Approach to TBM (Figure 1)



IMPROVING COST TRANSPARENCY

When creating an RFP, an enterprise buyer will often focus only on describing the services required, which can result in estimates from service providers that do not reflect the enterprise buyer's true needs. The outsourcing process should begin by establishing a base case, which gives service providers a higher level of detail than is usually provided in an RFP. More detail will give competing service providers a better understanding of what it costs to deliver services at the time of the tender. This may seem counterintuitive, but more detail will increase clarity and reduce risk for both parties.

If a service provider is equipped with insight into the current-cost scenario, it will have a much better understanding of the process, what it can do to improve it and how it can avoid returning after project launch to ask for additional costs it initially failed to consider. A TBM framework supported by cost transparency automates the monitoring and tracking of how those initial assumptions play out over time.

Sustaining this level of transparency throughout the duration of the contract is essential. What may make financial sense at the beginning of the contract may make less sense later, when market conditions and the assumptions made in the initial RFP have changed. A key value of TBM is monitoring and benchmarking on a continuous basis so that enterprise buyers and IT services providers can both track the value being delivered as long as the contract is active.



THE FUTURE

As outsourcing contract cycles continue to shrink and allow the enterprise to become more agile, cost transparency in the sourcing process becomes increasingly vital. Delivery methods that revolve around cloud computing, as-a-service and subscription-based provisioning are transforming the internal IT department from an all-encompassing create-and-deliver organization to a business-focused broker of services. As IT shifts its role to serve more and more as the central clearing house for IT services, whether those services originate from IT or a business-line manager, it will face a growing volume of work associated with managing the required sourcing and due diligence processes as well as the ongoing maintenance, monitoring and benchmarking of the sourcing relationships.

Service providers are changing the way they do business, and the next 18 months will see the largest number of contract restructuring in the history of the outsourcing industry. A significant number of these will be initiated by enterprises that want to divest a workload from an ITO provider and move it to the cloud or adopt automation or analytics to increase efficiency. The restructuring that will pay the most dividends over time will be overseen by organizations that truly understand both their IT environment and their IT investment. The outputs of TBM—the visibility into the total cost of ownership and the productivity and quality indicators from individual applications or services—will help enterprise buyers make the best choices when restructuring their sourcing agreements.

ABOUT THE AUTHOR

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Published May 16, 2016

ALEX-PAUL MANDERS

ISG TBM Practice Lead, Americas



Alex-Paul works closely with enterprise leaders, IT finance managers and IT business unit leaders to help implement the discipline of Technology Business Management (TBM) into their organizations and optimize their enterprise IT. He advises both commercial and public sector organizations on the adoption of TBM programs, designs fact-based analytical strategies and supports broader IT transformation initiatives. His development of a strategic TBM multi-dimensional framework addressing people, process, data, analytics, technology and strategy is part of ISG's industry-leading set of market best practices and methodologies. His thought leadership has been featured in *CIO Review*, *MiddleMarket Executive* and the TBM Council's book *The Four Value Conversations CIOs Must Have with Their Businesses*.



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Published May 16,2016



PAUL SCHMIDT

Partner, ISG Americas

As a leading expert in globalization, Paul advises clients across industries on information technology and digital strategies, optimization and outsourcing. He has deep experience in global operations and creative approaches to business growth, including captive operations, joint ventures, build-operate-transfers, and mergers and acquisitions. He recently helped a global consumer packaged goods organization save more than 40 percent by realigning its captive, joint venture and offshore operational strategies worldwide. Paul also assisted a major retail company redesign its global customer digital model to improve quality and increase transparency for executive decision-making. Prior to ISG, Paul served as CEO of a number of software and technology start-up companies.



ABOUT ISG

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