INTRODUCTION

Moving Beyond Outsourcing

Multisourcing: *the disciplined provisioning and blending of business and IT services from the optimal set of internal and external providers in the pursuit of business goals.*

OUTSOURCING WORKED. USING EXTERNAL SERVICE providers to cut costs and improve performance has become truly commonplace. As much as the popular press has focused on the debate over the benefits of outsourcing, no executive leadership team, board of directors, or government agency of any size would deny that outsourcing is a vital, even integral, part of successful operations today. Wall Street and other international capital markets certainly agree. Surveys show that companies that announce plans for outsourcing routinely see share price growth; CEOs who outsource see their compensation increase.[1] Economists will tell you that the cost savings and efficiencies associated with outsourcing have been a major factor in corporations' ability to control costs and maintain profitability despite extreme cost pressures since the 2000 downturn. There is no question, outsourcing has worked.

But precisely due to this success, new challenges are emerging. The high expectations associated with outsourcing are increasingly hard to meet. As more and more functions are outsourced, integrating and managing a portfolio of service providers is becoming more difficult—and is causing significant service disruptions in many organizations.

Large outsourcing services companies are coming under pressure from capital markets to grow revenues and generate predictable margins. And, of course, outsourcing to cut costs no longer provides significant competitive advantage—all your competitors are using outsourcing as well and are reaping the same cost advantages. As a result of all these pressures, our research shows that fully 50 percent of outsourcing contracts signed between 2000 and 2004 will fail to meet expectations.

Before continuing, we should take a moment to clarify terms. In this book, we are discussing services outsourcing, *not* manufacturing outsourcing. These two are very different animals, and they require very different management approaches. Even within the world of services outsourcing, however, there is significant misunderstanding of what outsourcing actually is. Outsourcing is contracting with an external firm for the *ongoing management* and delivery of a defined set of services to a prescribed level of performance. Key to this definition is the concept of the ongoing management of services by the external firm. Outsourcing is not simply hiring contract workers or short-term, project-based work provided by third parties—what is often referred to as staff augmentation or body shopping. Outsourced services may be provided domestically, that is, on-site (in the enterprise's own buildings) or off-site (at the outsourced service provider's site). Alternatively, outsourced services may be provided nondomestically, that is, offshore or nearshore (at the outsourced provider's site in another country or a country adjacent to where services will be delivered). Therefore, outsourcing does not always mean sourcing services from other countries, although this is how the term is often used in the popular press.

The Way Forward

Given that achieving strategic advantage via outsourcing is becoming increasingly difficult while expectations for success continue to be very high, how can we move forward? What can you do to ensure the success of your outsourcing initiatives—to use outsourcing to create competitive advantage, to improve your growth prospects, and to increase your agility in responding to changing circumstances? The way forward requires, somewhat paradoxically, that you abandon thinking about outsourcing in and of itself and adopt a more holistic and strategic approach to sourcing as a whole.

"This is not a supply chain opportunity to delegate or dump costs. It is a chance to use partnerships to augment skills, to scale a fast-growing business, or to provide capabilities for competitive advantage," notes Dick LeFave, CIO of Nextel, a provider of wireless communications services, which announced plans to merge with Sprint in 2005.[2] The question of what functions and services a company should build and provide for itself, versus what it should seek from the outside world, is at the heart of a decision process that can mean significant improvements to a company's profitability, agility, customer satisfaction, and competitive posture.

The way forward requires a new approach that goes beyond outsourcing as it has traditionally been viewed. It requires that the selection of the "right" sources for business services—whether internal or external—be an integral part of enterprise strategy. It requires identifying the desired business outcomes and creating contracts, relationships, measurement, and governance that support and enable those outcomes. This new approach is what we call *Multisourcing,* a new operational model that obtains business services from multiple sources inside and outside corporate walls to obtain the best business outcomes. Or to put it more formally, Multisourcing is the disciplined provisioning and blending of business and IT services from the optimal set of internal and external providers in the pursuit of business goals. To implement Multisourcing, a new operating model must be adopted, including new approaches to sourcing strategy, sourcing governance, sourcing management, service provider selection, and service measurement. Although most organizations by default employ an array of partners, service providers, and internal resources, few realize the strategic importance of blending internal and external providers in achieving business goals like agility and growth. Multisourcing must be embraced, developed, managed, and continually refined in an organization. The rewards of doing so can be enormous. Consider the example of DuPont and a global manufacturing and services company (which we'll call GMS), which have applied a Multisourcing approach to an increasingly large part of their operations.

Agility has been an absolute necessity for DuPont. In less than a decade, the company has seen more than $60 billion worth of investments, acquisitions, joint ventures, divestitures, and dissolved partnerships as it reshapes its business to compete in global markets. This figure is even more stunning when you consider that it is nearly two times larger than DuPont's annual revenues. The only way for DuPont to effectively provide information technology (IT) and other services in such a dynamic environment is through Multisourcing. DuPont has created what it calls a global IT alliance that blends services from more than ten service providers and DuPont's own internal resources to meet the demands of the business. "Providing high-quality service in such a rapidly changing environment would be impossible using only internal staff," says DuPont's CIO, Bob Ridout. Maryann Holloway, director of the IT alliance, says that integrated management is key to delivery: "We have to maintain positive partnerships with our service providers, and they have to work well with each other, so that we can all jointly meet changing needs."[3]

GMS, on the other hand, has used Multisourcing disciplines to drive dramatic cost reductions in business process services like accounts payable. GMS's accounts-payable process has in fifteen years moved from being highly centralized and internal, to globally decentralized and internal, to globally decentralized with a mix of internal and external resources. "The reason we've been able to manage such change while delivering effective services and cutting costs is that we have invested heavily in governance and management capabilities internally, while integrating our service providers seamlessly into those processes," says Claire White (a pseudonym), global VP of business services.

How Did We Get Here?

To understand the way forward, it's useful to look at how we have arrived at our current state—the need to move beyond outsourcing to Multisourcing. The current wave of the outsourcing of services can't be traced to any particular source, but a number of significant events and developments have served to amplify and reinforce it.[4] One of these seminal events occurred in 1991, when the concept of core competency was first advanced by management strategy consultants Gary Hamel and C. K. Prahalad in a *Harvard Business Review* article, "The Core Competence of the Corporation." Hamel and Prahalad sparked a period of introspection by corporate leaders on the essential question "What business am I in?" The success of many CEOs in shedding subsidiaries and business functions led to the rise of the "cult of core competency," and along the way, outsourcing—its decades-old heritage notwithstanding—came into its own as a path toward streamlining a corporation down to its essential elements.

The cult of core competency was reinforced by another significant management theory in the 1990s, put forth by James Champy and Michael Hammer in their book *Reengineering the Corporation.* Following the lead of Champy and Hammer, organizations studied in detail many of their business processes to find ever more efficient ways of carrying them out. Armed with this knowledge of process and frustrated by the difficulty of generating real performance gains, many executives followed reengineering to one of its logical conclusions: outsourcing processes to external providers that could perform them more efficiently.

On the back of core competency and reengineering, outsourcing swept over management theorists and practitioners in the 1990s, inspiring a revolution in corporate structure that continues today. The incredibly rapid economic growth the late 1990s and the sudden crash of the early 2000s only reinforced the wave. In the rapid-growth phase at the inception of the Internet-based economy, many organizations experimented with outsourcing in an effort to accelerate time to market, manage growth, and gain access to hard-to-find and expensive skills. During the downturn, outsourcing leaped to the fore as a cost-saving quick fix when budgets came under pressure. Soon every element of a corporation's IT and business operations was potentially up for outsourcing consideration.

We should also mention the reinforcing impact of technology and communications advances. Beyond the Internet, the availability of increasingly cheap computing power, storage, and communications bandwidth has meant that services never previously outsourced are now regularly delivered by external service providers. Take call centers as just one example. Not too long ago, every company had its own batch of operators taking calls. Advances in computing power and storage capacity ushered in computer-telephony integration—allowing automated resolution to more calls and enabling human operators to handle far more callers. At the same time, the plummeting cost of communications bandwidth means that calls can be diverted to a central location where one external service provider can answer calls for hundreds of companies with a small group of operators. Huge savings have been commonly realized by organizations that have capitalized on these newly available services.

The net result of all these factors has not just been a largely successful (for all parties) explosion in outsourcing, with the overall services outsourcing market reaching three-quarters of a trillion dollars in annual revenue by 2008.[5] It has created a "cult of outsourcing" every bit as powerful as the cult of core competency that led to a decade of reengineering and downsizing. Today, many organizations and executives pursue outsourcing almost compulsively. Every service in the organization is considered a candidate for outsourcing, even without any evaluation, benchmarking, or consideration of future impact. These organizations and executives vastly underestimate the complexity of managing and integrating multiple outsourcers. Often they treat the outsourcing of even the most critical services as simply a procurement exercise—lowest bid wins, with no consideration of the ability to deliver.

Compulsive outsourcing has also been driven by globalization. The entry of global competitors into so many markets has accelerated the need to seek competitive and especially cost advantages—outsourcing seems the only alternative. Similarly, the drive to rapidly build a presence in some of the world's fastest-growing markets such as India, China, Brazil, and Russia has caused many organizations to use outsourcing to ramp up quickly.

This compulsive outsourcing—outsourcing for cost reasons without integrated planning, strategy, and ongoing management—has masked the rapidly changing complexity of the services outsourcing world. Organizations are often giving the same level of attention to hiring an outside company to run the corporate cafeteria, or a landscaping service to mow their lawn, that they give to outsourcing the highest levels of their research and development efforts. While services outsourcing is not by any means a new phenomenon, for much of its history it has been primarily focused on discrete services such as the cafeteria, building maintenance, basic infrastructure, and the mail room. In these cases, managing outside suppliers was relatively simple—there is no chance that grass clippings will end up in the sandwiches or that meatloaf will show up in someone's inbox. The realm of services that can be outsourced, however, has grown exponentially and now includes many integral parts of an organization's workflow. These services both support and depend on any number of other workstreams in the organization. When the grass is not being mowed, the source of the problem is obvious. When a significant project fails to meet a deadline because key contracted personnel don't deliver, because the outsourced finance organization hasn't paid invoices, because the outsourced HR provider's personnel tracking systems were down, because the outsourced IT organization's systems were not functioning properly, who is to blame?

At the same time that we have become plagued by compulsive outsourcing, the market for services is changing rapidly as well. Outsourcing companies are driving to standardize their services so that these companies too can grow rapidly while keeping costs under control. This has often created huge tensions between the expectations of service recipients and the needs of service providers.

What's the Problem?

The experiences of so many firms show that the current state of chaotic and compulsive outsourcing creates as many challenges as it solves. And the problems are most often not with the external provider; they lie within the organization itself and in the shortcomings in their sourcing practices: miscommunication, misalignment, poor governance, and a lack of coordinated management. Take, for example, the experiences of these three clients that called us for help after their own outsourcing experiences led not to lower costs or improved performance but to wasted effort and misspent dollars.

Miscommunication

A large global manufacturing company decided to outsource all its IT support services to a global provider.[6] After nearly a year of research, due diligence, and negotiation, a five-year exclusive contract was signed. The firm's CIO promised the board that the deal would cut IT support costs by 15 percent per year. Three months into the deal, the company completed the acquisition of a competitor that had major operations in Taiwan. Suddenly, the CIO's staff began receiving frantic calls: "Our users in Taiwan can't get any support. No one at the help desk speaks the Taiwanese dialect of Chinese!"

The CIO later discovered that the acquisition of the competitor had been in process for some time, but the acquisition plan had not been shared with the CIO or the contract negotiation team. The outsourcing contract was drafted and signed with a vital piece of information missing. The original contract specified all the languages the service provider had to provide support in; the Taiwanese dialect was not among them. In fact, the service provider had no employees who spoke the Taiwanese dialect at all. The CIO entered another round of negotiations over a barrel: with the exclusive five-year contract already in place, the service provider had all the leverage and could pass on all the costs of building its own capability to provide support to this large new group of users.

Governance Failure

Through a series of crises, a large government agency realized that it was incapable of keeping up with technology change. Leaders of the agency believed it could be much more effective in fulfilling its mission if its installed technology was much closer to "leading-edge" than "dinosaur." Outsourcing seemed the fastest way to resolve the problem. Agency executives determined that the service provider should also enforce standards across the whole of the agency's distributed computing operations in order to cut costs and improve service. After two years of evaluation and negotiation, the agency entered a contract with a large IT service provider. The deal was announced with great fanfare, and significant IT operations staff was transferred to the service provider.

Less than six months into the contract, problems became very apparent. The service provider was not receiving orders—and the agency had committed to minimum monthly payments to the service provider. It turns out that the different departments in the agency, while supportive of the original intention of using outsourcing to provide fresher technology, were adamantly opposed to having standards imposed. When the departments learned that they were limited in what equipment they could order, they found ways to place orders with other providers and avoided the contract altogether. The agency hadn't set up governance mechanisms to enforce compliance with the outsourcing contract. From there, the problems got worse—the agency was now incapable of providing support internally as its staff had been transferred to the service provider or moved to other positions in the agency. Less than a year into the contract, the agency began negotiations to completely restructure its agreement and started the arduous process of establishing a sourcing governance model to ensure that the new contract would be fully utilized.

Poor Coordination

The senior management of a global petrochemical company decided that the outsourcing of business and IT services should be part of its operations strategy. The executives mandated that the cost of any new investment initiative had to be compared to the cost of obtaining the required outcome via outsourcing. Management developed a rigorous business case methodology and implemented it across the company to ensure that outsourcing was considered before the company funded any initiative. For a long time, it seemed that the program was a roaring success. The company's annual spending on outsourcing was rising at triple digit rates—but not as fast as the estimated savings from performing the same services internally.

Three years into the program, the company launched a corporate audit and benchmarking effort to make sure that the savings figures were accurate and to assess the success of the program. The audit discovered that there were more than five hundred outsourcing contracts in the company and that on average the company was paying 20 percent more than market price for the services it was buying. The auditors discovered that, since the program did not require any central coordination of services contracts, there was no opportunity to leverage the company's considerable buying power. Additionally, the mandate on comparing internal costs to outsourcing did not require externally benchmarked pricing, but only required that the external providers be less costly than internal provision. As a result, although the company appeared to be saving money when it compared the outsourcing costs with internal costs, it was paying well above the market rates for services.

The Eight Myths of Outsourcing Today

Why is there now such a disconnect between theory and practice in outsourcing? You might wonder why problems are so prevalent when the recipe seems so straightforward: hire experts to provide the services that are not core or are nondifferentiating to the organization, and reap the benefits of improved management focus and more efficient and effective services.

The root of the problem, we believe, can be traced to eight myths that pervade current outsourcing management approaches:

1. *The myth of sourcing independence:* Sourcing is an element vital to the fulfillment of business strategy. But very often we encounter organizations whose sourcing decisions are made entirely independent of business strategy. The nature of outsourcing relationships formed is entirely incompatible with the business results expected. This often takes the form of dramatic disconnects between senior executives, the board, and operational managers.

2. *The myth of service autonomy:* A similar myth is that services are autonomous—and one sourcing relationship has nothing to do with another. This myth is a holdover from the days when only very discrete services (like food service and building maintenance) were outsourced. In today's world, service providers depend on each other and on internal services to meet goals—autonomous services don't exist.

3. *The myth of economies of scale:* Many organizations enter outsourcing relationships to cut costs. They believe that service providers' ability to leverage economies of scale is unlimited and allows the providers to offer services at a lower cost through "mass production." While this capability exists to a certain extent, the benefits of economies of scale depend on the service providers' ability to deliver standardized services to multiple organizations. In practice, though, many organizations want to enjoy the benefits of economies of scale but refuse to allow service providers to provide standardized services; the result is often disastrous.

4. *The myth of self-management:* Most organizations that enter outsourcing contracts do not have a coherent plan for the ongoing management of the relationship and the services that are provided. Consciously or unconsciously, they assume that the contract and the various service level agreements that are negotiated will be self-managing and that investing in governance processes over the contract's lifetime is unnecessary.

5. *The myth of the enemy:* Far too many organizations enter negotiations for long-term outsourcing contracts under the misconception that the service provider is the enemy. They view the contract negotiations as a war in which there will only be one winner. The usual result of this approach is that both the organization and the service provider end up casualties.

6. *The myth of procurement:* A related myth is that the sourcing of services is primarily a procurement exercise where best price wins. In reality, many services outsourced today are vital to

corporate strategy, and therefore issues of capability, culture, relationship, and other factors are often more important to long-term success than price.

7. *The myth of the steady state:* The most common outsourcing arrangements seen today envision a steady state—the outsourced services will never need to change. Nothing in business operations today remains in a steady state for long, and when the needs change, outsourcing relationships often break down.
8. *The myth of sourcing competency:* Finally, and perhaps most painfully, virtually every organization we deal with, even when accepting the need for ongoing common management across service providers, believes that it has the required management competencies in house to perform the necessary governance. Organizations learn too late that managing external services requires vastly different competencies than managing the same, internally provided services.

If you take a moment to review the preceding case studies, you'll see many elements of these myths and the destructive impact they have. Moving beyond outsourcing to Multisourcing requires dispelling these myths and taking a new approach to all sourcing initiatives and actions.

New Terrain Requires a New Map

MULTISOURCING is new terrain, different from our traditional approaches to outsourcing. While outsourcing unquestionably has provided substantial benefits, traditional approaches have become far less useful in meeting business goals, for all the reasons we've discussed. Multisourcing will deliver the promised business benefits that managers, executives, boards, and investors have expected from outsourcing. It will allow organizations to focus capital and resources on those items that really matter. It will allow firms to aggressively pursue growth opportunities while mitigating risk. It will allow greater agility, higher quality, and lower costs. Organizations must take a Multisourcing approach to compete on a global basis.

We strongly believe that the full value of blending multiple internal and external service providers can be realized, despite the challenges and despite the need for new approaches, because we have seen it in action. Organizations like Anglo-Platinum, DuPont, General Dynamics, Nike, Nextel, GE, Entergy, Tetra-Pak, Thomson, Sun Microsystems, Ontario Power Generation, and many others are beginning to apply the principles of Multisourcing and are moving beyond outsourcing to improve their growth prospects and their agility.

The problem with the current state of affairs is that while businesses, executives, and managers have wholeheartedly embraced the use of outsourcing, they are trying to implement and manage multisourced operations with the wrong approaches and models. The world of Multisourcing is new terrain for operations and as such requires a new map. This new map is needed to guide managers in the rational and effective management of a multisourced organization, one where internally and externally delivered services are blended seamlessly, managed and governed effectively, and evaluated continuously for effectiveness and efficiency. This book will provide such a map to Multisourcing's new terrain. The first three chapters are primarily about sourcing strategy, the vital foundation to effective Multisourcing. In chapter 4, we look at sourcing governance—your secret weapon for keeping your sourcing strategy on course. Chapters 5 and 6 examine how to select the right service providers and create the right contracts to enable success. Finally, chapter 7 looks at the ongoing functions of Multisourcing management and measurement—your tools to ensure that your changing needs are being met.

Four Key Themes

FOUR KEY THEMES are reflected throughout the book; they underlie and are woven through every aspect of Multisourcing. The book is roughly organized along these themes, but they are not sequential steps and each appears in every part of the book. You can consider these key themes a crash course in Multisourcing.

1. *You must have a strategy.* Considering the complexity of Multisourcing and the rapidly changing needs of today's businesses, an organization must have a comprehensive strategy for how it will use sourcing to meet its long-term goals. You will never achieve optimal performance without a well-planned and integrated sourcing strategy.

2. *Multisourcing governance is the single most important factor in determining success.* Despite the importance of strategy, governance is, surprisingly, even more important. The lack of a strategy will certainly be a huge barrier to your being fully successful, but good governance can help you achieve positive outcomes from your sourcing relationships and keep your Multisourcing environment from spinning out of control while a strategy is formed. No matter how good your strategy is, if you don't have sourcing governance in place to implement your strategy, enforce it, change it, and adjust it to market changes, your strategy will be worthless.

3. *Multisourcing is built on a network of relationships—not transactions.* Success via Multisourcing requires the understanding that you are entering ongoing relationships with service providers that will in large part become partners with you in delivering business outcomes. Managing relationships is vastly different from managing one-off transactions—it means that you have to be concerned not just about what happens today but about ensuring a positive environment for working with your service providers tomorrow. This approach needs to dominate your thinking in how you deal with service providers.

4. *Multisourcing requires creating measures that matter.* This may seem a truism, and we only wish it were so. Far too many service relationships founder, not because of a lack of measurement, but because of a lack of measurement of the things that

> really matter. Service level agreements often measure incidental items that have no bearing on business outcomes. With every step you take in Multisourcing, from strategy to governance to relationship management, you need to keep in mind the imperative of creating meaningful measures that help managers steer toward required business outcomes.

Who Should Read This Book and Who Shouldn't

We've written this book for executives and senior managers who need help in shifting from compulsive (and often chaotic) outsourcing to Multisourcing—executives who want and need to improve cost structures, add capability, and expand globally, all while increasing agility and creating competitive advantage. Because we are writing for these executives who have a broad view of operations, we do not delve into the vagaries or specifics of any particular type of service.

Our goal is for this book to be a guide to enterprise sourcing issues for executive management, not a "sourcing for dummies" type of offering. Thus we have endeavored to keep the text readable and practical without becoming too detailed. In general, you won't find step-by-step guides, but you will see comprehensive discussions of the issues at hand and proven approaches for achieving success. You will also see some frameworks for decision making. These frameworks are intended to stimulate internal discussions and to be used for examining various approaches to your Multisourcing decisions. Our discussions are based on years of working with thousands of companies helping solve outsourcing problems and create Multisourcing solutions.

We should briefly mention case studies. There are both named and anonymous case studies throughout the book—all reflecting clients we have worked with since 2000. In both types of case studies, we have generally limited the details in these discussions for several reasons. First, the details tend to distract from the main points; second, many of our clients believe that their approaches to Multisourcing are providing them vital competitive advantage in their markets today and want to preserve that advantage. Third, as we're sure you're fully aware, outsourcing is a highly politically charged topic currently and we do not wish to add further fuel to any fires. In the anonymous case studies, minor details of each story have been changed to protect confidentiality.

Finally, the book is the result of not just our experience but that of hundreds of our colleagues and the combined learning of our clients who live in the world of Multisourcing every day. We sincerely hope you will find what we've learned to be helpful in bringing order to the chaos and in moving beyond the challenges of outsourcing and to Multisourcing.