

OUTSOURCING: Motivations, Market, Models, Governance implications

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Agenda

Base concepts

Business Strategy, Capabilities, Value Chain, Value Net

Outsourcing

Motivations, Market, Models

Professions and Competencies

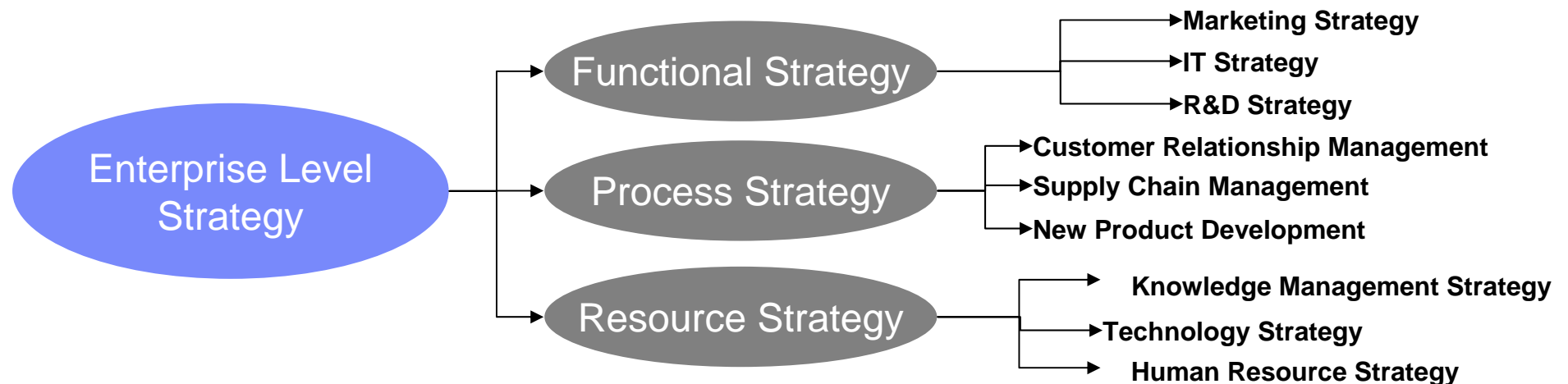
Business Development, Sales, Governance

Questions

Strategy is:

The formulation and execution of an integrated set of choices

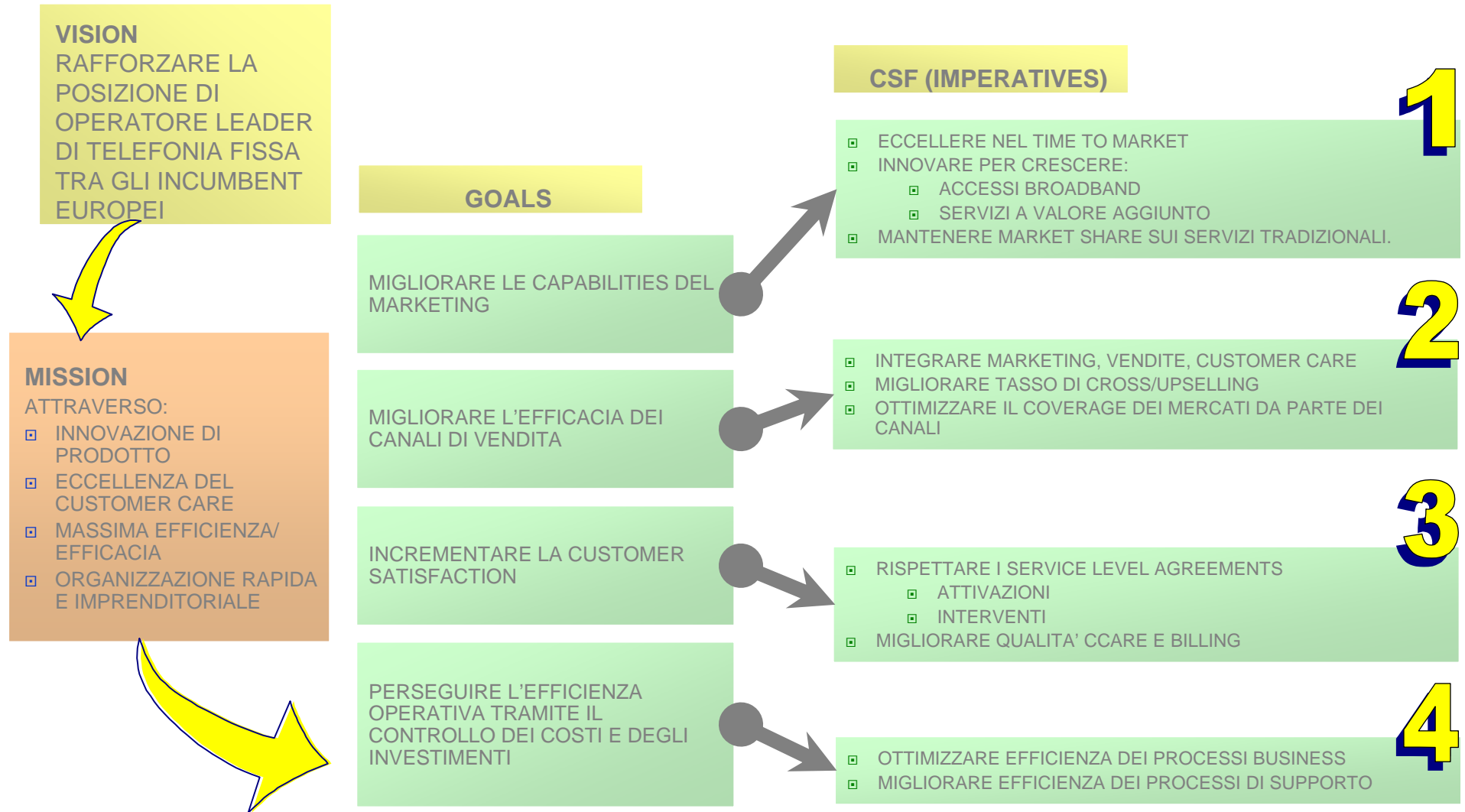
- ❑ Based on customer needs *Customer selection*
- ❑ Identifies the essential positioning, competitive advantages, and configuration of activities *Positioning*
- ❑ Necessary to create and sustain value superior to the competition *Value Capture*
- ❑ Required to generate superior financial returns in a dynamic environment *Strategic Control*



A business strategy and business model should be clearly stated in a structured format

- ❑ The primary elements of a strategic statement include:
 - Vision – a statement of the desired state of the business, to set a clear direction for the business
 - Mission – a description of why the business exists
 - Business goals – high-level business objectives that measure achievement of the desired vision
 - Critical success factors – the set of things that must go right to achieve the vision, limited to those that are collectively necessary and sufficient to ensure success
 - Key tactics – a description of the game plays or major thrusts that are being undertaken to achieve the vision
- ❑ The business model describes choices that have been made for:
 - Customer selection – choice of customer (and other external value net players) segments involved in the business model
 - Value proposition(s) – firm-level value propositions made to those customer and other player segments, described in terms of satisfying the recipient's wants or needs
 - Value capture – value captured by the firm from these segments in return for the value propositions, expressed as profit (or enhancements to capabilities that will generate future profits)
 - Competitive differentiation – description of what makes the client different from its direct competitors and other substitutes
 - Strategic control – description of a company's ability to protect its profit stream
 - Scope of activities performed – description of core capabilities, unique assets, and the firm's structure, which is responsible for creating/delivering the value propositions offered by the firm

Un esempio Telecom Italia 2003

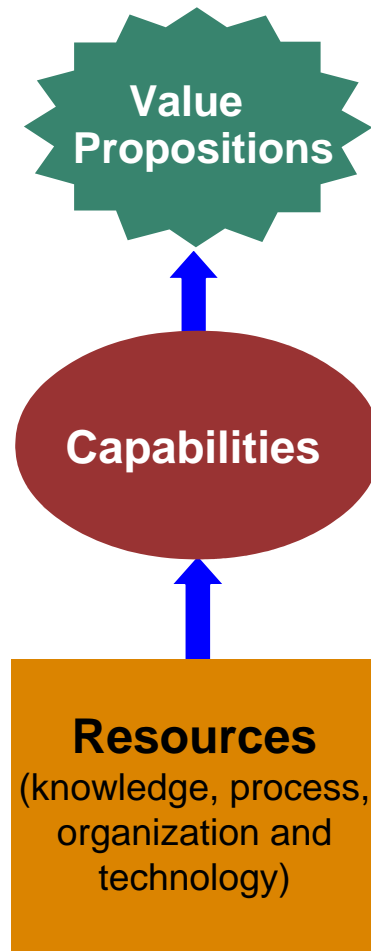


Several questions must be considered in the implementation of a business strategy. Several disciplines can be applied

Statements of **benefits**, both tangible and intangible, that are delivered to internal or external recipients expressed from an **external view**

Ability to perform a certain business function described in terms of **what must be done**, not how it is done. Provide an **internal view**.

What a company **needs to have** in order to perform the capabilities. **Tangible and intangible assets of the company.**



STRATEGY

addresses the question:
How should the organization create, capture, and sustain value?

DESIGN

addresses the question:
What should be built so the organization delivers the desired value?

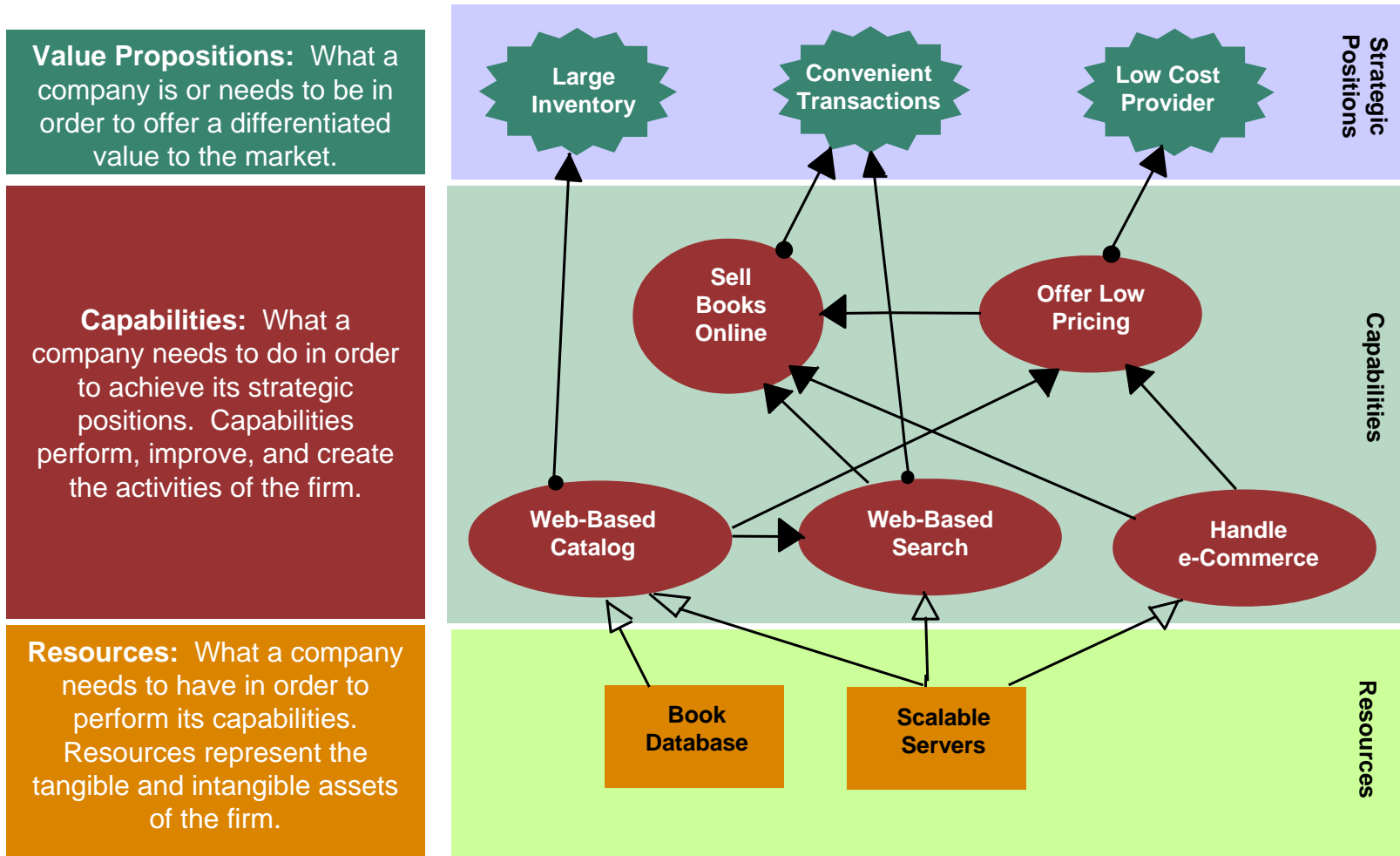
ORGANIZATION

addresses the questions:
What kind of organization do we need ?
How do we get there?

VALUE

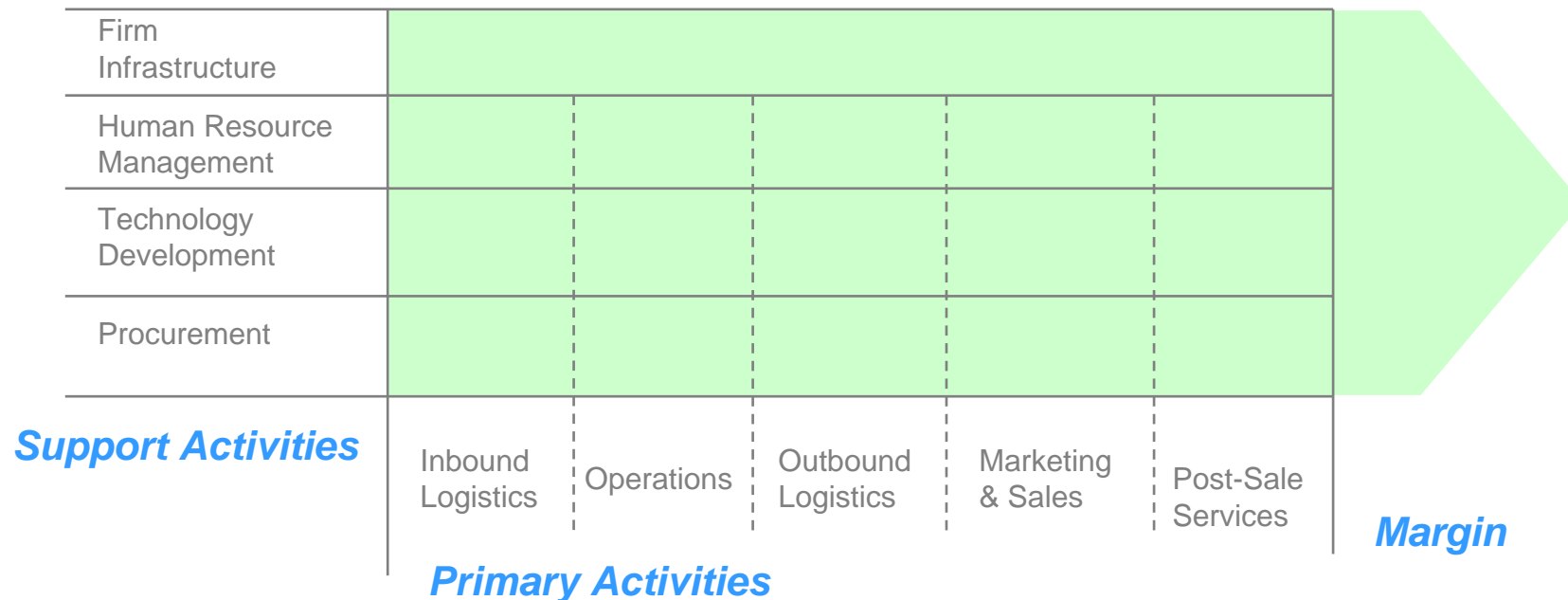
addresses the questions:
How do we determine the value of initiatives? How do we measure and manage the value captured?

Value propositions identified in the business model link to capabilities and resources in the Strategic Capability Network



A Company's Value Chain is a system of interdependent activities, which are connected by linkages

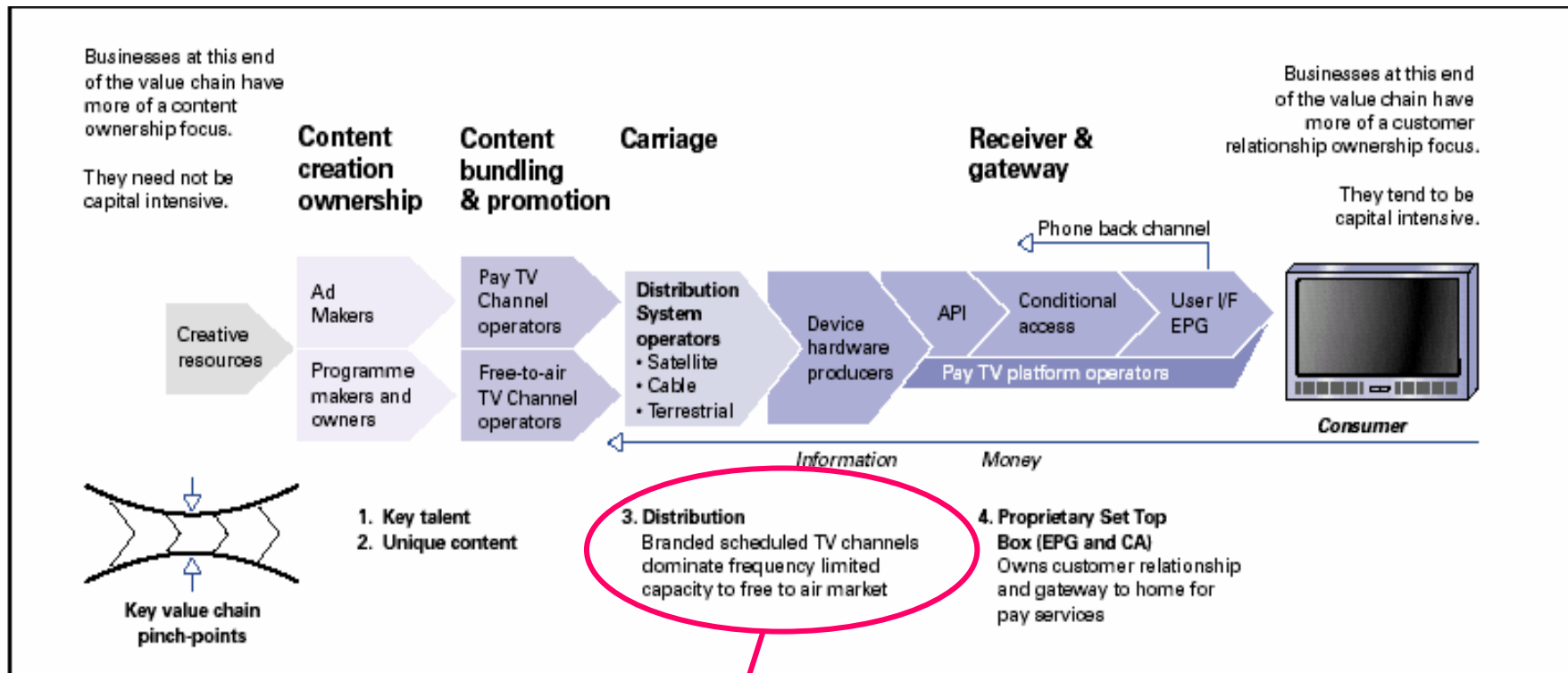
Linkages exist when the way in which an activity is performed affects the cost or effectiveness of other activities



A more costly product design can reduce post-sales services costs. A company must resolve such trade-offs in accordance to its enterprise strategy to achieve competitive advantage

The use of the value chain is very useful in understanding the business critical activities, opportunities and threats emerging from the continuous change of the industry

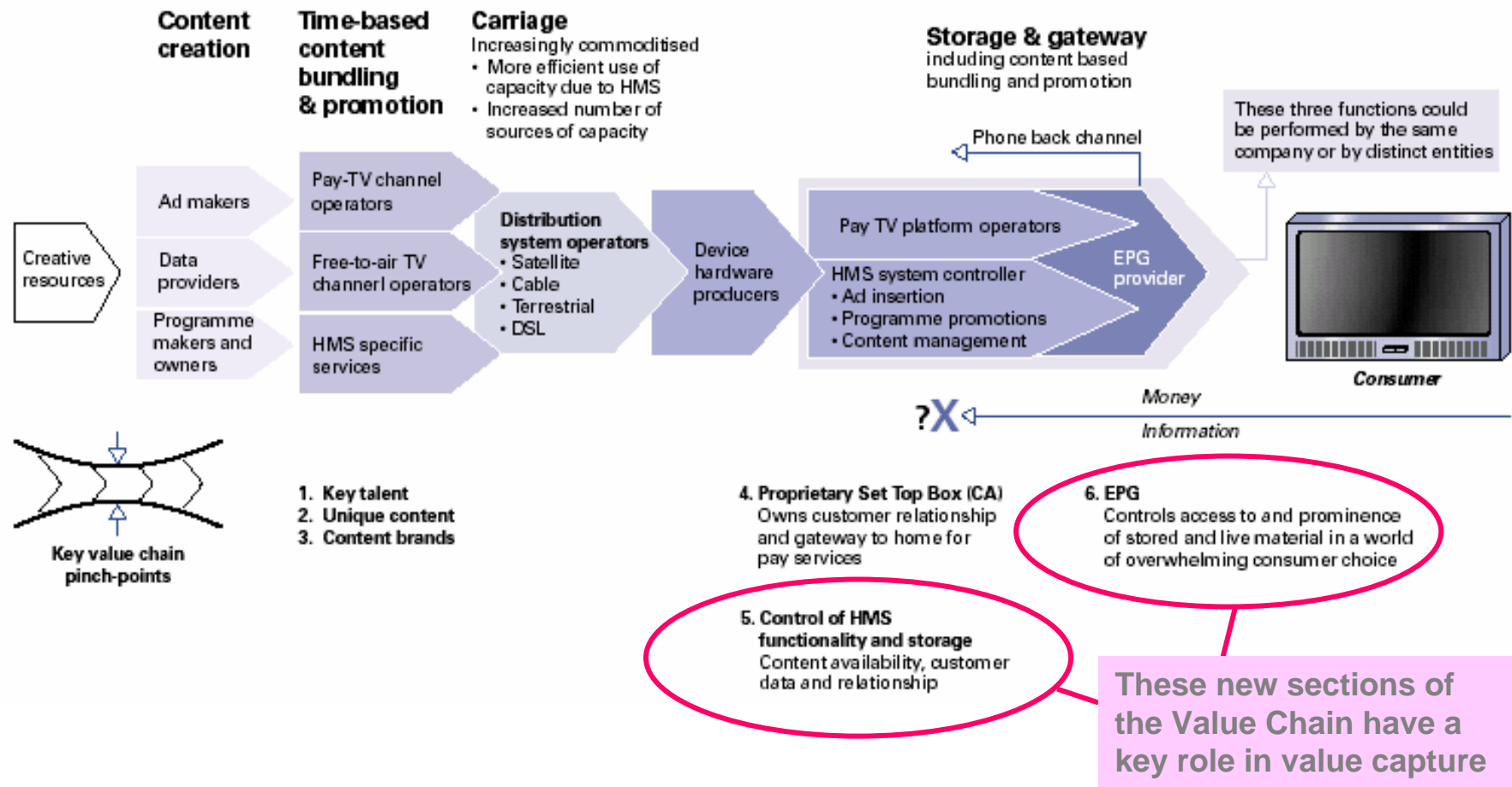
Traditional Value Chain without LVOD (Local Video On Demand)



This section of the Value Chain is losing value in a LVOD context in which content and not shedule is dominant

Changes in the value chain can include the points where most of the value can be captured. Profitability and eventually existence of the enterprise are put at threat, but the other side of the medal involves opportunities for growth

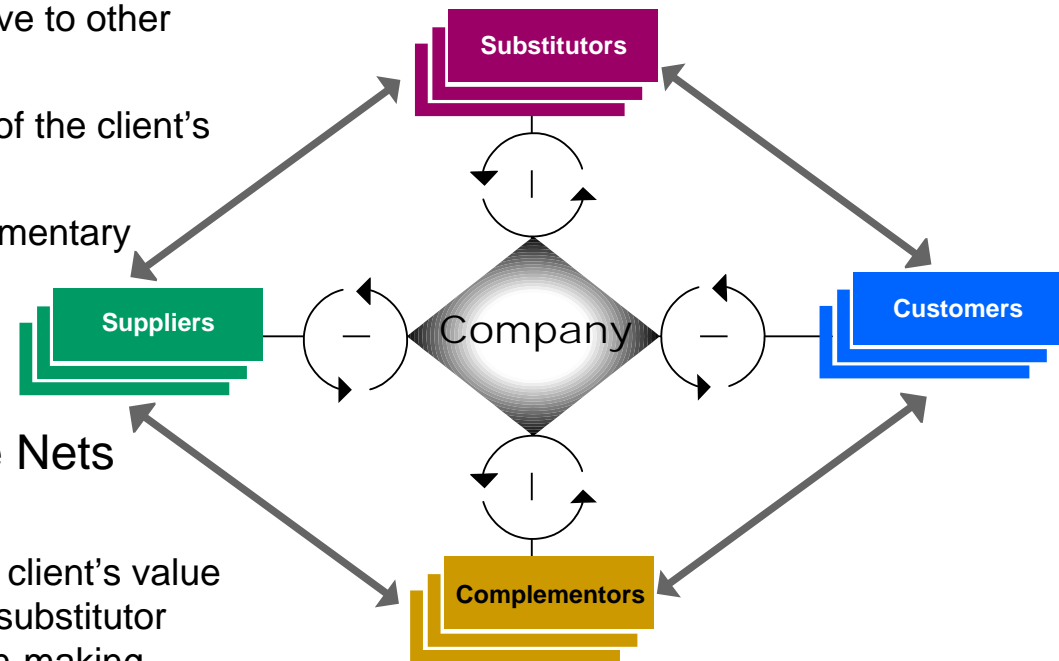
Future Value Chain with LVOD



Value Net analysis enables greater understanding of the client's position within the industry and of the relationships and activities that affect the client's decision-making

□ A Value Net:

- Describes the client's position relative to other players
- Provides an inside-out perspective of the client's business and industry
- Incorporates cooperative or complementary players into the view of the industry



□ Insights derived from using Value Nets include understanding:

- How players and activities along the client's value chain as well as complementor and substitutor relationships affect strategic decision-making
- Linking company behavior to the industry environment
- How manipulation of the environment may result in greater competitive advantage and creation and capture of value



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Base Concepts

Business Strategy, Capabilities, Value Chain, Value Net

Outsourcing

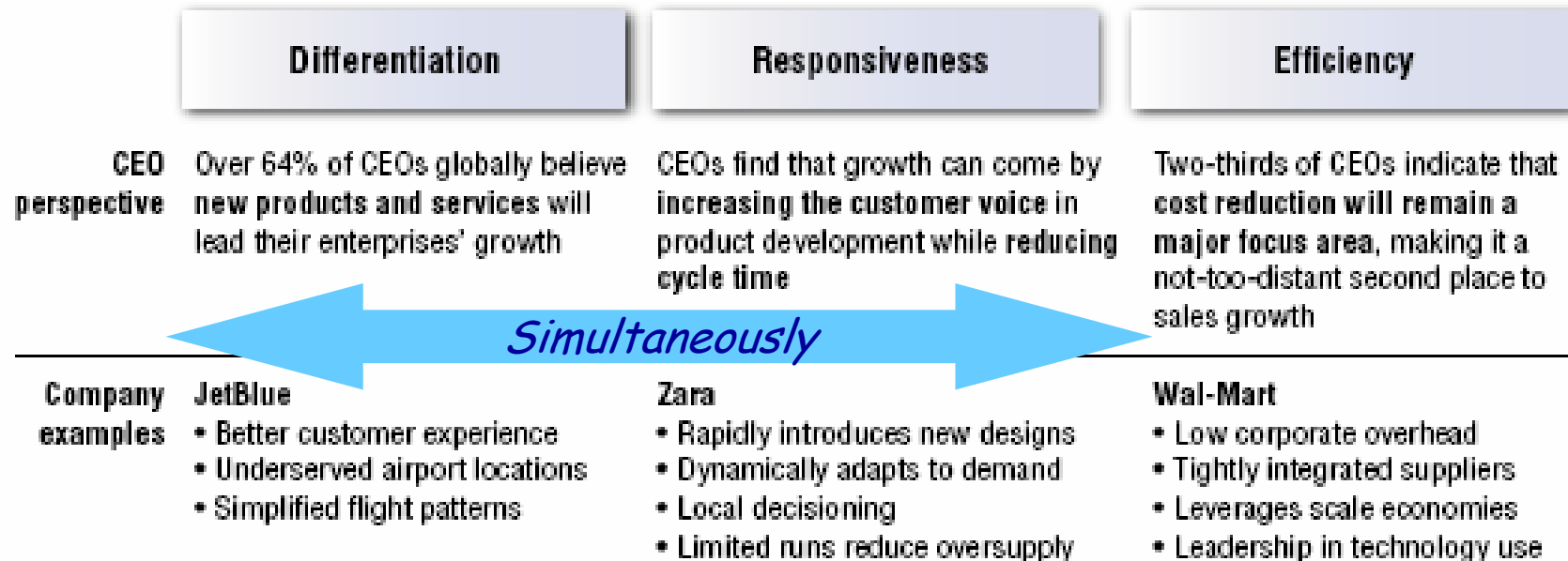
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Globalization, more demanding financial markets, technology proliferation; how they translate in challenges for the business ?



Source: "Your Turn: The Global CEO Study 2004" IBM Business Consulting Services, 2004; IBM Institute for Business Value.

In a recent global study, more than 450 CEOs responded about their most critical imperatives to achieve success in today's economy. Their top responses:

- **strong, differentiated value propositions are critical for growth and profitability;**
- **organizations must be able to sense and respond rapidly to customer and marketplace changes;**
- **cost structures and business processes must be adapted in a flexible manner to maintain productivity and reduce risk**

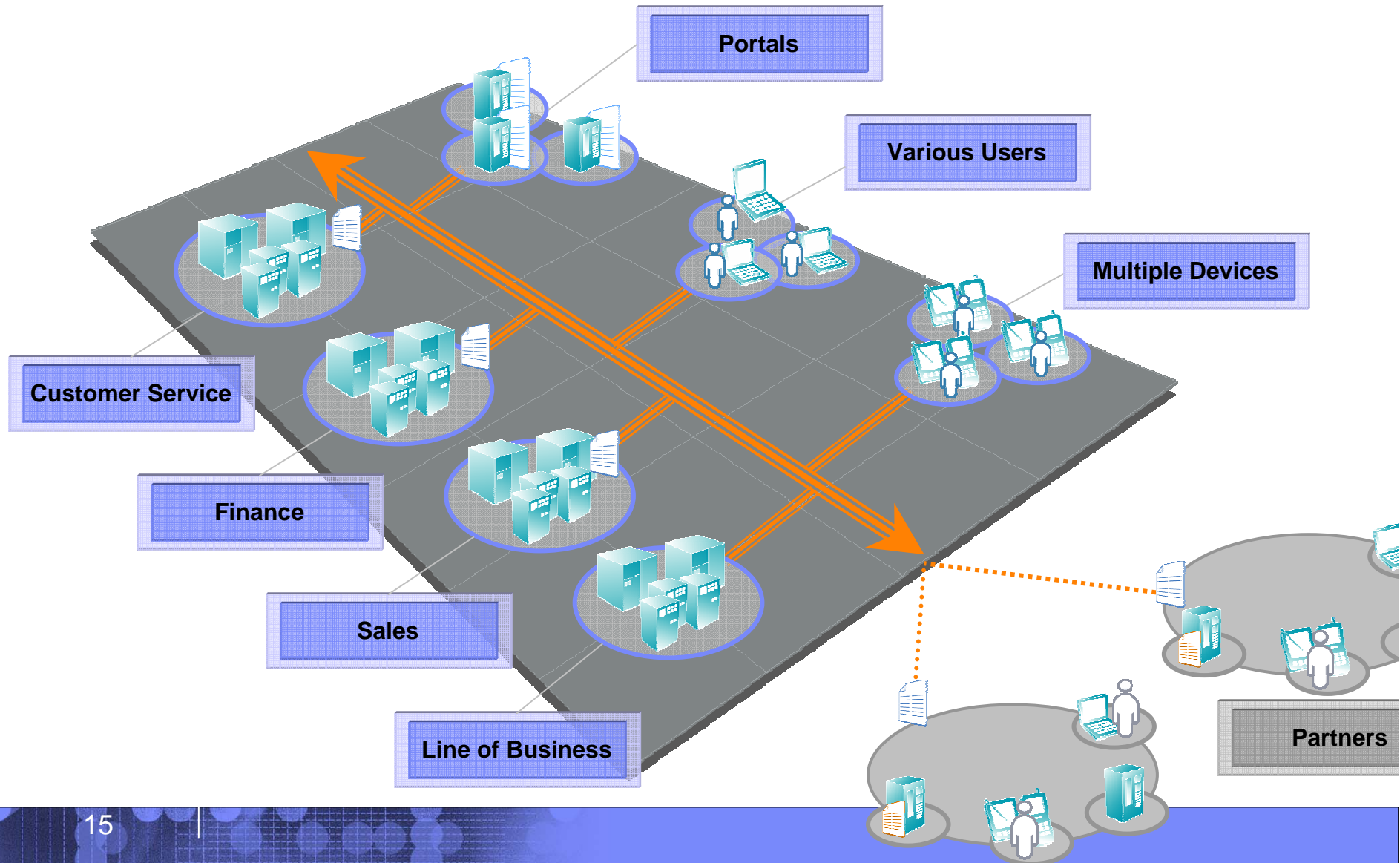
Today's enterprises can increasingly "program" the business by selecting from a variety of established modules or disparate components



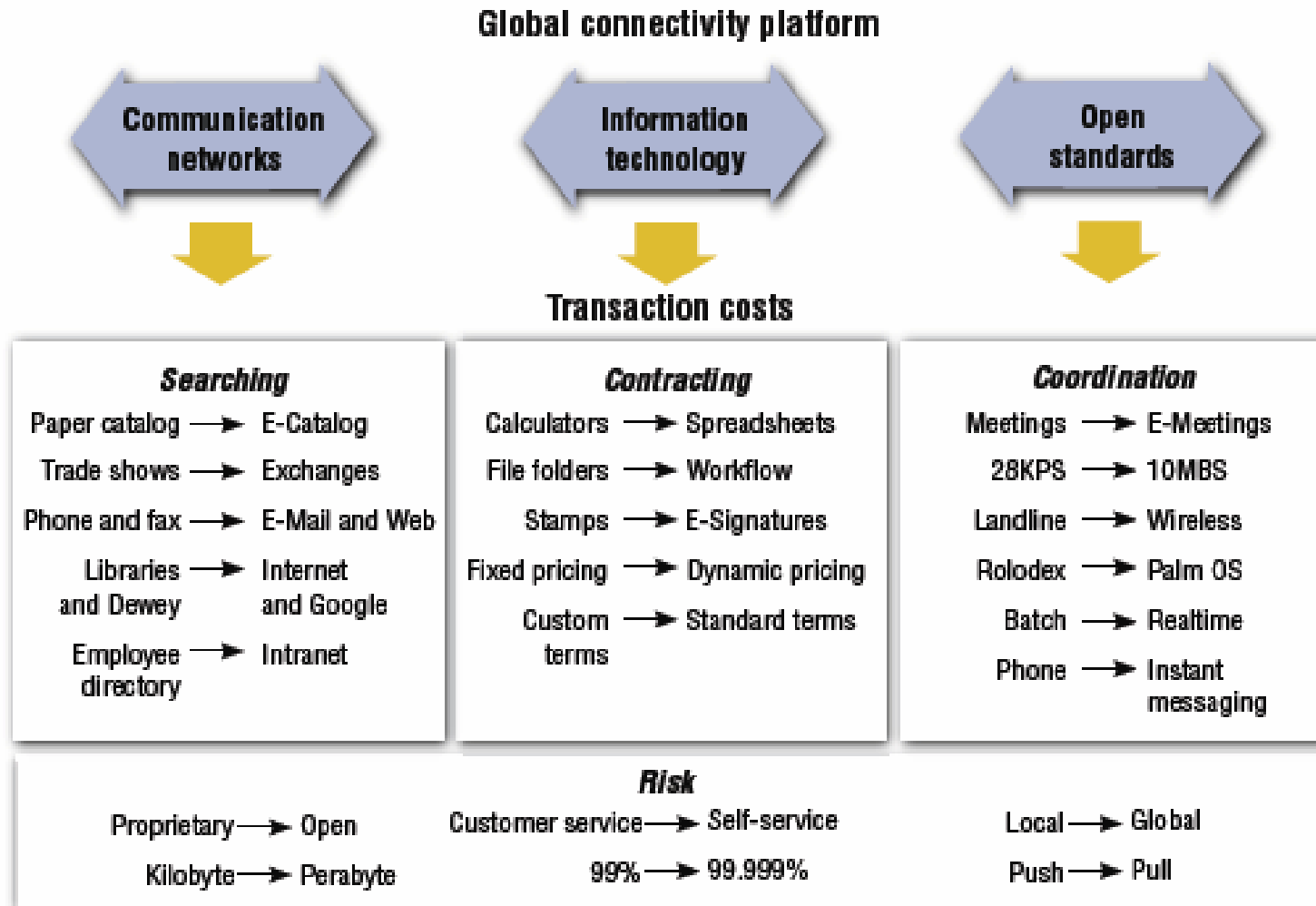
- ❑ Over the last 5-7 years, a number of diverse business and technology architectures have matured and converged to form a global connectivity platform that supports widespread collaboration.
- ❑ By slashing the cost of coordination both within the firm and externally, with partners, this new platform represents a de facto weakening of traditional business structures and boundaries.

- ❑ First, communication networks, specifically broadband and wireless technologies, have made digital connectivity faster and more affordable.
- ❑ Second, information technology has evolved. With the consolidation of the enterprise software market and the proliferation of business integration software, companies now have a common platform upon which broader and better functionality can be built.
- ❑ Third, open standards – both technology and business – are optimizing interoperability and creating the potential for truly modularized infrastructures.
 - On the technology side, XML has been adopted by 25 percent of companies and is currently being rolled out in another 33 percent.
 - On the business side, the increasing ability of enterprises to define common processes and activities is simplifying day-to-day commerce and improving work flow.

Web Services is a standards-based approach to “componentising” applications and allowing those components to be inter-connected



The rapid decline of transaction costs is having an especially profound and lasting effect on ownership decisions



Source: IBM Institute for Business Value.

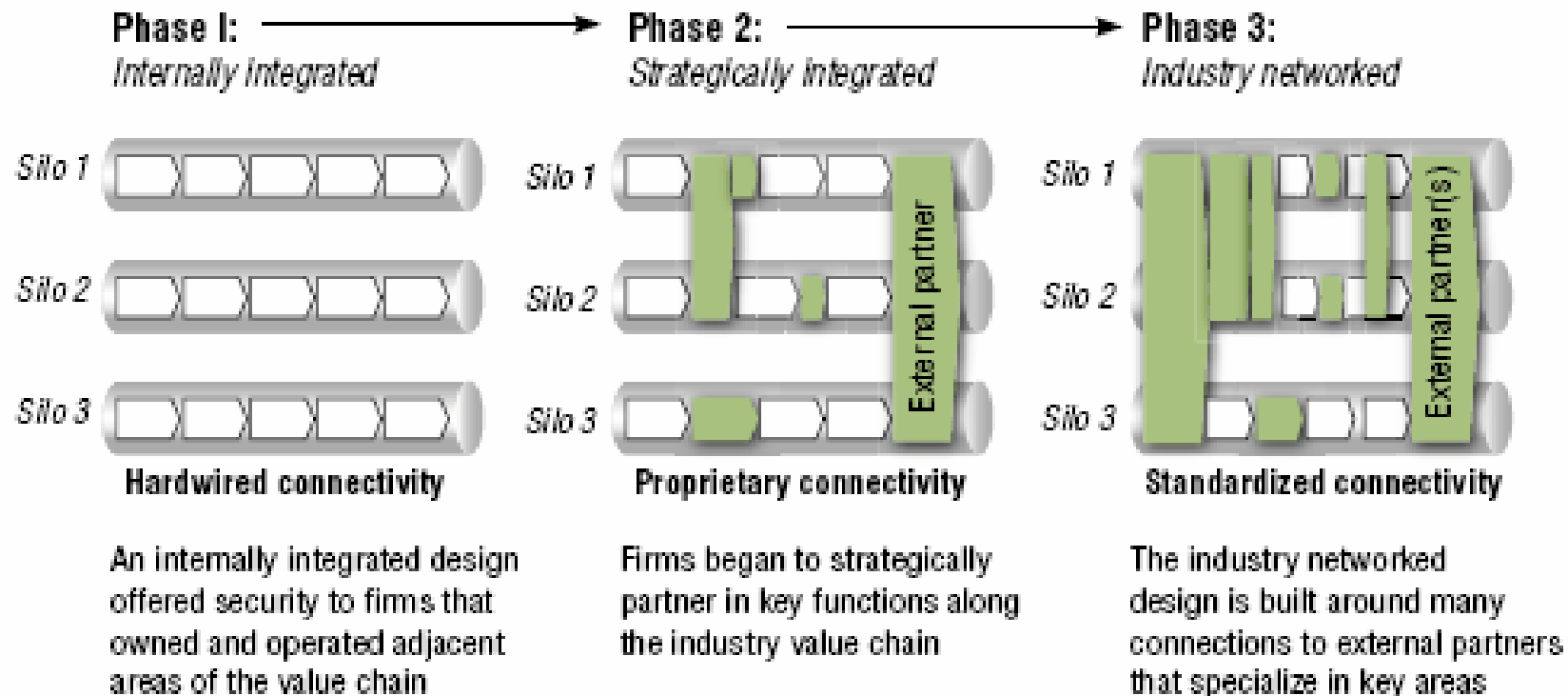


Changes in interaction costs can cause entire industries to reorganize rapidly and dramatically.

- ❑ As business interactions move on to electronic networks such as the Internet, basic assumptions about corporate organization will be overturned

- ❑ Activities that companies have always believed to be central to their businesses will suddenly be offered by new, specialized competitors that can do those activities better, faster, and more efficiently. Executives will be forced to ask the most basic and discom-fiting question about their companies: what business are we really in?
 - ➔ Developing a capability in-house confers no differentiation if an outside specialist can provide the same more effectively or efficiently

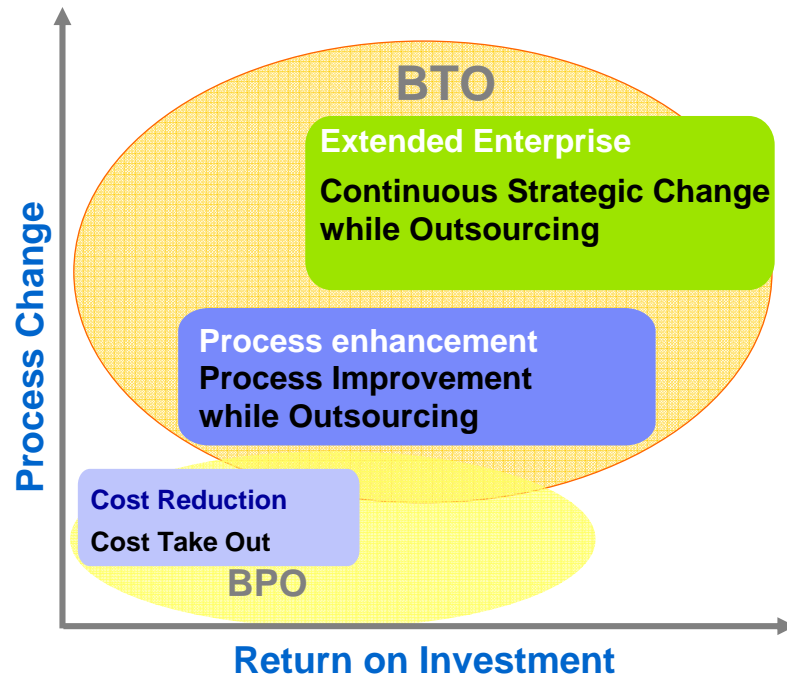
As standards-driven internal specialization matures, firms gain the ability to leverage the benefits of lower transaction costs by engaging with partners through collaborative industry networks.



Source: IBM Institute for Business Value.

- The reduction of the transaction costs changes the rule of the business.
- The entire Value Net must be analysed and re-designed to exploit the emerging opportunities
- Reducing cost of transactions can cause a growth of transactions !

Business Transformation Outsourcing and Business Process Outsourcing



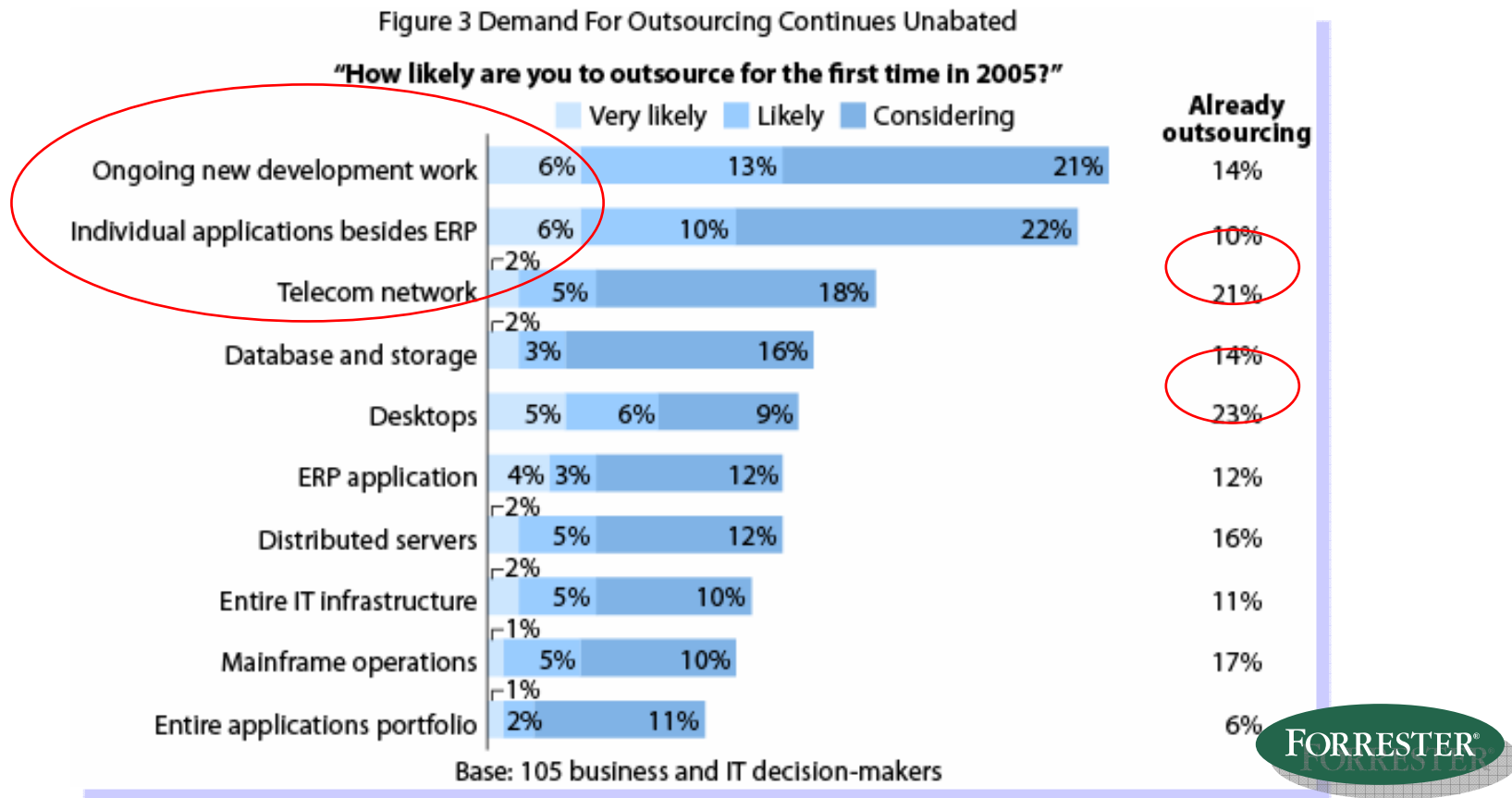
BTO client benefits:

- Focus on core business
- Increase flexibility to adapt quickly
- Reduce barriers to change
- Innovate, improve and transform processes
- Speed time to benefits
- Improve decision support
- Enhance consistency of customer information and customer service
- Reduce costs

BTO client needs:

- Outsourcer-derived processes (with substantial changes) or client own processes (with some changes)
- Minimal to significant technology deployment
- SLAs oriented toward slight improved to leading practice business metrics
- Cost savings from process and application transformation, labor arbitrage and economies of scale
- Resource-based and/or business-metric based pricing

Market analysts tells that IT outsourcing will maintain significant growth rates, with applications and network outsourcing becoming top drivers



Source: Sizing The Market For IT Services Through 2009, Forrester, September 2005

The SO market is growing and becoming more complex including multiple “service towers”

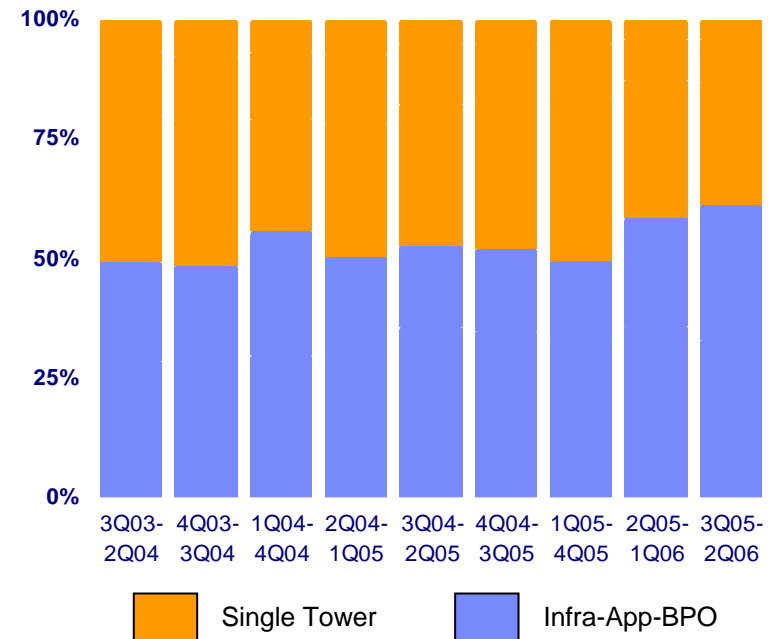
- By 2012, 50% of the worldwide Fortune 1.000 companies will have outsourced IT (Gartner source)
- The Outsourcing market will grow 7.2% annually by the end of 2009 (Gartner source)

Large deal market is very active
(IBM source)

Vendor	Client	TCV
Accenture	Unilever-US	1000 \$
CSC	BAE Systems	1900 \$
	US Army	2000 \$
EDS	Kraft Foods	1700 \$
	General Motors	3800 \$
	US Army	2000 \$
	US Navy	3000 \$
IBM	GAP	1100 \$
	AGF	220 \$
	US Army	2000 \$
TSystems	Daimler Chrysler	1000 \$
HCL	Skandia Insurance	780 \$
Cap Gemini	UK HM Rev and Customers	1210 \$

1H 2006 large deals (TCV in M\$)

Deals become more and more complex - including a mix of Infra, Apps and BTO
(IBM source)

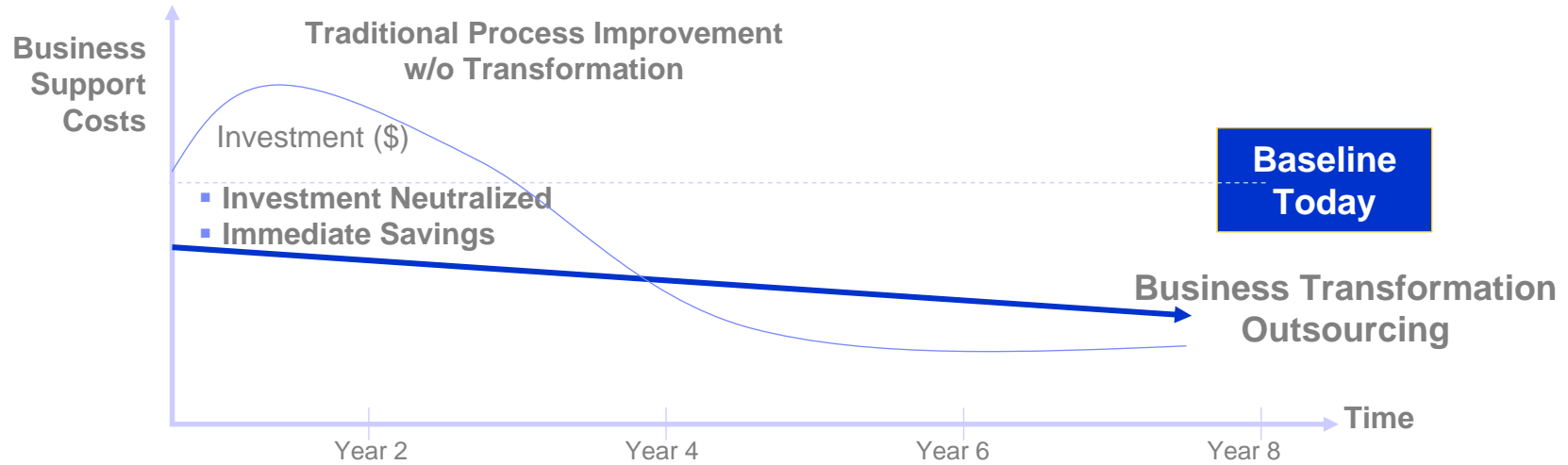


By outsourcing its IT (or a part of it) an organization changes its relationship with the information system moving from a role of owner of a technological infrastructure to user of a “well-defined” service

- ❑ This is a major change if compared with Facility Management where the provider is just a manager of the technological infrastructure without any involvement in its evolution

- ❑ The drivers for the outsourcing decision are:
 - ➔ Relevant and immediate reduction of costs (30% or more)
 - Consolidation and Transformation of the Infrastructure
 - Process Improvement & Standardization
 - Offshoring
 - ➔ Improved flexibility by reducing the fixed costs of the operations
 - Shared risks / Shared rewards
 - People & Asset transfer
 - Way-out
 - ➔ Innovation
 - Reconfiguration of the business
 - Exploiting IT evolutionary opportunities
 - Moving Commitments from SLAs to KPIs

Relevant and Immediate reduction of costs



Transition

Transformation

Innovation Sourcing

Innovation is required on all key dimensions of a large deal

Characteristics of classic SO

- People transfer to partner
- Partner responsible for HR restructuring
- Partner fully responsible for service and transformation
- Relationship between partners managed by contract
- Aggressive cost cutting

Innovation required on all key dimensions of a large deal

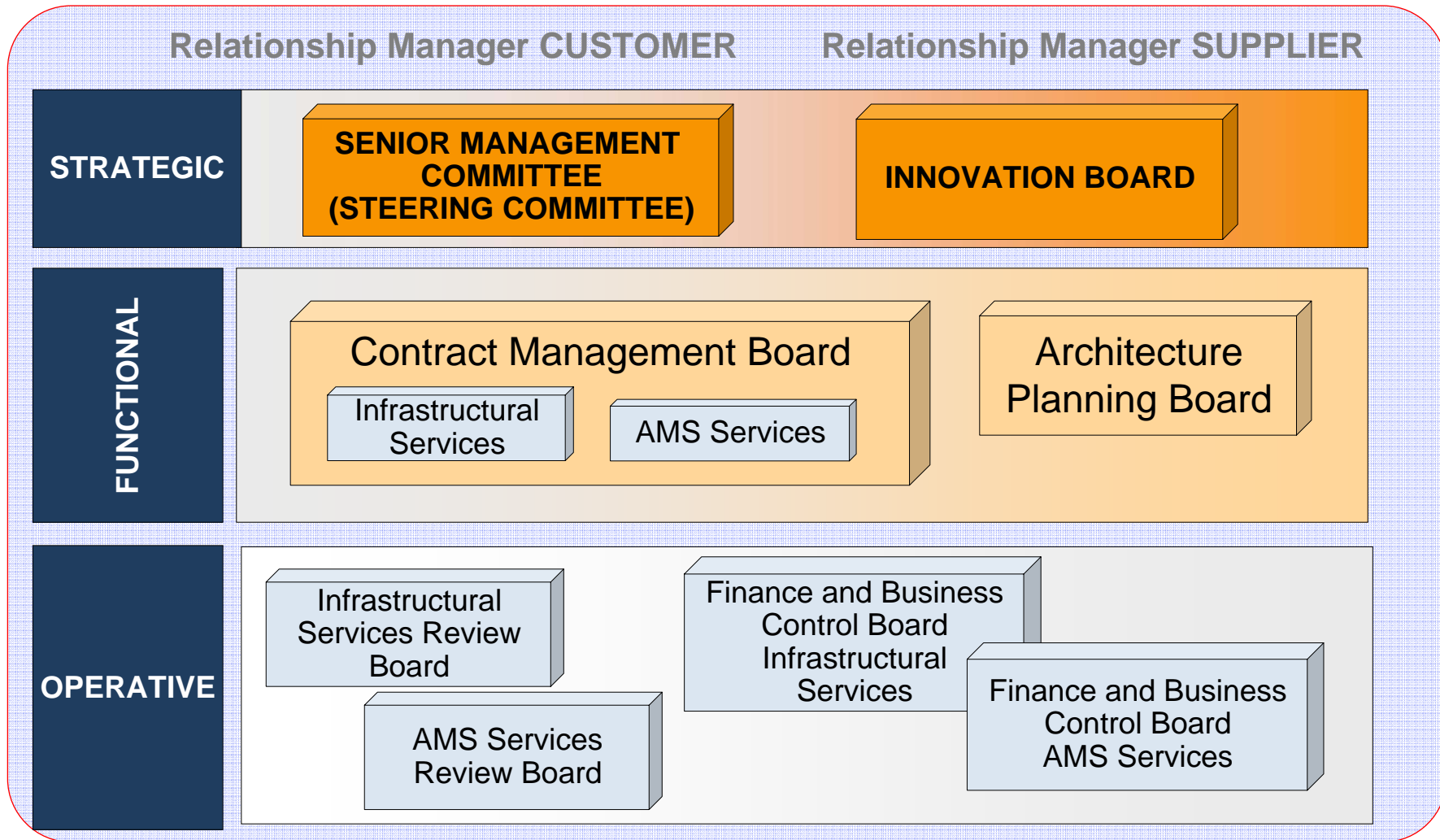
Organization & Structure

Financial Solution

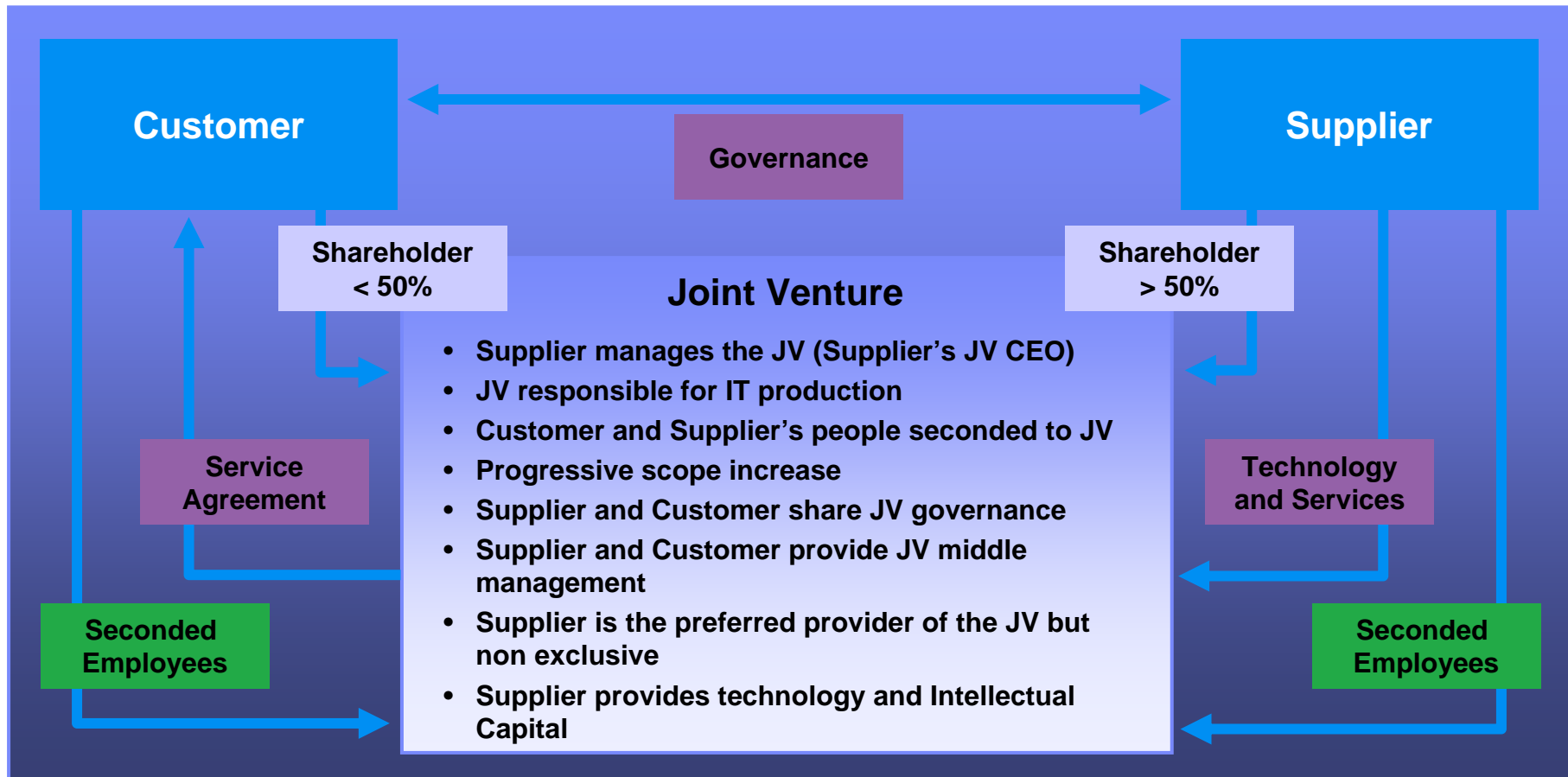
Human Resource

Transformation & Innovation

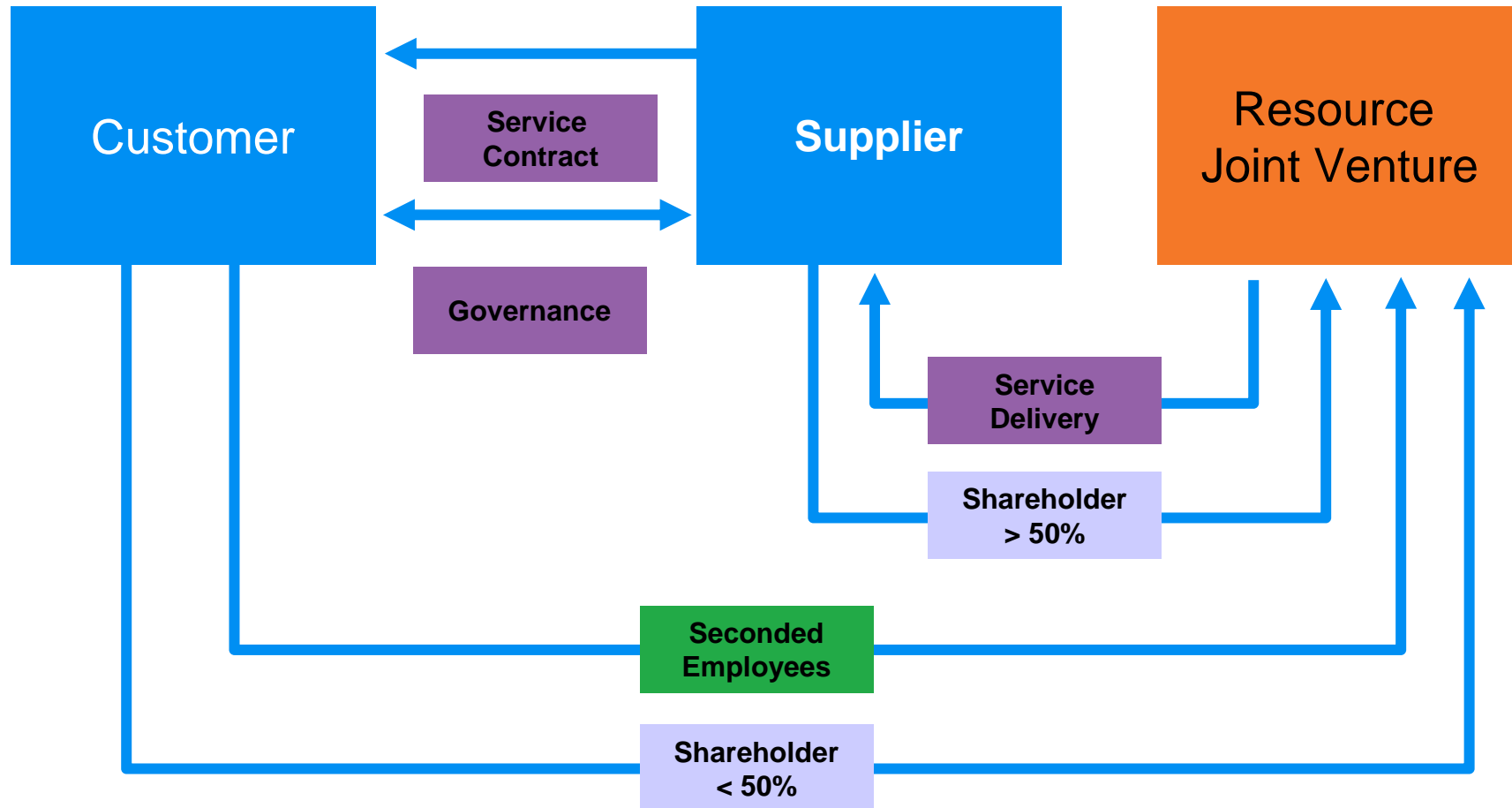
Sometimes a sound governance model can satisfy all customer requirements



Some other times a more complex arrangement is needed including a Joint Venture to satisfy customer requirements for image or HR purposes



A Resource Joint Venture is a less complex means to meet customer transition requirements than the delivery JV



Datacentre outsourcing services value proposition

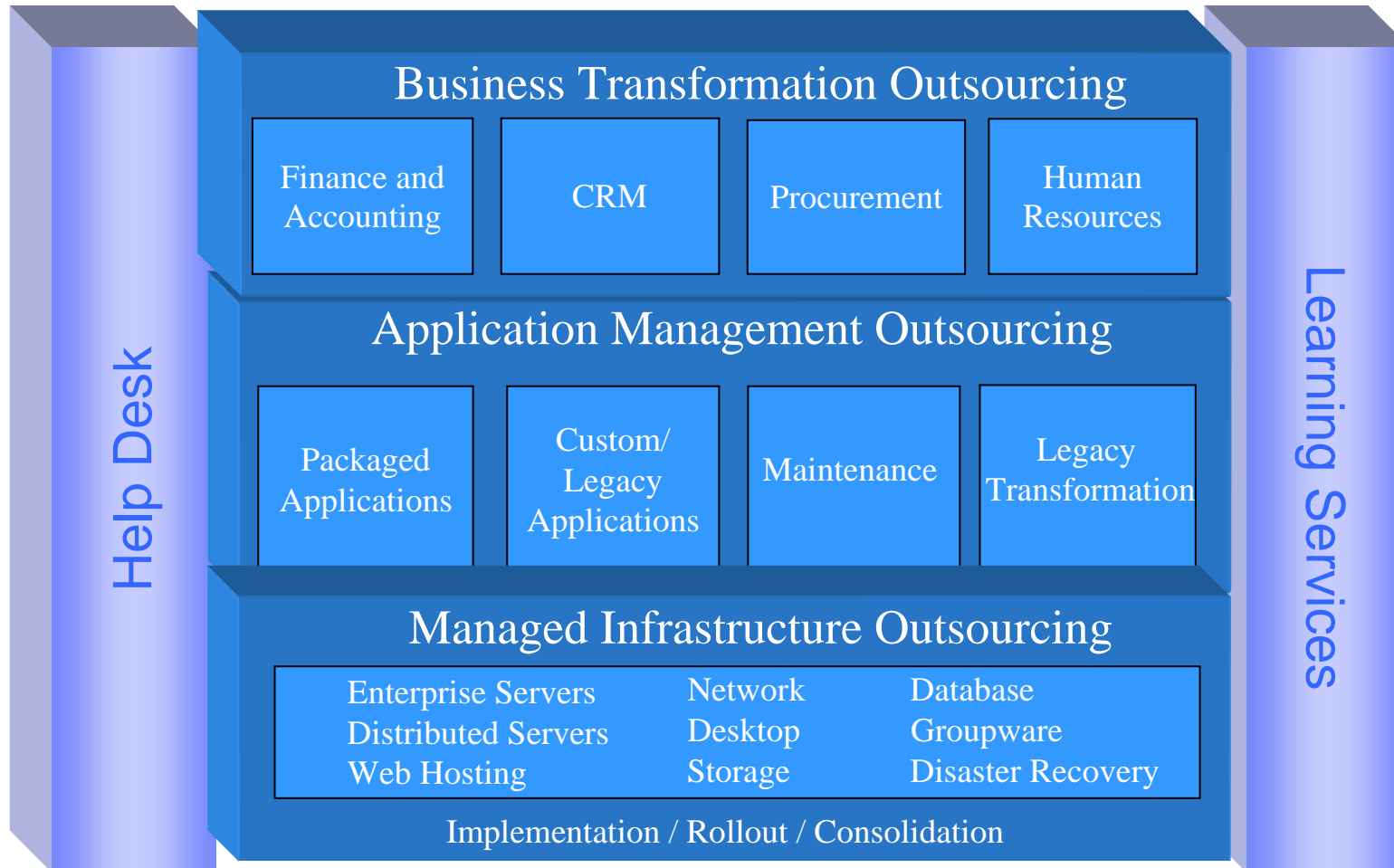
- ❑ **Services:**
 - management of major multi-vendor mainframe and server environments
 - disaster recovery and security services
 - database administration services
 - storage management and output services

- ❑ **Transformation:**
 - design and build of complete datacentre installations
 - migration to best of breed processes and working practices
 - exploitation of economies of scale
 - consolidation of geographic sites and server estates
 - technological transformation
 - transformation to on demand delivery and pricing models

- ❑ **Benefits:**
 - reduced cost of datacentre operations
 - improved IT service levels supporting business critical applications
 - Improved security, availability and resiliency of datacentre operations
 - Improved deployment and management of business applications
 - access to new technologies and skills to match changing business needs

Account Management
Asset Services
End User Services
Server Systems Management
Server Management
Server Planning Support
Server Security
Database Subsystem Support
Data Communication Support
Middleware Support
Batch Operations
Application Operation
Storage Management
Managed Storage
Media Management
Print (Output) Services
Print Shop
Print Management
Network Services
AMS
DR (BCRS)
Disaster Recovery
Infrastructure
Basic Transition
Transformation Projects

Datacentre outsourcing within a broader portfolio



“Work that requires judgment and inference is not likely to be off-shored easily”
Ravi Aron’s, Professor at Wharton Business School

- ❑ Work that involves making decisions based on a repository of knowledge, which can be meaningfully monitored in real time and where the quality of execution can be precisely measured, can--and will be--offshored
- ❑ Work that requires judgment and inference in ambiguous contexts, or where communication and grasp of linguistic nuances are important, is not likely to be offshored easily.
- ❑ It is the nature of the work--and not the industry--that determines what can or cannot be moved offshore
- ❑ Expertise that is required for diagnosing a problem and formulating its solution will require analytical abilities and the ability to deal with ambiguity and uncertainty. The premium placed on dealing with complex ideas--which means applying abstract frameworks to real-life problems and reducing complex, poorly understood business problems to combinations of well-understood and solvable problems--is not about to go away any time soon.

“Far from being a zero-sum game, off-shoring is a story of mutual economic gain”
Diana Farrell Director, McKinsey Global Institute

- ❑ For every dollar of corporate spending the United States outsources to India, our domestic economy captures more than three-fourths of the benefit and gains as much as \$1.14 in return
 - But this global wealth creation comes with a price: continuous change for the economy and higher turnover for workers
- ❑ The reality is that offshoring is another form of trade, and trade brings both opportunities and challenges. Benefits have always exceeded costs, however, and our great imperative is to maximize the former while minimizing the latter. Specifically, we must do the following:
 - Open more markets to American goods and services.
 - Enforce current and future trade agreements.
 - Enable global flows of goods, services, capital and people.
 - Improve effectiveness of retraining offered by government and employers.
 - Promote lifelong learning environments, efforts and skills.
 - Identify ways to encourage saving and to maintain health coverage during work force transitions, but ways that don't restrain future hiring.
 - Promote innovation and innovative capacity.
 - Ensure our business climate encourages entrepreneurship (access to capital, employer flexibility, and more rational regulations and torts).
 - Improve our infrastructure to maximize companies' and workers' productivity.
 - Introduce measurement and accountability into elementary and secondary schools.
 - Ensure adequate resources for educational innovations that work.
 - Improve math and science achievement by U.S. students.



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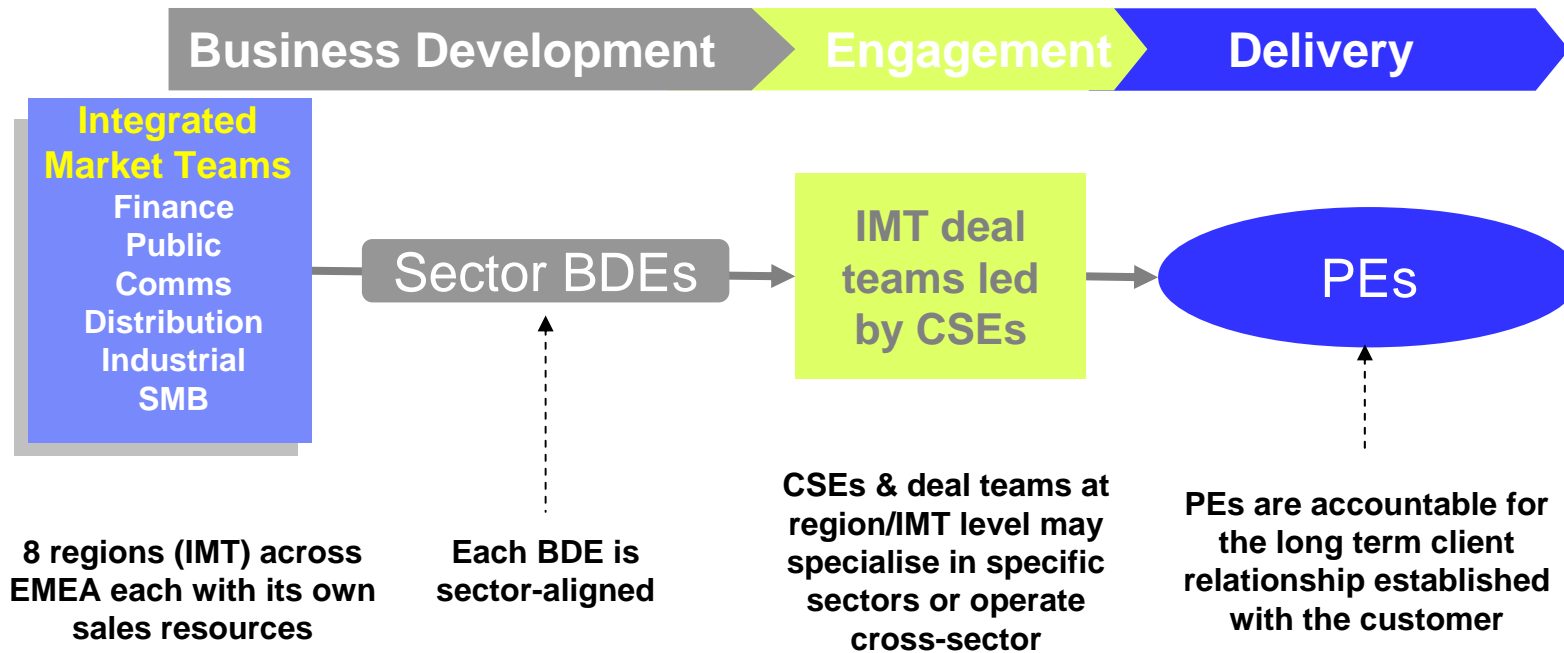
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Outsourcing Sales Process



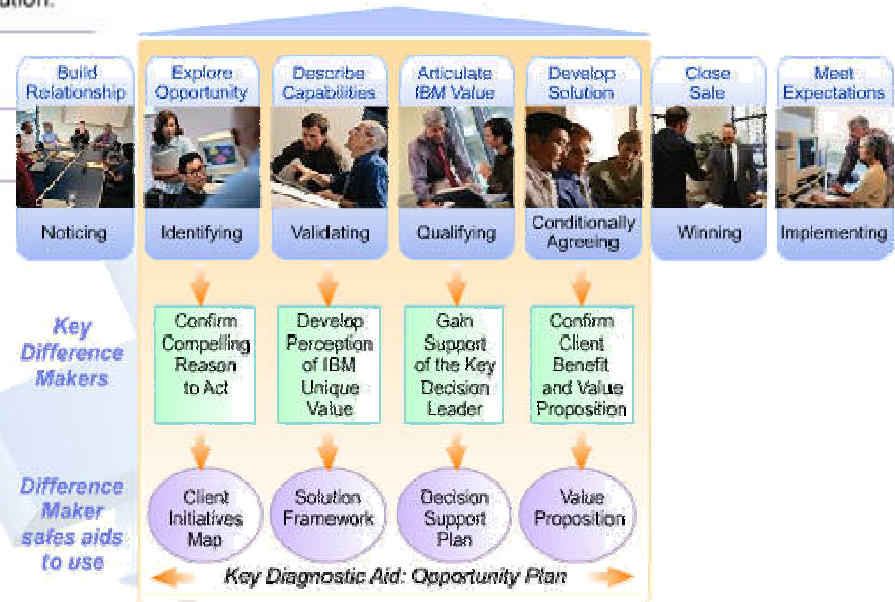
- ❑ **Business development executive (BDE)**
 - ➔ cultivates deal opportunities in their early stages, promotes IBM’s capability, secures agreement with client to engage with IBM

- ❑ **Client Services Executive (CSE)**
 - ➔ runs sales and negotiation process with client to signature of contract

- ❑ **Project Executive**
 - ➔ Manages the contract and the relationship with the customer for mutual satisfaction and constant alignment with changing customer’s situation and expectations

Sales Process is a structured process with well defined steps, objectives, tools and transition criteria

Sales stage	Verifiable Outcome
Noticing	The client values the relationship because Team IBM has demonstrated an understanding of the client's issues and needs.
Identifying	The client demonstrates an interest in working with Team IBM.
Validating	The client-stated business need, business capability, and agreement to support Team IBM's access to the Key Decision Leader are confirmed.
Qualifying	The Key Decision Leader and Team IBM agree to go forward with an initial solution.
Conditionally Agreeing	The Key Decision Leader conditionally approves the proposed solution.
Winning	The client and Team IBM sign the contract.
Implementing	The client acknowledges the value of the Team IBM solution and additional relationship capital is created.



Business Development Executive

- ❑ Employees in this role are responsible for the ongoing identification, development, and assessment of cross-IGS services business opportunities with key accounts, selected based on proactive market screening, targeting, and business analysis.
- ❑ They develop extensive executive and senior management relationships in client organizations. They identify and develop the most attractive opportunities for potential engagement.
- ❑ They work collaboratively with other teams across IBM and with other partners and outside consultants as appropriate. They are responsible for the ongoing qualification of these opportunities and recommend whether to engage, disqualify, or refer opportunities to other IBM groups.
- ❑ They own the opportunity until formal sales engagement and facilitate the transition to an engagement team, and remain involved during the engagement phase, as appropriate.

Client Solution Executive

- ❑ Strategic outsourcing engagements
 - are characterized by a complex combination of technical, business, financial, and human resources issues related to the strategic and tactical direction of customers. Change (such as economic conditions, financial performance, global competition, business strategy, mergers, acquisitions, and growth) tends to be the driving factor in these engagements.
 - are normally large, complex and highly competitive sales situations that are often global in scope and engagement negotiations are conducted at the highest levels.

- ❑ This role has the responsibility for successfully selling and negotiating one-of-a-kind complex business relationships.
- ❑ They lead sales engagements, selling solutions to complex IT and business requirements.
 - Once an opportunity is qualified, they are responsible for assembling the IBM sales engagement team, managing the team (which can involve dozens of people) and economically managing the substantial engagement budget.
 - They must also manage the customer relationship, participate in complex solutioning, establish beneficial pricing that is highly competitive and close the opportunity. In so doing, they must demonstrate a clear understanding of the customers business, organization, culture and the compelling reasons to act and manage the third party consultant relationship (if applicable).

- ❑ This role must be
 - an extraordinary team leader, an astute business person, exhibit exceptional business insight, show executive/boardroom presence and outstanding judgment.
 - creative enough to devise and articulate a unique and compelling value proposition (which typically leverages IBM and creates value), so that customer decision-makers clearly grasp the short and long-term business and financial value of a relationship with IBM.

Project Executive

- ❑ This role constructs partnerships between clients, team IBM, vendors, and subcontractor organizations and manages the implementation of these partnerships to address business opportunities for the IBM Corporation.
- ❑ They have equally balanced skills in five key general management areas of client relationship management, consultative selling, financial / business management, portfolio / program management and team / people management.
- ❑ Be the primary focal point and owner for all activities on a large complex contract.
 - Accountable for meeting revenue, profit, and growth objectives and for improving overall customer satisfaction targets.
 - Responsible to build and maintain strong client relationships at all levels with the objective of being a trusted business partner.
 - Proactively work with client to identify their business objectives, priorities and directions, critical success factors and applies this knowledge to establish and implement an Account Strategy.
 - They translate customer requirements into formal agreements, establishing specific solutions, and leading the efforts that culminate in client acceptance of the results.
 - They have overall responsibility for their contractual cost, schedule, and contractual deliverables.
 - They manage IBM resources and coordinates client resources to deliver services and solutions to support the client organization.
- ❑ They are recognized for business acumen by the customer set they support.

PEs have equally balanced skills in five key general management areas

□ Program Management

- Overall responsibility for managing schedule, contractual deliverables and programs that will support a client's business strategies and objectives
- Responsible for overseeing the implementation and use of formal program management methods and processes
- Responsible for managing resources from multiple IBM organizations to tailor the solution to the client's business needs.
- Knowledge of project management methodologies and PM disciplines at the program level.
- The PE must make sure that defining, planning, executing/controlling, and reporting mechanisms are implemented.

□ Client Relationship Management

- Primary point of contact for all client needs, requirements and expectations
 - helping the client define them
 - translating them into formal agreements,
 - establishing and deploying specific solutions, up to client's acceptance and satisfaction.
- Focus on retaining customers and grow wallet-share by providing increased value.

□ Consultative Selling

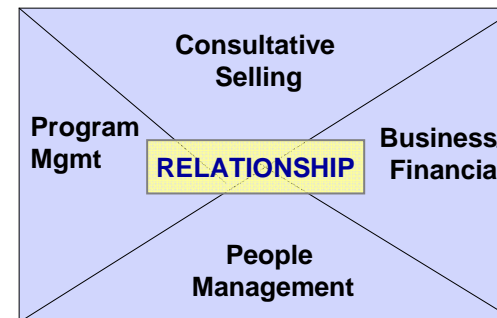
- To proactively enable growth and to counter any loss
- Understanding of IBM selling techniques to build relationships, identify opportunities, demonstrate IBM unique value and closing deals against the client's buying cycle and perception of value.

□ Financial and Business Management

- Overall responsibility for managing a significant P&L or contractual budget be it partial, full, local or global.
- Financial basics such as income statements, balance sheets, and cash flow are all critical topics
- Knowledge about contract types, how to manage subcontractors, interfacing with IBM's financial management systems
- Deployment of financial management tool for analyzing, controlling and directing resources and assets
- Manages IBM resources and coordinates client resources to deliver services and solutions to support the agreements with the client

□ Team and People Management

- The PE needs to lead teams of people to execute existing contract terms and conditions and drive contract growth.
- Enabling breakthrough thinking, resolving conflict, effective communications, understanding and managing cultural differences
- Working knowledge of basic people management techniques / disciplines in order to lead and motivate the team



Program Management is based on the Program Management System (PgMS)

❑ What is PgMS?

- PgMS is a comprehensive set of integrated processes, plans, and policies used by the Account team to manage contract performance
- Provides a common understanding of status with the client via Governance and early warning of any exception condition
- Worldwide standard for accounts, simplifies contract start up and steady state by reducing cycle time and deployment costs

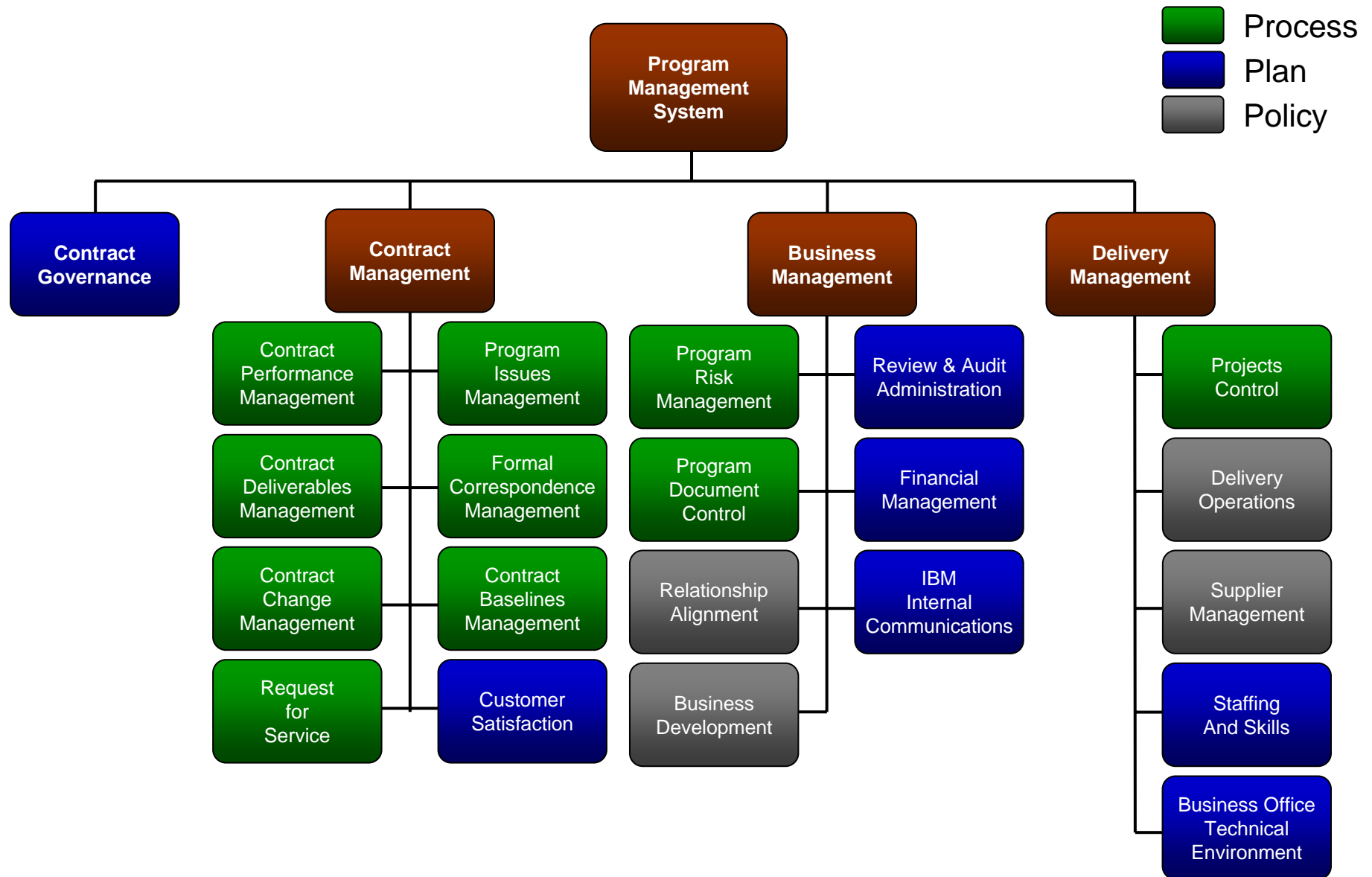
❑ Processes included in PgMS can be tailored to fit geographical, regional, and client-specific requirements.

- These processes are expanded to the procedure and work instruction level in the PgMS templates.

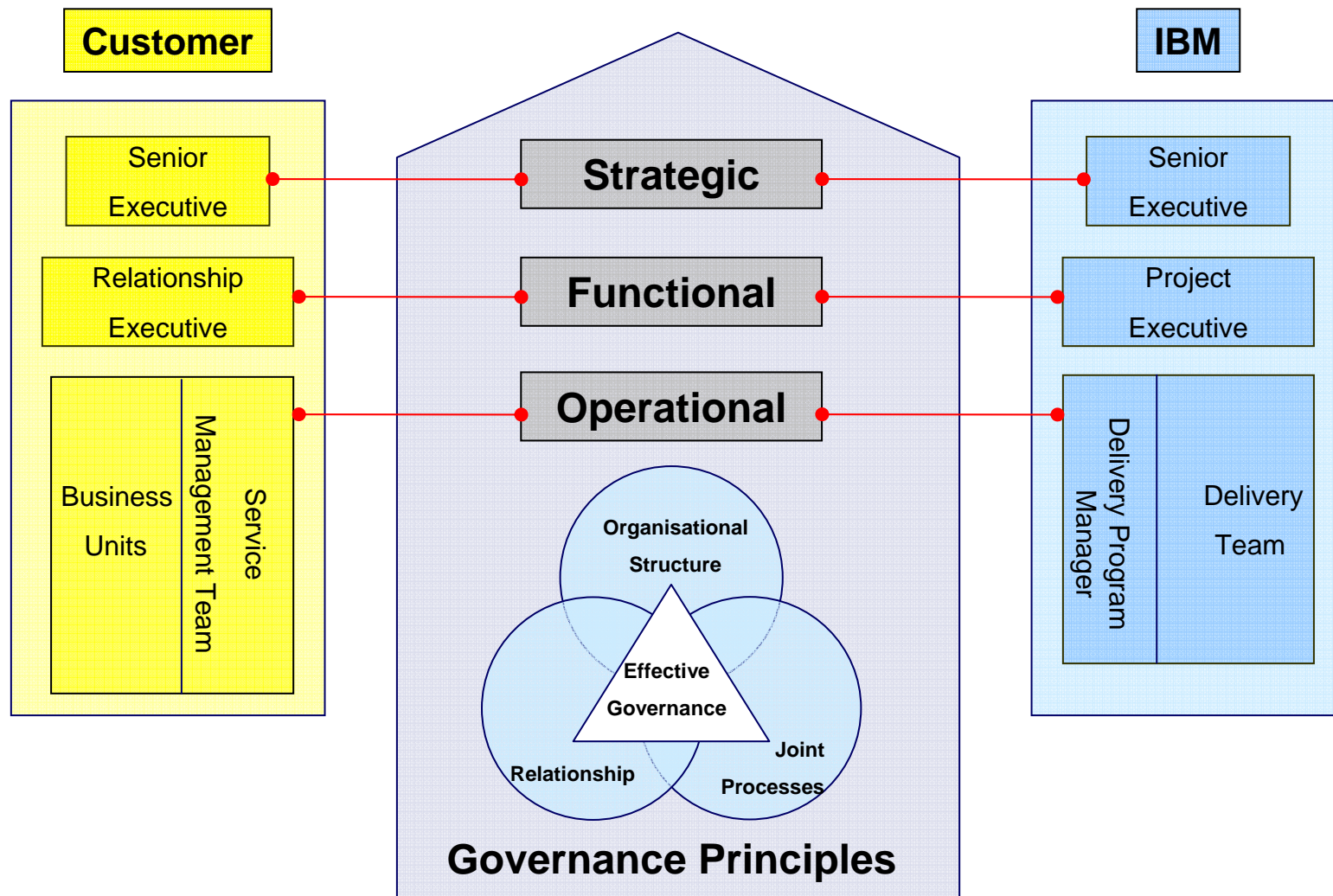
❑ Plans are a description of the means for achieving an objective.

❑ Policies address processes that are defined and managed outside the PE's span of control, but which significantly impact or control aspects of how the PE manages the account.

Program Management System

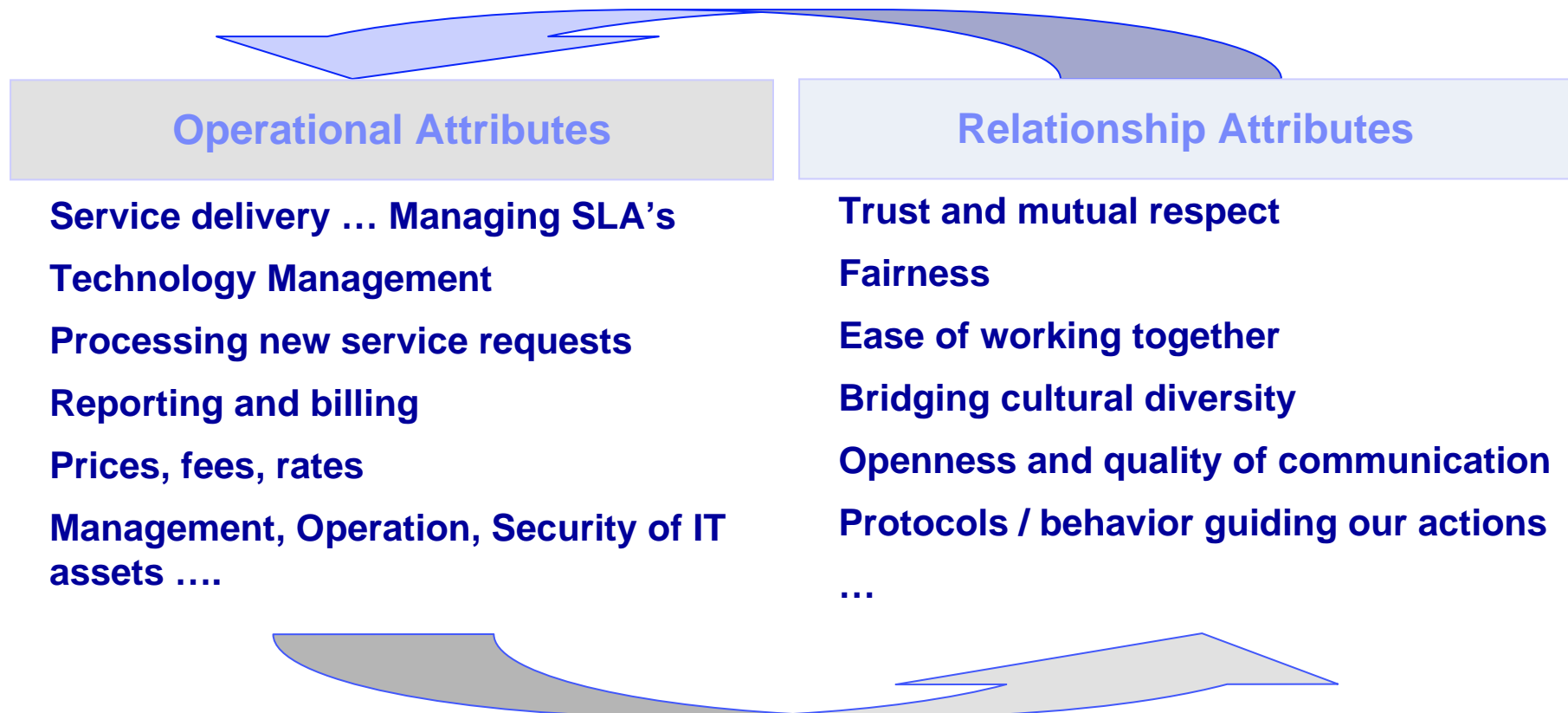


A mature Governance Model is used across all contracts



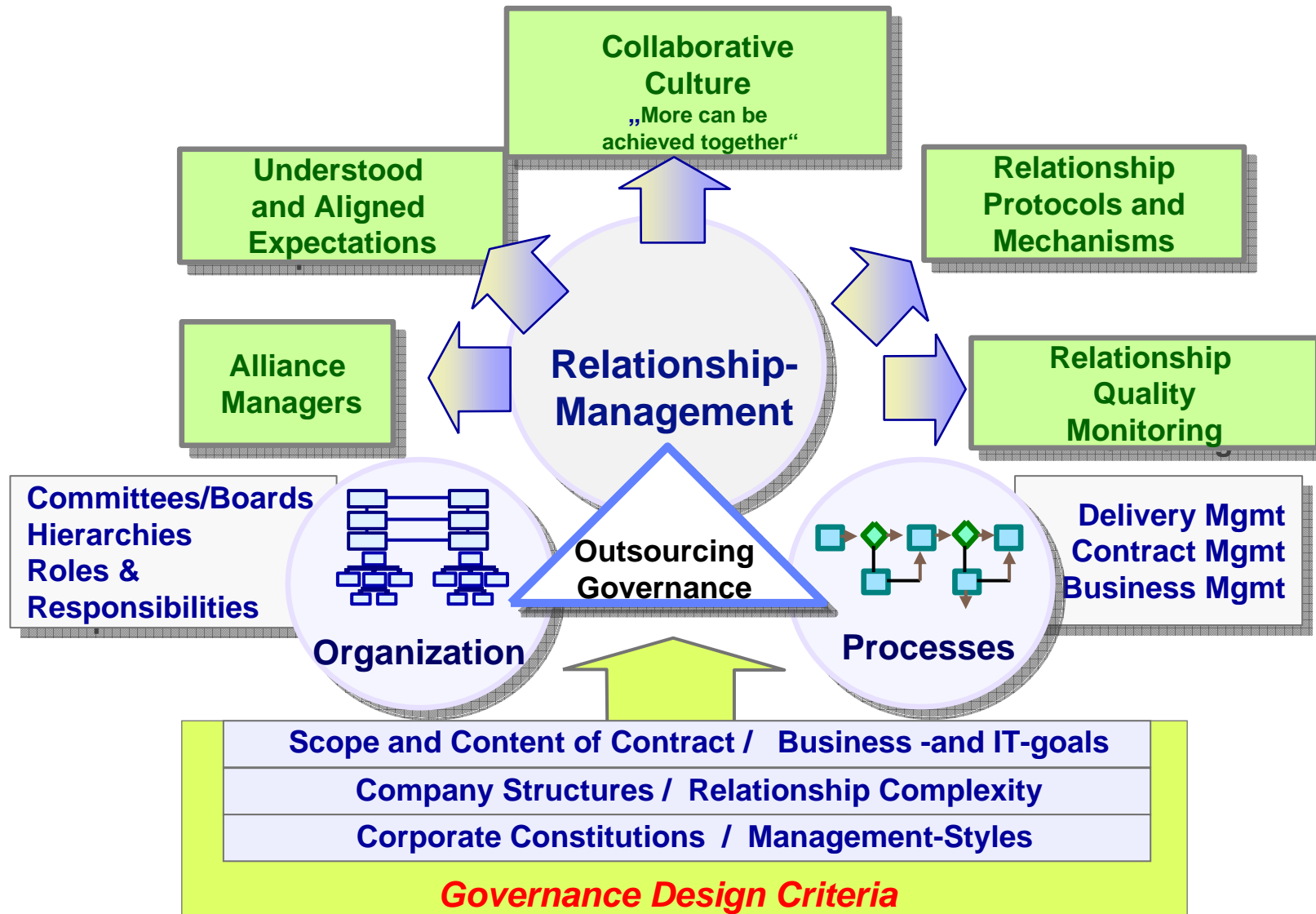
Even though relationship attributes have a huge impact on operational performance, they are often ignored.

Relationship Quality Impacts Operational Performance



Operational Performance Impacts Relationship Characteristics

The 3 elements of good Outsourcing Governance



Collaborative Culture: how do we work together



Adversarial Relationship Typical Mindset and Behavior

- When things go wrong focus on assigning blame and on applying contractual penalties
- This is about getting „Them“ to meet our needs
- Customer decides, vendor executes
- Each party is often surprised and learns of decisions after they are made

Collaborative Relationship Typical Mindset and Behavior

- When things go wrong focus on understanding joint contributions and how to avoid repetition
- This is about meeting both our needs in a sustainable way
- Wise decisions need joint input
- Parties work as a team to maintain alignment and coordination
- **Parties agree on a code of conduct**

Customer Satisfaction Management is an integral part of IBM Customer Relationship Management

Customer Satisfaction Management

1. Determine CS Strategy

2. Understand & Manage Customer Expectations *Conditions of Satisfaction, Set/Met*

3. Collect Unsolicited Feedback *Complaints*

4. Collect Solicited Feedback *Surveys*

5. Respond to Specific Customer

6. Aggregate & Analyze Data *Pervasive Issues*

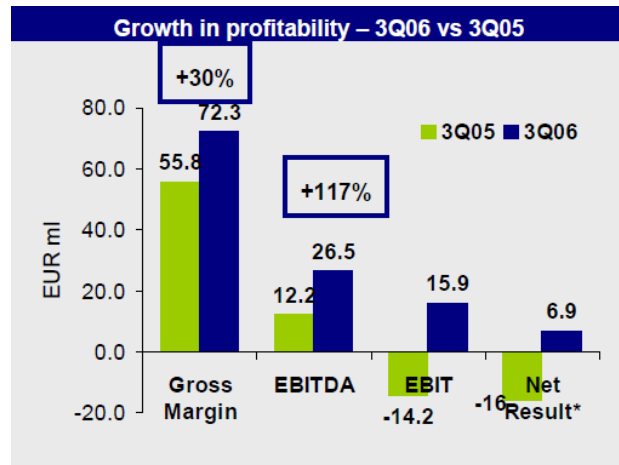
7. Resolve Pervasive Issues

8. Communicate with Customers & IBM

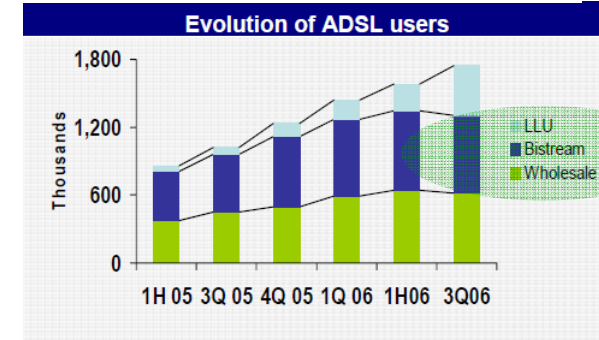
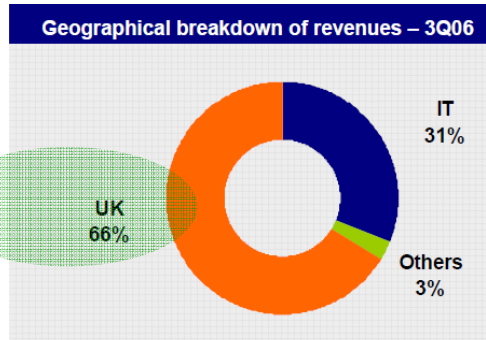
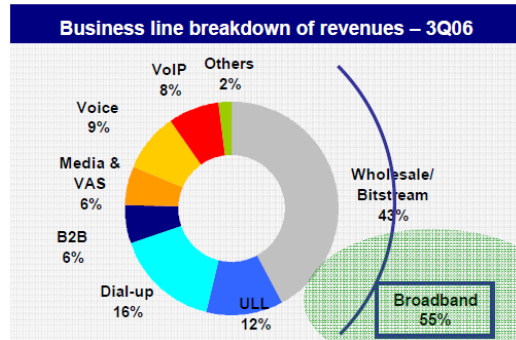
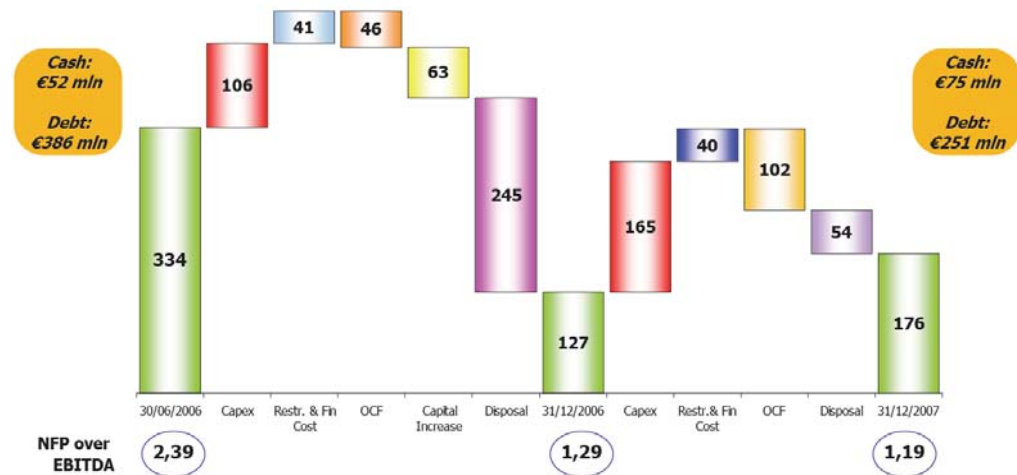
- ❑ The IBM Project Executive is responsible as part of contract execution for customer satisfaction levels. As a consequence, this metric also applies to the delivery teams supporting the PE
- ❑ The key processes for determining customer satisfaction within DCO are:
 - ➔ Customer Executive Relationship Survey (regular survey conducted by third party)
 - ➔ Set/Met survey – regular IBM survey of customer expectations and its performance in meeting them
 - ➔ Complaint Management Process
- ❑ Continuous improvement processes are linked closely to these activities.

Example of Financial Mgmt. Analysis of a customer's business strategy

All the financial indicators of Tiscali, including debt, have been improving in the last quarters^(*). The core business is shifting toward broadband subscribers that account for 52% of revenue (+27% over YE05), with UK weight approximately twice than Italy. The number of direct customers (ULL) is significantly improving.



Tiscali Credit Rating is going to improve as an effect of the improved financial situation



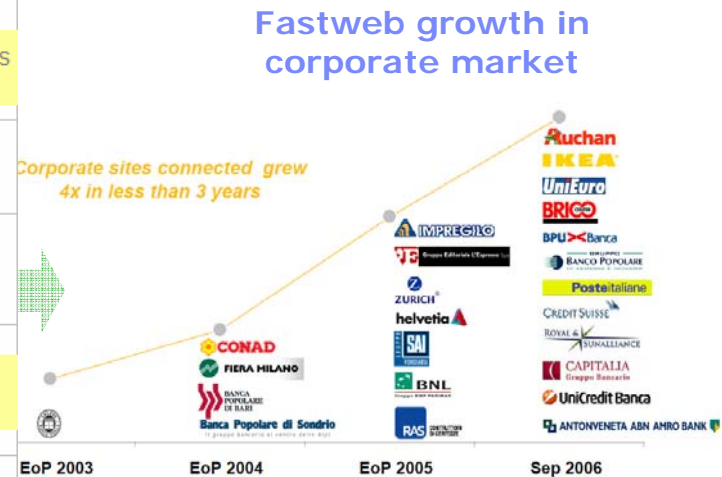
^(*) Tiscali has sold the French Operations to Telecom Italia in 2Q05 for 266 M€ and the Dutch Operations to KPN in 3Q06 for 255 M€

Example of Financial Mgmt. Analysis of a customer's business strategy.

Financial analysts commented that generating shareholder value is challenging. The transformation will require to further extend the network and to develop capabilities in new services (IPTV, MVNO, ...) and in new markets (SMB, Local Administrations)

Fastweb is the best company to benchmark Tiscali because of the market position, size and strategy

Key Performance Indicators	TISCALI	FASTWEB	Comments
Share Price / Ebitda	14,6	9,1	Analysts consider the share price of Tiscali overvalued. Challenge of creating shareholder value
ARPU (€/month)	17	65	Tiscali is not able to capture the same value than Fastweb from its customers.
Ebitda Growth (3q06 on 3q05)	117%	32%	For Tiscali this value benefits of the divestiture of Dutch subsidiary happened in September
Ebitda Margin (on revenue)	14%	33%	Lower than industrial average. Telecom Italia is around 40%, Wind 30%
Revenue Growth (3q06 on 3q05)	31%	30%	For Tiscali this value benefits of the divestiture of Dutch subsidiary happened in September
Revenue Growth from Enterprise Customers	N.A.	60%	Fastweb is developing a strong focus on the enterprise market
Revenue MC (2006 forecast)	688	1.200	Revenue generated in Italy is 212 M€.
Network Coverage in Italy	30%	45%	It will take more than 1 year and hundreds millions investments to catch-up Fastweb
Number of ADSL users (thousands)	2.100	800	For Tiscali 750 in Italy and 1.350 in UK



Questions ?