# From One Relationship to Many: Making the Most of Your Outsourced Relationship Portfolio

3:30 – 4:20 pm

Monday, February 23, 2004

Stuart Kliman
*Partner*
Vantage Partners, LLC

**Michael F. Corbett & Associates, Ltd.**

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# The 2004 Outsourcing World Summit
## Conference & Exposition

February 23–25, 2004 • Disney's Yacht & Beach Club Resorts • Lake Buena Vista, Florida

**Stuart Kliman**
Partner
Vantage Partners, LLC

Stuart Kliman is a founding partner of Vantage Partners, LLC. As a management consultant, Mr. Kliman's practice focuses on helping clients build the capacity to negotiate, build and manage stronger and more mutually valuable customer, vendor and partner relationships.  He has worked with clients in the I.T., pharmaceuticals, financial services and manufacturing industries. Mr. Kliman is a former member of the Harvard Negotiation Project, and practiced as an attorney with the law firm of Arent, Fox, Kintner, Plotkin & Kahn in Washington, D.C.  Mr. Kliman is a member of the Maryland Bar and received his J.D. cum laude from Harvard Law School and his B.A. magna cum laude from Franklin & Marshall College.  Mr. Kliman is a frequent writer, lecturer and speaker on issues of negotiation and relationship management.  His latest article *"Mending Broken Relationships: Foundations of Success"* in Cutter Consortium's Executive Update.

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*Stuart Kliman
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## Session purposes

- **Explore common challenges to, and value gained from, outsourced relationships**

- **Discuss continuum of relationship types, and the kinds of management implications related thereto**

- **Share / discuss thoughts on a portfolio approach to the management of multiple outsourced relationships**
  - **Goals, value, enablers, barriers**

## About Vantage Partners

- **Spin-off of the Harvard Negotiation Project**

- **Expertise in building corporate negotiation and relationship management capability**

- **Extensive Experience**
  - **Exclusive focus on negotiation and relationship management since 1984**

- **Recognized thought leaders**
  - **Co-authors of *Getting to YES: Negotiating Agreement Without Giving In***
  - **Three-year study on Alliance Relationship Management**
  - **Cross-industry study of Best Practices for Supplier Relationship Management**
  - **Partnering Handbook for relationship managers**
  - **Frequent keynote speakers on negotiation and relationship management**

- **Leaders in international dispute resolution through CMG**

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## Challenges and Barriers to Realizing Value
### What is happening now?  What is possible?

"It's the next level of real-time vendor relations.
But we're still beta testing."

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# Current and desired provider relationships

- **Sources of value**
  - **What kind of value are we getting from our provider relationships today?**
  - **What value does the provider get?**
  - **What value would we *like* to realize? How about our providers?**

- **Relationship characteristics**
  - **What are the observable indicators of the kinds of relationships we currently have?**
  - **What would a more effective relationship look like?**

- **Barriers and challenges**
  - **What problems do we face?**
  - **What makes having a good relationship difficult?**

# A framework for considering sources of value

| Strategic | Operational | Financial |
|---|---|---|
| New business ideas | Performance (against business plan objective) | Revenue |
| New capabilities | Sales win/loss rates | Cost savings (fixed and variable) |
| New product/feature development | Cycle time | Operating costs |
| Market share and penetration | Inventory levels and turnover | Investment required |
| Business process innovation | Product time to market | Profit |
| Knowledge transfer | Product defect rate | |
| Reduction of competitive threat | Resource requirements (FTEs) | |

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# Segmenting Types of Outsourcing Relationships
### How are different provider relationships different?

# The relationship continuum: The different types of business relationships

*Outsourcers can be viewed on a continuum: at one end are commodity suppliers, and at the other end, solutions providers or partners*

**Transactional**  **Enhanced**  **Collaborative**  **Partnership**

**Commodity**
**Price**
**Interchangeable**
**Product**

**Customized**
**Value**
**Integrated**
**Solution**

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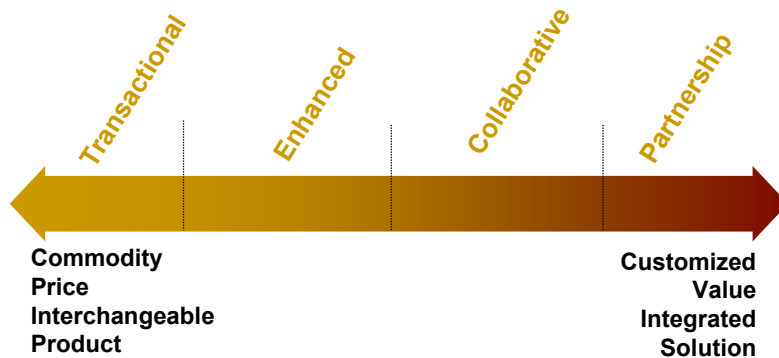
# Transactional relationships

## Description

- ✓ Market Pricing
- ✓ Commodity Product or Service
- ✓ Mass Production

## Characteristics

- ✓ No Knowledge of Each Other's Processes
- ✓ Price is only differentiator
- ✓ Unable to Beat Competition with Relationship

*Service provider does same for you as for everyone else*

## Enhanced relationships

### Description

- ✓ Some Customized Expertise
- ✓ Expectations Negotiated
- ✓ Performance Contract
- ✓ Little Willingness to Change Process

### Characteristics

- ✓ Customer Service and/or Product Quality are Superior
- ✓ Value Derived From Reliability
- ✓ Some Client Knowledge/Intimacy

*Service provider uses limited customer knowledge to provide value-added services*

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## Collaborative relationships

### Description

- ✓ Customized Expertise
- ✓ Integration of Process

### Characteristics

- ✓ Joint planning and sharing of information
- ✓ High Degree of Client Knowledge and Intimacy
- ✓ High Degree of Loyalty

*Develop an appreciation for each others capabilities, and use that knowledge to develop solutions*

## Partnership relationships

### Description

- ✓ **Customized Expertise**
- ✓ **Full Process Integration**
- ✓ **Shared Responsibility**
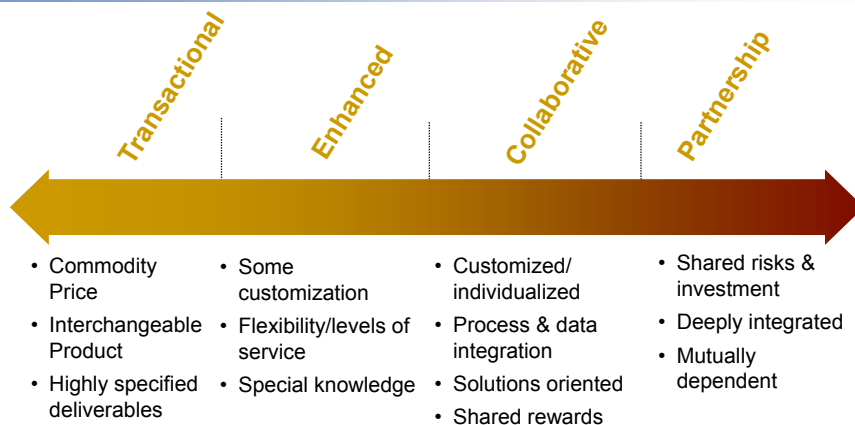- ✓ **Focused on Outcome**

### Characteristics

- ✓ **Intent to Innovate**
- ✓ **High Degree of Mutual Knowledge and Intimacy**
- ✓ **High Degree of Loyalty**
- ✓ **Shared Risks/Rewards**

*New competitive capability through joint innovation*

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## The relationship continuum

**Transactional** — **Enhanced** — **Collaborative** — **Partnership**

| Transactional | Enhanced | Collaborative | Partnership |
|---|---|---|---|
| • Commodity Price | • Some customization | • Customized/ individualized | • Shared risks & investment |
| • Interchangeable Product | • Flexibility/levels of service | • Process & data integration | • Deeply integrated |
| • Highly specified deliverables | • Special knowledge | • Solutions oriented | • Mutually dependent |
| | | • Shared rewards | |

## The band of balance helps determine the right type of relationship
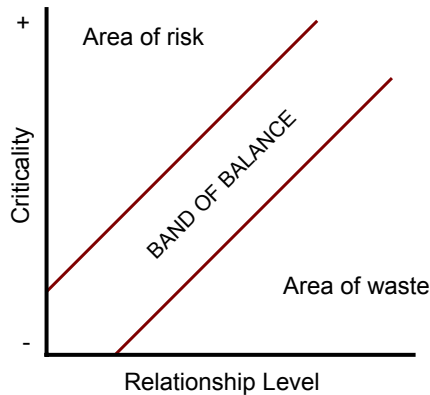


The level of the outsourcing relationship should correlate with the criticality of services to *your* business

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## Different types of relationships have different management implications

### Areas impacted by different provider segments

- Governance structure
- Performance monitoring activities
- Scorecard elements
- Communication protocols
- Negotiation strategy

- Required contract terms
- Relationship duration and replacement strategy
- Senior management involvement
- Target sources of value
- Disengagement criteria and process

## Illustrative provider segmentation management implications

| Relationship Category / Implication | Transactional | Enhanced | Collaborative | Partnership |
|---|---|---|---|---|
| Driver | Price | Competitive advantage | Maximize value; lowest total cost | Critical need |
| Negotiation Strategy | Maximize price leverage | Sole source | Leverage number of suppliers and business volume awarded | "Win/Win" maximize joint gain and good precedent |
| Presumed Duration | Short to medium term | Dependent on market environment | Medium to long term | Long term |
| Governance | Commodity group portfolio manager | Dedicated relationship manager | Dedicated relationship manager; internal customer coordination committee | Joint customer-supplier oversight board; dedicated relationship manager |
| Communication | Limited to transactional exchange of info | Regular, though limited in scope | Robust and frequent, with some executive contact | Robust and multi-level, with senior executive contact |
| Quality Management | Managed on exception basis; leverage penalties | Managed on exception basis; leverage incentives | Joint effort; customer investment driven by switching costs | Joint effort, equal investment |
| Planning | Annual; narrow in scope | Regular, but limited in scope | Joint and frequent; time horizon varies by context | Integrated, frequent, and long term focused |
| Provider's Viability | N/A | Safeguard when benefits outweigh costs | Understand and monitor | Safeguard |
| **Investment in Relationship** | **Low** | **Medium to low** | **Medium** | **High** |

ILLUSTRATIVE

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## Identification of kind of relationship leads to appropriate investment choices

### If understaffed / under funded -

- **Value leakage will occur - a significant problem for companies that do not take Relationship Management seriously (5%-20% of spend).**

- **Value leakage flows to the bottom line.**

- **At the very least, companies must invest enough to ensure the results of the outsourcing decision are consistent with the original business goal and expectations.**

**Value leakage**
- Incorrect Billing
- Overcharging
- Unauthorized scope expansion
- Missed service credits
- Reduced service levels

## Identification of kind of relationship leads to appropriate investment choices (con't)

### Can I "Over Invest"? - Yes

- **How ?**

- **Using the RM Function as a home for retained personnel.**

- **Have wrong skills, experience, process, tools = rework**

- **Perform more responsibilities than this core set;**
  - **Integration and enforcement of policy & standards**
  - **Centralized authority to negotiate services, disputes, price and services**
  - **Ownership of governance protocols**
  - **Limited other retained services (e.g. innovation, security, business resumption)**

**Potential Unintended Consequences**
- **Micro-management of Service Provider**
- **Duplication of work**
- **Intense Friction**

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## Investment

- **Buyers invest from 3% to 6% of the annual outsourcing spend on Relationship Management (outliers are 1% - 10%).**

- **Range depends on complexity:**

- **(Scope of services, geographic coverage, number of suppliers, industry, management culture, desired relationship management type)**

# Technology has a key role in implementing a portfolio approach



# Technology has a key role in implementing a portfolio approach (con't)

# Technology has a key role in implementing a portfolio approach (con't)

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# A portfolio approach:  Items for discussion

- **Given the above, what would a portfolio approach in a multi-relationship environment entail?**

- **What kind of value would one hope to achieve from such an approach?**

- **What would be the key barriers to its implementation**

# A Portfolio Approach:  Some thoughts re: goals

## Goals of a Portfolio Approach:

- Optimize the strategic, operational, and financial value of the portfolio of outsourced relationships, both currently and over time as it evolves.

- Provide an outsourcing operating model that is dynamic and flexible enough to manage multiple tiered service provider relationships so that each tier and relationship is achieving the expected and maximum value.

- Ensure that the customer is leveraging and monitoring its outsourced relationships in way that links the portfolio to its organizational strategy and ensures that the ROI over the entire portfolio is maximized.

- Enable cross organizational knowledge management such that the customer is effectively sharing and embedding relationship management learnings, best practices and other critical information across its relationships

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# For further information

**Vantage works with outsourcing customers to enable them to maximize the value of their outsourcing and other key supplier relationship management activities**

- Putting in place the appropriate relationship management structure and infrastructure to maximize outsourcing success

- Building and deploying a systematic, scalable relationship management process and tools for the management of outsourced and other key supplier relationships, and enabling such with behavioral skills training and coaching, and with technology, using Vantage Technologies' Partnersmith® software

- Launching, diagnosing and re-mediating key relationships

Email skliman@vantagepartners.com

vantage*partners*

# Knowledge in Outsourcing:
# The Missed Business Opportunity

11:00 – 11:50 am

Tuesday, February 24, 2004

**John Hindle**
*Partner*
Knowledge Capital Partners

**Leslie Willcocks**
*Professor*
Warwick University

**John Hindle**
Partner
Knowledge Capital Partners

John has an extensive international business background, having served for more than 20 years as a senior executive and adviser to several companies in the US and Europe on market entry, customer relationship, outsourcing, and brand development strategies. Prior to his commercial career he was a university teacher, researcher, and administrator. John holds MA and PhD postgraduate degrees, and is Adjunct Professor of Human and Organizational Development at Vanderbilt University.

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### Leslie P. Willcocks
### Professor
### Warwick University

Leslie has an international reputation for his work on e-business, information management, IT evaluation and information systems outsourcing. He is Professor of Information Management and E-business at Warwick Business School, UK. He is also Associate Fellow at Templeton College, Oxford, Visiting Professor In Information Systems at Erasmus University, Rotterdam, Professorial Associate at the University of Melbourne, and Distinguished Visitor at the Australian Graduate School of Management. He holds a doctorate in information systems from the University of Cambridge, and has been for the last 13 years Editor-in-Chief of the Journal of Information Technology.

He worked for twelve years in accounting and management consultancy, for Touche Ross and several smaller firms, before heading a Research Centre at City University Business School, London. He moved to Oxford University in 1992 where he was for nine years Fellow and University Reader at Templeton College. He is co-author of 23 books, including **Global IT Outsourcing: In Search Of Business Advantage (**Wiley, 2001**), Moving To E-Business** (Random House, 2000), **Building The E-Business Infrastructure** (Business Intelligence, 2001), **Managing IT As A Strategic Resource** (McGraw Hill, 1997**), Net Sourcing: How To Rent Services and Infrastructure Over Networks** (Prentice Hall), **Strategic Sourcing of Information Systems** (Wiley, 1998), **The Relationship Advantage: Information Technologies, Sourcing And Management** (Oxford University Press), and **Delivering IT and E-Business Value For IT** (Butterworth, 2001). He has published over 140 papers in journals such as Harvard Business Review, Sloan Management Review, MIS Quarterly, Journal of Management Studies, MISQ Executive, California Management Review, Communications Of The ACM, and Journal of Strategic Information Systems.

**In February 2001 he won the PriceWaterhouseCoopers/Michael F. Corbett & Associates Outsourcing World Achievement Award** for his contribution to this field. He is also a Board Director and Chief Adviser of Los Angeles-based hi-tech services provider MainPass Surveillance. He is a regular keynote speaker at international practitioner and academic conferences, has extensive consulting experience, and is regularly retained as adviser by major corporations and government institutions. Recent clients have included Dupont, Transco, Thames Water, IBM,

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Standard Chartered Bank, Lend Lease Corporation, ANZ Bank, NatWest Bank, Compass, Technology Partners, Royal Sun Alliance, Commonwealth Bank, Hewlett Packard, Abbey National, Australian Wheat Board, Norwich Union, Ericsson, WH Smith, Eli Lilley, RailTrack, and several government institutions in the UK and Australia. **In 1998 he served as expert witness on information management issues to the US Congressional Committee on Restructuring the Internal Revenue Service,** and provided evidence to the UK Government's report on public sector IT projects published in March 2000. **In May 2001 he was expert witness to the Senate Inquiry into the Australian government's IT outsourcing initiative.**

His co-authored books for 2003 are **Second Wave ERP: Implementing For Effectiveness** (Cambridge University Press, February), **Making I.T. Count: Strategy, Delivery, Infrastructure** (Butterworth, January), and **Effective Outsourcing: Building Blocks For IT Success** (Butterworth, July.

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# Knowledge and Outsourcing: The Missed Opportunity

John Hindle & Leslie Willcocks
Knowledge Capital Partners
24 February 2004

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# The importance of knowledge

- The *only sustainable source* of competitive advantage
  - non-rival assets
  - highly scalable
- The *intrinsic rationale* for outsourcing
  - specialist knowledge
  - core competencies
- The *preeminent economic resource*
  - the primary ingredient in all goods and services
  - liberates capital and enables new business models

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# Building blocks of knowledge capital value

Effective informed decision making

Methodology

Reference IPR

**Product innovation**

Processes

Informed investment choices

Thought leadership

Communication

Alliances

Expectations

**Brand**

Market reference

Social responsibility

Behaviour and culture

Corporate databases

Content

Effective, informed decision-making

Corporate agility

**Internal relationships**

Effective use of internal know-how

Culture

Employee collaboration

Proactive explicit codification of know-how

Service level distinctiveness

Shareholder relationships

Processes

**External relationships**

Supply chain relationships

Speed and quality of response

Customer ownership (repeat and referred business)

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# A framework for intellectual capital



personal and institutional cohesion; cooperative behaviour and group preference

**customer capital**

the value of an organisation's relationships – shared knowledge

**structural capital**

codified bodies of knowledge that can be transferred; tools that bring data and expertise to people

partnering

business solutions

social capital

product solutions

transactions

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**human capital**

the capabilities of the individuals required to provide solutions to customers

*Source:* Skandia/CIBC;
*Modified:* KCP

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# What's your knowledge stock?

Start with the *knowledge audit* . . .

|  | **KNOW** | **DON'T KNOW** |
|---|---|---|
| **KNOW** | Knowledge that you know you have<br><br>*EXPLICIT KNOWLEDGE* | Knowledge that you know you don't have<br><br>*KNOWN GAPS* |
| **DON'T KNOW** | Knowledge that you don't know you have<br><br>*TACIT KNOWLEDGE* | Knowledge that you don't know that you don't have<br><br>*UNKNOWN GAPS* |

Liam Fahey, Babson College

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# What's your value model?  (1)

**VALUE CHAIN**
**(manufacturing)**

PRIMARY ACTIVITIES



Examples:
• Autos
• White goods
• Hardware
• Food
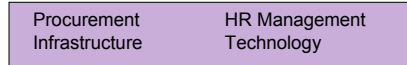
SUPPORT ACTIVITIES

c.f. Porter

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# What's your value model?  (2)

**VALUE NETWORK**
**(transaction exchanges)**

Examples:
• Banks
• Telecoms
• Distribution
• Insurance
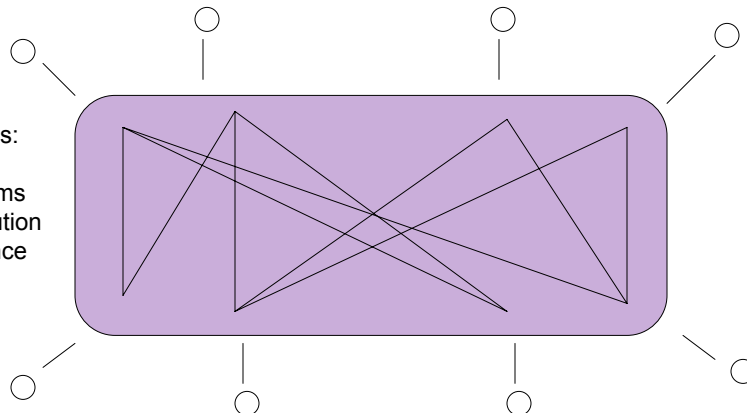


after Stewart. Intellectual Capital

# What's your value model?  (3)

**VALUE SHOP**
**(problem solving)**

Examples:
• Law firms
• Consultancies
• Hospitals
• Laboratories

Infrastructure
Methods
Specialists
Customer
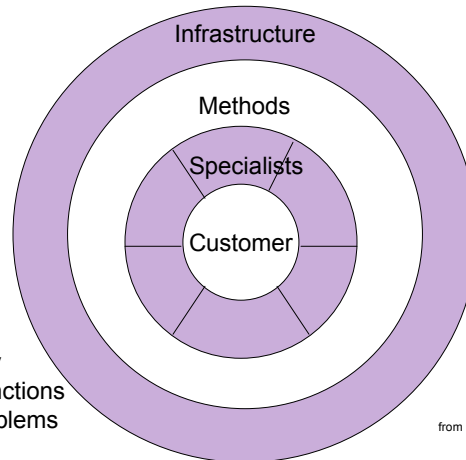
Note:  valuable IC may
hide in "secondary" functions
involved in solving problems

from Stewart, Intellectual Capital

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# Knowledge and Outsourcing: theory v. practice

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## IT outsourcing & knowledge:  the theory

- World class supplier brings:
  - superior technical know-how across many fronts
  - access to superior management practices
  - access to production & labour economies of scale
  - access to strategic business advice (e.g., PWC/IBM, EDS/AT Kearney)
- Enables client to focus on core capabilities/ knowledge
  - greater business, strategic, core focus
  - 'value added v. value realisation' focus
  - 'partnering' – complementary client & supplier knowledge bases, synergistic effects . . . . .

**But does it work like this in practice?**

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## Practice Example - Commonwealth Bank/EDS

- 1996 10-year deal, CBA takes 33% shares in EDS (A)
- Significant cost reductions achieved 1996-2001
- But . . . little innovation, leveraging of IT for business value
- 2001:  recognised *knowledge implications…* the need to build up core in-house IT capabilities in order to control IT destiny
- 2001:  IT identified as key enabler of 6 strategic business initiatives
- 2003:  IT a key component of major 3-year bank-wide business transformation project

Success is ultimately reliant on the ability to learn, create and leverage ***knowledge . . . .***

## CBA and The Knowledge Base 2001: Nine Core IT Capabilities (Feeny & Willcocks, 1998)

RB= 0
BST = -
L= +

*BUSINESS and I.T. VISION*

Business Systems Thinking

Relationship Building

Contract Facilitation

Leadership

CF = 0
CM = +/+
IB = 0/+
VD = -

AP= -/0
MTW = -

Informed Buying

Vendor Development

Architecture Planning

Making Technology Work

Contract Monitoring

*DESIGN of I.T. ARCHITECTURE*

*DELIVERY of I.T. SERVICES*

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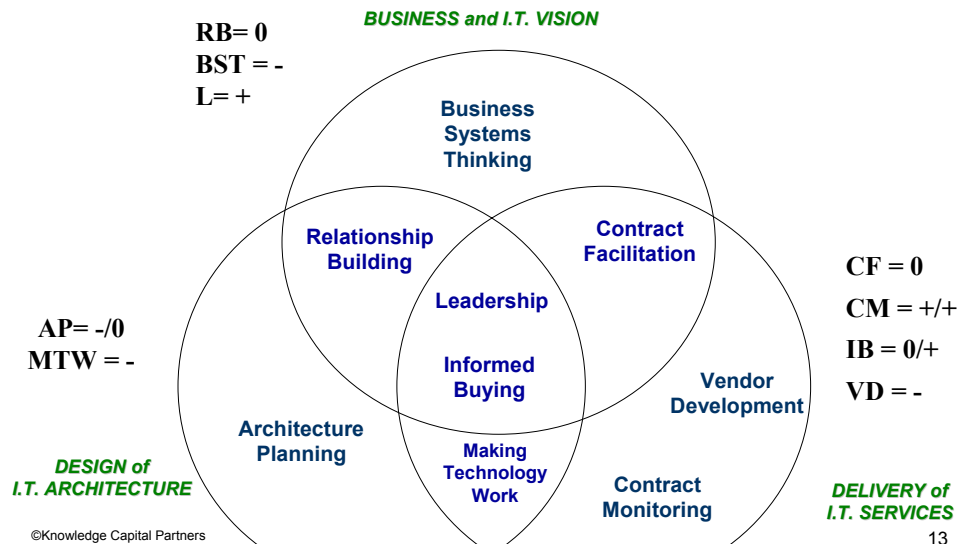
## A BPO Example:
### Lloyds/IUA & XIS - May 2001

- **May 2001:**
  - creation of Xchanging Ins-sure Services (XIS) to process premiums and claims worth over £20 billion annually for 220+ insurance companies and syndicates

- **Xchanging Models:**
  - 1. Business Model and Governance
  - 2. Implementation Model
  - a) Four stages:   Preparation -  3 months
    - Realignment - 6 months
    - Streamlining - 6-9 months
    - Continuous Improvement - on-going
  - b)  Seven Competencies
  - c)  Build The Team

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# The XIS "Enterprise Partnership" business model

| LLOYDS OF LONDON | | | | |
|---|---|---|---|---|

**LLOYDS OF LONDON** ← 25% share → **XIS (May 2001)** ← 50% share → **Xchanging**

**IUA LONDON MARKETS** ← 25% share →

**LPSO and LPC staff** →

- 5 year deal
  12 months termination notice thereafter
- Joint non-exec. Chair ←
- 5 Board members (Xchanging) ←
- 2 non-execs. Board members (Lloyds/IUA) ←
- Ownership of I.P. created by the enterprise
- "As-is" cost/service for 6 months ←
- Service Review panel
  (Lloyds 4 members)
  (IUA    3 members)
  = Approval for all price + service charges ←
- Termination for 'chronic and consistent underperformance'

- Xcellence toolset/ software use under licence
- Management expertise seconded at cost
- Guaranteed investment and cost of first year implementation (up to £15m)
- CEO + executive management team

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# Enterprise Partnership:  Implementation Model



| | Preparation | Realignment | Streamlining | Continuous Improvement |
|---|---|---|---|---|

**COMPETENCIES**
- Set-Up
- Service
- People
- Process
- Technology
- Environment
- Sourcing

2-3mths    3-6mths    6-9mths

**IMPLEMENTATION**

■ Critical activity    ■ Preparation    □ Operational
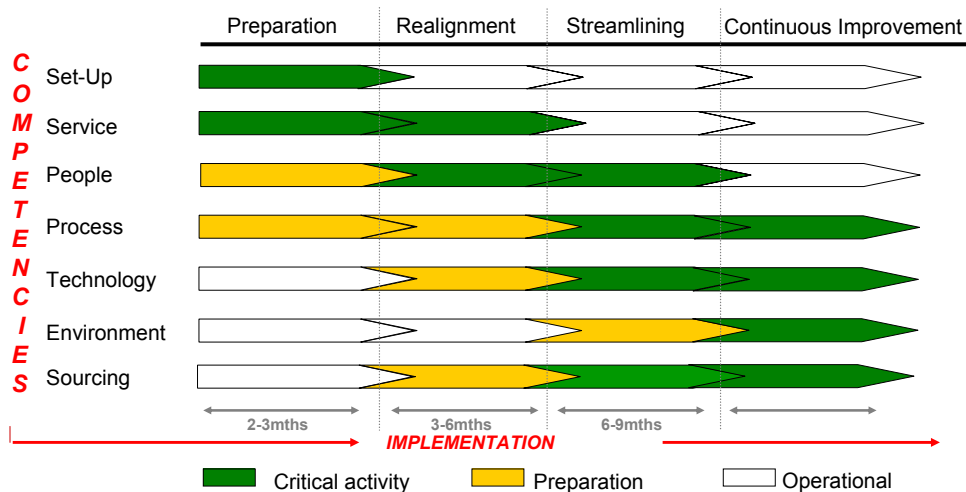
Source:  Xchanging

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# Let's Step Back: Types of Knowledge Capital
### (developed from Stewart, 2002 and Nahapiet et al, 1998)

## Human Capital
– *"the capabilities of the individuals required to provide solutions to customers"*

XIS:

- transferees have insurance and systems knowledge
- transformation competency leaders are all high-knowledge, proven operational performers
- high focus on training and continuous learning within competencies and within each EP
  – Black Belts, Six Sigma projects, communities of practice
  – continuous external recruitment for specific EP roles & competencies

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# Let's step back (2) . . .

## Structural capital
– *"codified bodies of semi-permanent knowledge that can be transferred"*
– *"tools that augment the body of knowledge by bringing relevant data or expertise to people*

XIS:

– continuous recycling, creative utilisation, and sharing of knowledge and experience
– structuring and packaging of generic competencies
  • rule-based 'explicit' knowledge
  • 'tacit' knowledge made explicit from each project
– SC used iteratively to reinforce/expand human and customer capital
  • institutionalises learning
  • increases share-of-customer and attractiveness to other customers

## XIS Knowledge Management Processes Are Built Into Transformation Competencies and Their Application

(After Davenport and Völpel,2001)

CREATE

CAPTURE/ STORE

REFINE

DISTRIBUTE

USE

MONITOR

FEEDBACK from performance

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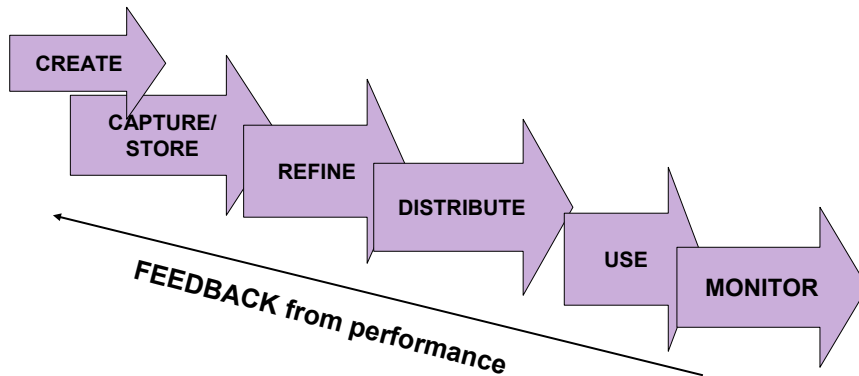
# Let's step back (3) . . .

## Customer and social capital

– *"the value of an organisation's relationships with the people with whom it does business – shared knowledge"*

XIS:
– co-location with Lloyd's and London Insurance Market companies
– constant social relations with clients at managerial and operating levels
– partnering mechanisms and processes

# XIS: Social Capital and Knowledge Capital

## Five Established Enablers of Partnership*

- **Trust** - *from relationships and credibility*
  *Phased Implementation, Service Definition, Relationship Managers*

- **Interdependence** - *all parties have a necessary role*
  *Xchanging generic Competencies vs Client Domain Knowledge*

- **Information Sharing** - *including critical /proprietary information*
  *Business Plans, Open Book Accounting, Performance Reporting*

- **Information Participation** - *joint planning and goal setting*
  *Board of Directors, Service Review boards*

- **Conflict Resolution** - *via joint problem solving*
  *Service Review Board*

*from Mohr & Spekman, 1994

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# Emerging knowledge issues in outsourcing

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# *Characterisation* issues

- Definition
  - What type of knowledge is involved?
- Differentiation
  - What is its brand value?
- Codification
  - How is it represented?

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# Codifying knowledge: creating an architecture

| manuals (structural capital) | organisation | education | tools | integration | management | enterprises (customer capital) |

**knowledge**

practitioners
(human capital)

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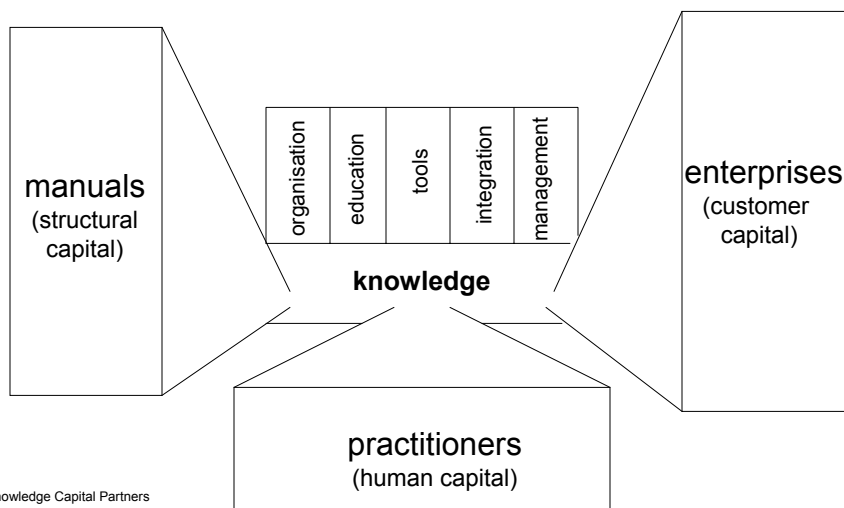
# *Commercial* issues

- Valuation
  - Appraising intangibles
- Ownership
  - Apportioning IP rights
- Protection
  - Safeguarding data and systems

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# Intellectual capital model

Total market value

Tangible assets

Intangible assets

HUMAN CAPITAL
(skills and knowledge
of our people)

STRUCTURAL CAPITAL
(patents, processes,
databases, networks, etc.)

CUSTOMER CAPITAL
(relationships with
customers and suppliers)
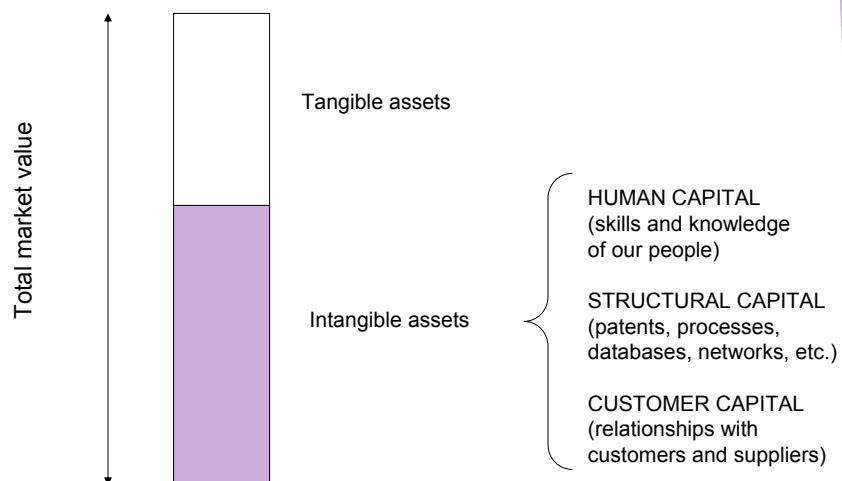
# *Innovation* issues

- Preservation
  - Sustaining "living memory"
- Development
  - Generating new knowledge
- Exploitation
  - Creating new products

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# Creating value from knowledge capital

Define the knowledge gaps in you industry were you aspire to be the "market reference"

Build brand reputation through effective communication of thought leadership

Identify the know-how you already have and explore how to exploit and communicate it as part of your brand/ marketing agenda

**Knowledge Capital**

Create distinctiveness through documenting tacit knowledge and packaging it for internal use

Identify new ways to package your product or service offering to increase business with existing customers

Strengthen customer relationships through increasing value in content and delivery of your service

Identify new channels or marketing opportunities for exploiting existing or new knowledge

# *Retention* issues: the "core" questions

- What core competency should the organization seek in choosing a provider?
  - *does it complement or mirror existing knowledge capital?*
- What core knowledge must the organization retain in order to successfully manage the relationship?
  - *policy & strategy v. operations & transactions?*
- Is *contracting* the real core competency in outsourcing?
  - *does the structure enable innovation and create new value?*

---

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*Specialists in the creation, identification, and exploitation of intellectual capital*

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# The Role of Risk Management in Sourcing

1:40 – 2:30 pm

Tuesday, February 24, 2004

**David Britman**
*Senior Manager*
Ernst & Young

**Michael F. Corbett & Associates, Ltd.**

Lexington Park · North Building Suite B · 1133 Route 55 · LaGrangeville, NY 12540
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**David Britman**
Senior Manager
Ernst & Young

David Britman is a Senior Manager in Ernst & Young's Financial Services Advisory Practice in New York, which provides risk management, regulatory, and business performance services to financial institutions and energy companies, and global treasury advisory services to a broad range of corporations, financial institutions, and government organizations.

David has 18 years of experience in Business Process Reengineering, Project Management, IT Strategy and Planning, Information Security, and Enterprise Technology Architecture. David manages advisory and project teams to assess, architect, and implement strategies and solutions necessary to help financial services clients work through issues of cost, efficiency, effectiveness, and strategic advantage. Recently, he has also been leading a number of Sarbanes-Oxley efforts within the corporate services functions at clients within the Insurance and Broker-Dealer community.

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# The Role of Risk Management in Outsourcing

### David Britman

### February 24, 2003

# Agenda

- **Introduction, About E&Y**

- **Setting the Table**
  - The Current Environment
  - Why Risk Management?
  - What About  Controls?
  - The Human Element

- **Establishing a Course of Action**
  - Types of Vendor/Third-Party Risks
  - Outsourcing Risk/Value Framework
  - Vendor Risk Management Process

- **Keys to Success**
  - Control and Risk Management Leading Practices
  - Role of Governance
  - Information and Communication
  - Critical Success Factors

- **Concluding Remarks**

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# About E&Y
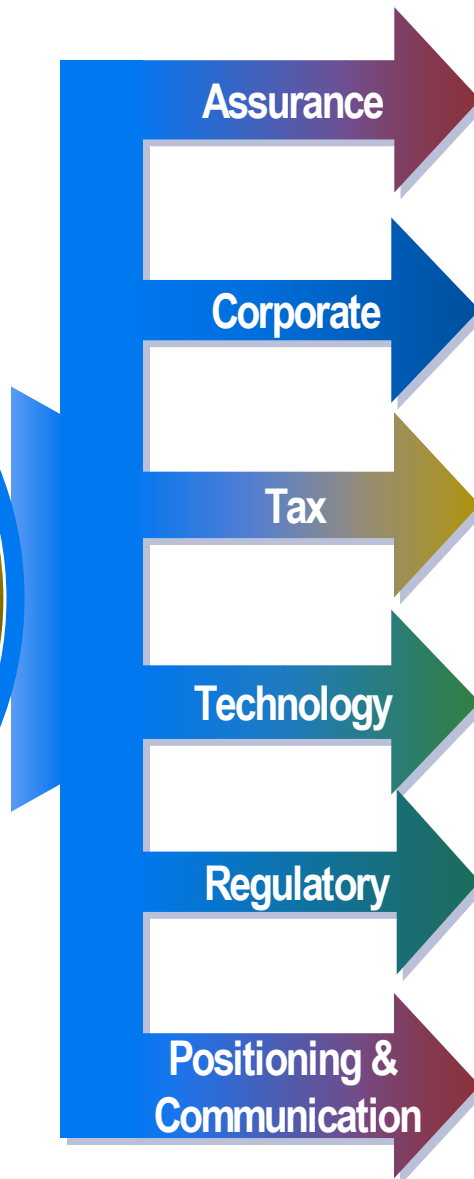


**Assurance**
- Financial Reporting and Disclosure Transparency
- Accounting
- Organization Structure
- Internal Controls, Control Self Assessment & Reporting
- Global Investigations and Conflict Resolution
- Transaction Advisory

**Corporate**
- Due Diligence, Vendor Risk Management
- Financial Management
- Human Resources Solutions
- Real Estate Advisory
- Risk Management and Regulatory Services
- Business Process Improvement
- Cash Management, Treasury Advisory

**Tax**
- Tax Function Transformation
- Tax-Advantaged Accounting for Finance Transformation Costs
- Incentives

**Technology**
- System Integrity
- Information Security
- Business Resiliency
- Migration Support
- Decommissioning
- Application Reviews
- eLearning
- Infrastructure Reviews

**Regulatory**
- Sarbanes-Oxley
- Basel II Accord
- Federal/ SEC Reporting
- Cross-Border Regulations
- Policies and Procedures
- Privacy/Data Protection

**Positioning & Communication**
- Project Management
- Customer Satisfaction Surveys, Reporting
- Business Case for Change
- People Readiness Assessment
- Change Acceleration
- Communication

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# The Current Environment

- **Successful Outsourcing and Strategic Partnerships Require a Diligence and Comprehensive Focus on Risk.**

- **Today's Multi-Vendor and Complex Partner Arrangements Touch Every Aspect of an Organization.**

- **A Firm's Risk Management Program Must Be Extended to Include Its Partners, Which Can Add Strain and Complexity to Ongoing Efforts If Not Done Properly.**

- **From Operational Risk to Information Technology Risk to Reputational Risk, There Must Be Active Management to Evaluate Deal Components and Working Relationship to Ensure No Risk Elements Are Missed.**

- **The Issues Go Far Beyond Contract Performance, Product Quality or Time-and-budget and Extend to Workplace Management, Human Capital, Marketplace and Geo-Political Concerns.**

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*"a financial institution's use of third-parties to achieve its strategic goals does not diminish the responsibility of the board of directors and management to ensure that the third-party activity is conducted in a safe and sound manner and in compliance with applicable laws."*

Office of the Comptroller of the Currency (OCC), OCC Guidelines Cautions

National Banks on Third Party Relationships, NR 2001-92, November 2, 2001

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# Why Risk Management?

- **Every Business Change Is Exposed to Risk, and Outsourcing Represents a Significant Change Across the Organization.**

  - An Early Appreciation of the Risks Associated With the Change Will Help in the Formation of the Business Strategy and Evaluation of Sourcing Options.

- **Analyzing the Potential Exposures Against the Typical Categories of Risk, Makes It Possible to Draw a Risk Profile That Uniquely Represents the Situation.**

  - Once the Extent of Risk Exposure in Each Category Is Understood, It Is Possible to Assess the Ability to Manage Exposure to Risk in Each of the Categories.

- **This Approach to Assessing Risk Associated With an Outsourcing Transaction is Used to Explore and Understand Business Change, Set Expectations, and Identify Opportunities to Increase the Probability of Success And/or Reduce the Exposure to Failure.**

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# What About Controls?

- **Controls, No Matter How Well Conceived and Operated, Can Provide Only Reasonable – Not Absolute – Assurance to Management and the Board Regarding Achievement of an Entity's Objectives.**

- **Certain Limitations Exist in All Control Environments:**
  - Judgments and Decision Making Can Be Faulty
  - Simple Errors and Mistakes
  - Circumvention of Controls by Collusion of Two or More People
  - Resource Constraints (Benefits of Controls Must Be Considered Relative to Their Costs)

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# The Human Element

## Common Behaviors

- Incongruence
- Haste
- Incompleteness
- Pride
- Hidden Agendas
- Embarrassment
- Politics

## Implications

- Financial, Performance Baselines
- Inventory of Assets (e.g., Technology, Facilities, etc.)
- Ongoing Product Lifecycles
- Maintenance and Support
- Vulnerability Management
- Operational Integrity
- Scope Management
- Unwind/Exit

# Types of Vendor/Third-Party Risks

| External Risks | Process Risks | Technology Risks |
|---|---|---|
| **Competitor Risk** - What if there is vendor consolidation or failure? How seamlessly could we transfer our business to another vendor? | **Vendor Reliance** - Your vendor may in turn rely on another vendor in order to fulfill service obligations. How are these sub-contractors vetted and monitored? | **Performance** - Vendor may not be able to meet service obligations due to systems that were inadequately designed or evaluated. |
| **Reputation Risk** - Damage to reputation or loss of clients due to poor customer service, errors, or processing delays. | **Competency** - Vendor may not be able to retain skilled employees. Will this turnover lead to process errors or poor customer service? | **Data Security** - Failure of vendor to appropriately manage access controls, which may result in misappropriation of client data. |
| **Technology Change** - The vendor may have to invest heavily in new technologies in order to remain competitive. Will the vendor's business model support this investment? | **Privacy** - The vendor may operate in a non-regulated environment and may not have an adequate data privacy policy and program. | **Scalability** - Vendor may not be able to support growth and/or usage spikes without service failures or performance degradation. |
| **Capital & Financing** - The vendor's business model may be very dependent on new sources of funding. It may have to invest more slowly in infrastructure than anticipated. | **Business Continuity** - The vendor may operate in a non-regulated environment, and may not have an adequate business continuity policy, program, or testing. | **Availability** - The vendor's architecture may not offer sufficient redundancy or resiliency in the event of individual component failure. |
| **Fraud** - The vendor's employees or service providers may perpetrate fraudulent activities resulting in service abuse or defalcation of assets or information. | **Knowledge Management** - The vendor may lack the operational maturity to document, capture and leverage knowledge about effective service delivery. | **Reliability** - The vendor may not be able to adhere to a contracted level of service if infrastructure is unreliable. |

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# Control and Risk Management Leading Practices

- **Implement Risk Management As a Service Organization, Rather Than a Compliance Function.**

- **Define Chief Risk Officer Responsibilities to Coordinate Risk Assessment, Management Activities.**

- **Perform Ongoing Assessments of External and Internal Audit Functions, Control Self Assessments, and Compliance Reviews.**

- **Assess the Impact of Changes on the Control Environment Whenever Organizational Changes Are Made (Including the Reduction of Head-count).**

- **Perform Periodic Rotation of Duties (Especially With Respect to Cash Handling).**

- **Business Process Profiles, Roles, and Responsibilities Drive User Entitlements.**

- **Provide a Seat at the Table for Business Units to Be Part of the Deal and Ongoing Governance.**

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# Role of Governance

- **A Governance Model That is the Key to a Successful Implementation of an Outsourcing Strategy:**

  - Clearly Articulates Approach Covering Project Management and the Control, Risk and Communication Structures Required

  - Enables Senior Management to Have Clear Oversight of Issues Impacting Plans and Expectations As Detailed in the Business Case.

- **Our Experience With Long-Term, Complex Projects – Including Outsourcing – Reinforces the Need For:**

  - **Project Management :** Clearly Defined Roles, Responsibilities and Escalation Paths Using a Risk Based Approach to Implementing the Project Across a Number of Distinct, Measurable Phases

  - **Quality Assurance :** Independent Quality Assurance Over All Aspects of the Project Using Risk Based Assessment Tools to Identify Areas of Weakness or Risk to the Successful Delivery of Aspects of the Project

  - **Continuous Evaluation :** of Project Success Criteria Including Assessment of Project Against Business Objectives, the Business Case and the Benefit Case, All of Which May Have Moved Since Originally Defined and Agreed.

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# Information and Communication

- **Pertinent Information Must Be Identified, Captured, and Communicated in a Form and Timeframe That Enable People to Carry Out Their Responsibilities**

- **Information Systems Are Key in Providing Relevant and Reliable Information to Users in a Timely Manner**

- **Effective Communication Must Also Take Place in the Broader Sense, Flowing Down, Across and up the Organization**

- **All Personnel Must Receive a Clear Message From Top Management That Control Responsibilities Must Be Taken Seriously**

- **All Employees Must Clearly Understand Their Respective Roles, and Have a Means of Communicating Significant Information Upstream**

# Critical Success Factors

- **Clearly Stated Objectives Need to Be Understood, Communicated, and Properly Managed Over Time, in Order To:**
  - Reduce Transformation Costs
  - Focus on Core Competencies
  - Establish Commitment and Project Ownership
  - Provide Quality Management
  - Improve Operational Efficiency
  - Reduce Financial/Regulatory/Legal/Reputational Risk
  - Serve As a Liaison Among Business Units and Technology
  - Manage Cross-functional Alignment
  - Provide Senior Management With Tactical and Strategic Recommendations
  - Protect Sensitive Information and Intellectual Property
  - Provide Assurance Over Internal Controls and Reporting

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## Looking Ahead:

- **Customers Will Use Risk Management As a Key Lever to Structure Successful Partnerships From the Outset.**

- **Service Providers Will Follow Suit As Quality, Reliability, and Confidentiality Will Be the Key Decision Criteria Rather Than Cost.**

*"….in some manner, [the partner] must warrant and demonstrate a controlled environment that allows us to meet our standards as if we were operating this business ourselves. Everything else aside, it's a mandate in order to meet our regulatory requirements, and our signoffs under Sarbanes. Your arguments are spot on about the SAS70--it will be required if they are to be taken seriously in the marketplace. If they equate being able to have less overhead without one, or if we will be less stringent in our review of their controls environment, they are mistaken. In fact, we will be more thorough if there is not an independently verifiable controls review. If I recall, the controls environment elements in many cases have to be established with our joint work, and in part on our dime. The tech risk resource overhead for reviews and follow-up will need to be factored into this deal above current plan if they do not have a SAS70…"*

-- Chief Risk Officer to Line of Business Executive & Legal

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# Outsourcing Contracts and Meeting Sarbanes-Oxley Requirements

Tuesday, February 24, 2004                                    2:40 – 3:30 PM

**Rick Julien**
*Executive, Corporate Governance*
Crowe Chizek and Company LLC

**Warren Chan**
*Executive, IT Audit*
Crowe Chizek and Company LLC

**Michael F. Corbett & Associates, Ltd.**

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**Rick Julien**
**Executive, Corporate Governance**
**Crowe Chizek & Co. LLC**

Rick Julien, CIA, CPA is Crowe Chizek and Company LLC's Executive of Corporate Governance.  Rick began his career at Arthur Andersen in 1981 and spent several years in the areas of technology consulting and information technology auditing. In 1987 Rick moved to Carolina Power and Light (CP&L) as an internal audit manager.  At CP&L, Rick worked on large operational audits and managed the information systems audit function.  He returned to Andersen in 1990 to develop its internal audit outsourcing/consulting business.  In this role, Rick took the lead in developing firm-wide internal audit services risk assessment, audit execution and reporting methodologies.  In addition, he contributed extensively to the firm's internal audit best practices and human resource transitioning best practices.  Rick has also authored articles and spoken on Corporate Governance, strategic outsourcing and numerous internal audit topics, including benchmarking and best practices.

In 1994, Rick moved to Andersen's Chicago office, where he was actively involved in a variety of client engagements and regularly consulted with organizations on improving internal audit practices.  Rick has been actively involved in helping clients think about managing business risk as a strategy to increase shareholder value, as well developing optimal audit strategies for evaluating information technology functions.  In this role, Rick pioneered internal audit's role as an integral component of organizations' risk management and information processes.

In addition to his leadership role in the Firm's Corporate Governance, Enterprise Risk management, and Internal Audit Services offerings, Rick also currently works with clients to efficiently and effectively respond to Sarbanes-Oxley requirements.

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## Warren Chan
## Executive, IT Audit
## Crowe Chizek & Co. LLC

### Experience
Warren has over 20 years of experience in technology auditing and consulting experience that includes performing numerous technology risk assessments and technical audits for large multi-platform environments of Fortune 500 corporations. Some of his specific technology audit and implementation experience includes mainframe technologies such OS/390, CICS, VM, CA-ACF2, RACF, server operating systems such Windows NT, Citrix Metaframe, Novell NetWare, and applications such as Hyperion, PeopleSoft, MSA, and McCormack and Dodge. He has worked with senior executives of client companies in a variety of industries that include technology, manufacturing, healthcare, banking, energy and transportation.

A significant portion of Warren's career was spent at Arthur Andersen in which one of his responsibilities was leading the Firm's efforts in developing methodologies addressing security issues in IBM mainframe environments and application controls and the implementation of thin-client technologies such as Citrix MetaFrame. He has authored several Arthur Andersen internal publications on auditing IBM mainframe controls for MVS, VM, CICS, RACF, and CA-ACF2. He also instructed numerous Andersen training courses on information technology auditing in the United States and England as well as conducting presentations for ISACA.

### Education
Loyola University – New Orleans
BBA with a concentration in computer science and management

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**Outsourcing Contracts &**
**Meeting Sarbanes-Oxley Requirements**
*2004 Outsourcing World Summit Conference Series*



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## Session Agenda & Goals

**Why is this session important to you?**



Corporate Governance & Sarbanes-Oxley
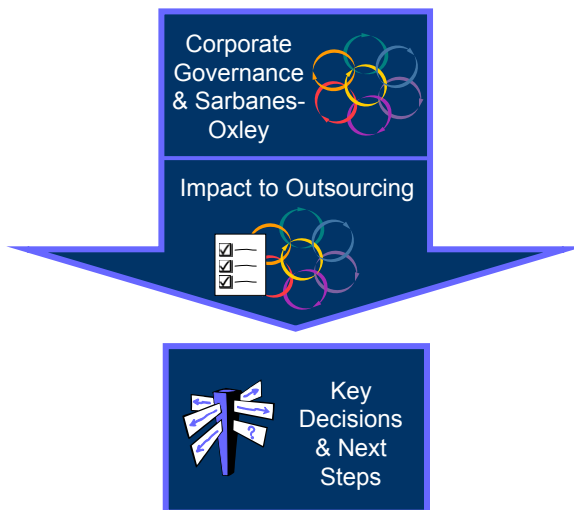
Understand the importance of "GOOD" corporate governance, and how it impacts Outsourcing

Impact to Outsourcing

Determine the impact that Sarbanes-Oxley is having on outsourcing contracts and responsibilities

Key Decisions & Next Steps

Discuss potential decision criteria and next steps for establishing/managing outsourcing relationships to ensure Sarbanes-Oxley compliance

2

## Corporate Governance & Sarbanes-Oxley

### "Good" Corporate Governance

- Good Corporate Governance requires **more than an active Board**, the right committees and meeting legal requirements. It requires:
    - Establishing a culture of sound business practices and ethics
    - Ensuring that management has a comprehensive understanding of how to manage risks
    - The right process for managing and monitoring risks
- The best Corporate Governance approach recognizes that the **stakeholders impacted are broader than the shareholders**. Impacted stakeholders also include employees, customers, vendors, the community, etc.
- All areas of a business are intrinsically connected and for this reason, we believe it is critical to assess, source, measure and manage risks across an enterprise.
- To meet the Board's responsibilities, new expectations suggest that organizations implement **strong risk management processes**.

*Key Point:*
*Gain competitive advantage through reduction in business risks, improvements in internal controls and business ethics, and a reduction in the risk of financial reporting surprises.*

3

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## Corporate Governance & Sarbanes-Oxley

### "Good" Corporate Governance – What does this mean to Outsourcing?

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4

Corporate Governance & Sarbanes-Oxley

**Dynamics of Corporate Governance$^{SM}$**

Corporate governance is the systems and processes an organization has in place to protect the interests of its diverse stakeholder groups, e.g. shareholders, employees, customers, vendors, community, etc.

Board of Directors & Committees

Legal & Regulatory

Monitoring

Communication

Business Practices & Ethics

Enterprise Risk Management

Disclosure & Transparency

"It's what counts, not how it's counted"- Warren Buffett

5

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Corporate Governance & Sarbanes-Oxley

**Components of Corporate Governance – Relationship to Outsourcing**
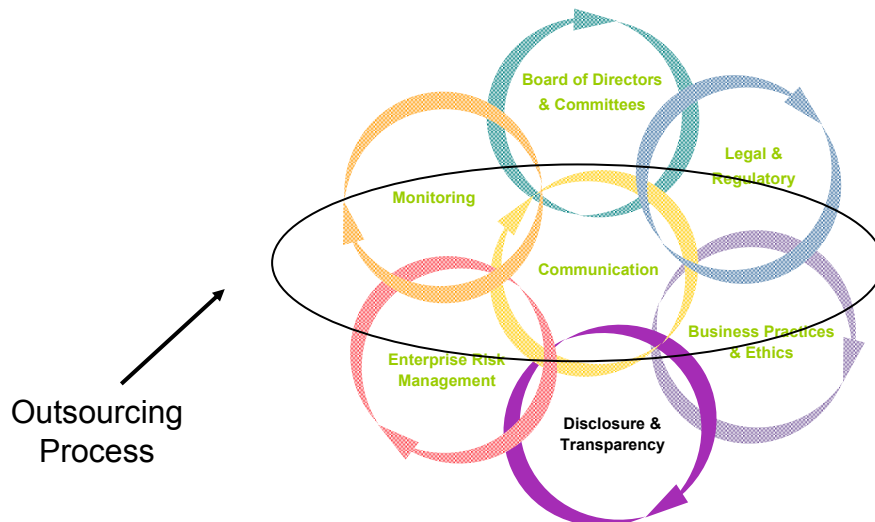
Board of Directors & Committees

Legal & Regulatory

Monitoring

Communication

Business Practices & Ethics

Enterprise Risk Management

Disclosure & Transparency

Outsourcing Process

6

## Corporate Governance & Sarbanes-Oxley

**△ Crowe**

**Three Important Sections for Outsourcers**

The Public Company Accounting Reform and Investor Protection Act of 2002 ("Sarbanes-Oxley Act") and related SEC rules establish new requirements for **one type** of disclosure and transparency stakeholder – the public investor.

- Section 302 (a)  - Management is responsible for establishing and maintaining "disclosure controls and procedures". The CEO and CFO must certify.

  Disclosure controls and procedures are those designed to ensure that information required to be disclosed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported on a timely basis.

- Section 404 (b)  - Each 10K must contain an internal control report that states that management is responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting and assess the effectiveness of the internal control structure and procedures for financial reporting.

- Section 409 – Calls for real-time reporting of material events that could affect a company's financial performance.

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## Disclosure Example

**△ Crowe**

**10/16/03 8-K Current Report Management Discussion & Analysis**

Risk Factors that May Affect Results of Operations and Financial Condition

The risks and uncertainties described below are not the only ones facing eBay. Additional risks and uncertainties not presently know  to us or that we currently deem immaterial also may impair our business operations. If any of the following risks or such other risks actually occur, our business could be harmed.

Our operating results may fluctuate.

Our operating results have varied on a quarterly basis during our operating history. Our operating results may fluctuate significantly as a result of a variety of factors, many of which are outside our control.  Factors that may affect our quarterly operating results include the following:

- Volume, size, timing and completion rate of transactions on our websites;
- Our ability to upgrade and develop our systems, infrastructure and customer service capabilities to accommodate growth at a reasonable cost;
- Technical difficulties or service interruptions involving our websites or services provided to our users by third parties (such as photo hosting);
- The continued financial strength of technology suppliers and other parties with which we have commercial relations;

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## Corporate Governance & Sarbanes-Oxley

**Penalties of the Sarbanes-Oxley Act**

| Action | Punishment | Reference |
|--------|-----------|-----------|
| "Knowingly" altering, destroying, or falsifying documents in an effort to impede, obstruct, or influence an investigation | Fines up to $15 million and/or Imprisonment up to 20 years | Title VIII, Sec. 802 |
| Securities Fraud | Fines and/or imprisonment up to 25 years | Title VIII, Sec. 807 |
| Mail and Wire Fraud | Imprisonment up to 20 years | Title IX, Sec. 903 |
| "Willfully" certifying financial reports that do not meet regulatory requirements | Fines up to $5 million and/or Imprisonment up to 20 years | Title IX, Sec. 906 |
| Violating SEC regulations | May be ineligible to hold a director or officer level position at any publicly traded company | Title XI, Sec. 1105 |

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## Corporate Governance & Sarbanes-Oxley

**Traditional Financial Reporting Responsibilities (Simplified)**



**Typical Processes & Tools**

- Financial statement preparation
  - ✓ Reg S-X checklist
  - ✓ Reg. S-K checklist

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Corporate Governance & Sarbanes-Oxley
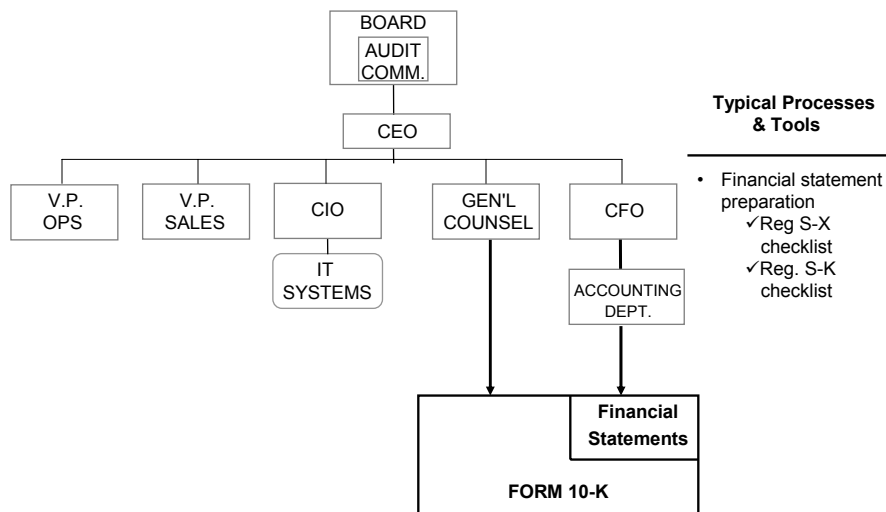
**Financial Reporting Responsibilities with Sarbanes-Oxley**
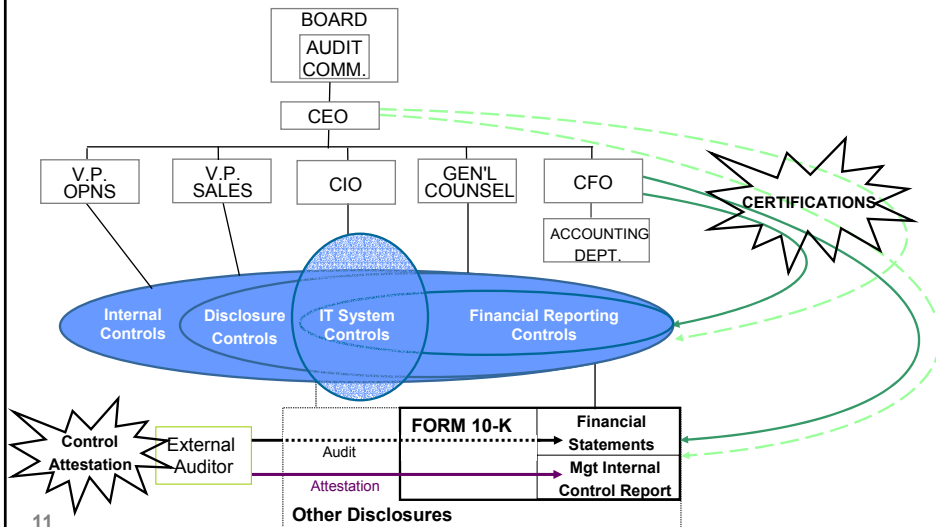
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**Hackett Study**

"A year from now, it won't just be about cost and value.  The CIO and CFO have to come to grips with the integrity of their applications and integrity of their data.

Sarbanes-Oxley will have a serious impact on average companies"

12

Corporate Governance & Sarbanes-Oxley

Impact to Outsourcing

**Determine the impact that Sarbanes-Oxley is having on outsourcing contracts and responsibilities**

Key Decisions & Next Steps

13

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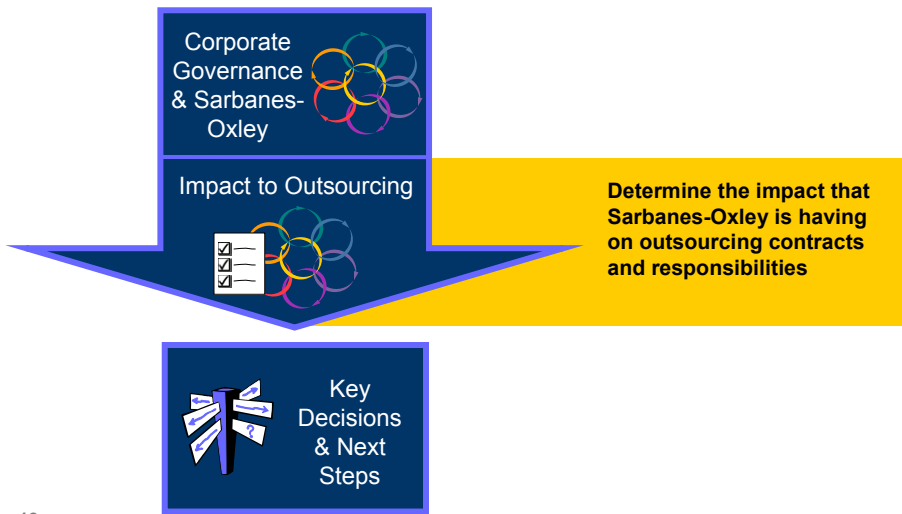
You can outsource functions

BUT

You cannot outsource responsibility

FOR

Sarbanes-Oxley 302/404/409 Compliance

14

# Impact on Outsourcing

 Crowe

**BIG Picture**



**Your Processes**

Financial/Statements

**Outsourcer Support**

3rd

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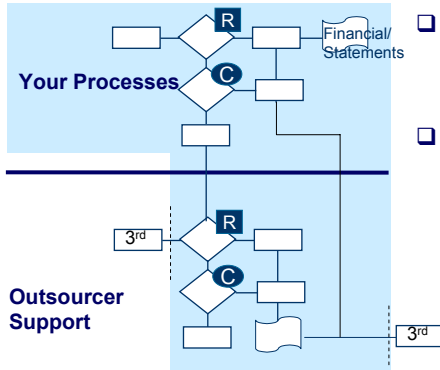
- ❑ Management's assertion on internal controls,and the external auditor's attestation required by law

- ❑ Scope focuses on internal controls over financial reporting (i.e. internal controls impacting the financial statements)

  - Internal control design & operations must be documented and tested annually)

  - Does not matter if function or technology is supported via internal or external resources

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# Impact on Outsourcing

 Crowe

**Types of Controls**

- Controls over financial reporting are relevant, which include:

  - Process controls
    - Manual
    - Automated

  - Pervasive controls
    - IT general controls impacting Sarbane relevant applications
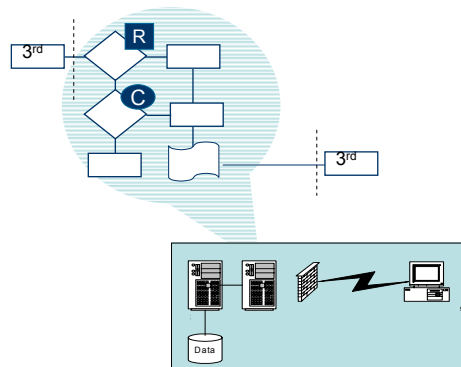


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Data

**16**

Discuss potential decision criteria and next steps for establishing/managing outsourcing relationships to ensure Sarbanes-Oxley compliance

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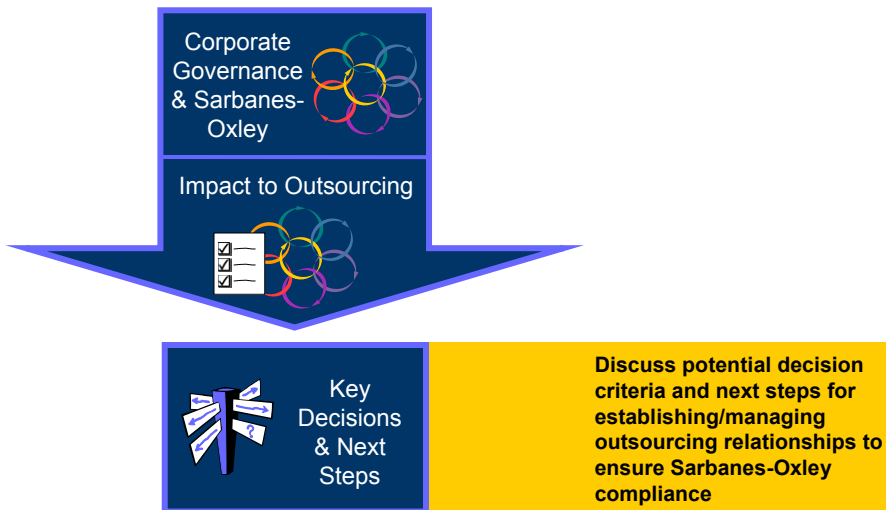
**How do you know if the outsourcer's controls are good?**

- Statement on Auditing Standards (SAS) No. 70, Service Organizations, is an auditing standard developed by at the American Institute of Certified Public Accountants (AICPA). A SAS 70 audit represents that a service organization has been through an audit of their control activities, as defined by the company requesting a SAS-70 audit. A SAS 70 report is issued by an independent auditor ("service auditor") who issues an opinion on a service organization's description of controls through a Service Auditor's Report.

- SAS 70 is not a pre-determined set of control objectives or control activities that service organizations must achieve. These controls are defined by the requesting organization, and the service auditor confirms compliance through a formal audit process.

- You want a Type 2 SAS 70 Report – controls are tested

## Impact on Outsourcing

**Crowe**

**Reliance on Outsourcer Control Assertions**

- The outsourcer should provide an attestation by an accounting firm as to control adequacy and operational effectiveness (i.e. SAS 70)

    – Will enable you (the customer) to rely on their control assertions, documentation and tests

    – Without a SAS 70, you will have to audit the outsourcer, creating any needed control documentation

    – The SAS 70 must have been conducted within the current fiscal year to be applicable

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## Impact on Outsourcing

**Crowe**

**Contracts**

- Contracts should require:
    – Internal controls should be documented and tested (Section 404)
    – Annually independent auditors to attest on the state of internal controls (SAS 70 Type 2)
    – Monitoring risks of 3rd party providers on an as needed basis
    – Disclosures of business issues are made timely (Section 302)
    – Roles and responsibilities are adequately defined and agreed upon
    – Outsourcer will only assign/utilize competent/experienced personnel
    – Outsourcer will assume level of liability and responsibility
    – Performance requirements are identified and outlined
    – Only authorized activities will be conducted

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## Impact on Outsourcing

**Monitoring**

- You (the customer) must monitor outsourcer activities to ensure all contract requirements are met, especially that:

    – Outsourcing risks are managed

    – Only authorized activities are conducted

    – Internal controls are understood

    – Performance requirements are met

- Monitoring techniques/controls must be documented and testable

---

**SOX and Quality Assurance – Competitive Advantage**

As outsourcing continues to mature, as is the case in IT outsourcing, quality will be a differentiator

Out of the Crisis                          W. Edwards Deming

1. Create constancy of purpose toward improvement of service, with the aim to become competitive and to stay in business.

2. Eliminate the need for inspection on a mass basis by building quality into the product in the first place.

3. Move toward a single supplier for any one item, on a long-term relationship of loyalty and trust.

4. Improve constantly and forever the service, to improve quality and productivity, and thus constantly decrease costs.
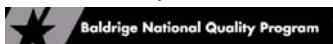
Baldrige National Quality Program        EFQM            e<sup>scm</sup>

ITIL & Standards        ISO International Organization for Standardization        Six Sigma

# The 2004 Outsourcing World Summit

## Conference & Exposition

February 23–25, 2004 • Disney's Yacht & Beach Club Resorts • Lake Buena Vista, Florida

# More Effective Sourcing through Value Chain Analysis

Tuesday, February 24, 2004                    3:50 – 4:40 PM

**Robert Zahler**
*Partner*
Shaw Pittman

**Trevor W. Nagel**
*Partner*
Shaw Pittman

Robert Zahler
Partner
Shaw Pittman

Robert Zahler, a partner and chair of Shaw Pittman's outsourcing practice group and the lead director of the firm's management board, has been practicing law for more than twenty-five years.

Mr. Zahler participates in a wide range of legal work at Shaw Pittman, with special emphasis on technology issues. His work includes the negotiation of systems integration and custom system development contracts, the protection of intellectual property rights, the licensing of computer software, the structuring of telecommunications and managed network services transactions, creation of multi-vendor Internet and web-enabled eCommerce transactions, and counseling and negotiating large-scale facilities management and outsourcing arrangements. During the past fifteen years, Mr. Zahler and his colleagues at Shaw Pittman have represented more than 450 corporations and governmental entities on strategic outsourcing initiatives. Their work includes cutting-edge transactions in the United States (American Express, J.P. Morgan, Apple Computer, Amtrak, MCI WorldCom, Enron), Canada (Air Canada, Canadian Imperial Bank of Commerce), Australia (AMP, Government of South Australia, Telstra), South Africa and Europe (Aventis Pharmaceuticals and Crop Science, DeutscheBank).

Mr. Zahler has written widely on the subjects of outsourcing and procuring complex information technology services, and is a frequent speaker on the subject having appeared at conferences sponsored by *CIO* and *Forbes* magazines, the Society of Information Management (SIM), the Sourcing Interests Group, the Outsourcing Institute, Digital Consulting Inc. and the Yankee Group.

Mr. Zahler was awarded his S.B. in Physics from the Massachusetts Institute of Technology in 1972 and his J.D., *cum laude*, from the Harvard Law School in 1975. While at Harvard, Mr. Zahler was Articles Editor of the *Harvard Journal on Legislation*. He is a member of Sigma Xi, a scientific research honorary society.

Mr. Zahler is admitted to practice in the District of Columbia. He is a member of the bars of the District of Columbia Court of Appeals, the United States Supreme Court, the United States Courts of Appeals for the First, Third, Fourth, and District of Columbia Circuits and the United States District Court for the District of Columbia.

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Trevor W. Nagel
Partner
Shaw Pittman

Trevor Nagel, a partner in Shaw Pittman's Washington, D.C. office, chairs the firm's technology practice group and its global practice group. Mr. Nagel, who has considerable experience in European Union and Pacific Basin transactions, concentrates his practice on information-technology industries, in particular telecommunications and computer hardware and software. He advises clients on a wide range of legal and business issues, including joint ventures and other strategic alliances; mergers and acquisitions; outsourcings; licensing and technology transfer transactions involving patents, copyrights, trade secrets and trademarks; distribution, agency, and sales representative agreements; export controls; and effective ways to structure foreign operations.

Before coming to the United States, Mr. Nagel was a Barrister of the Supreme Court of New South Wales and the High Court of Australia, and a professor at both the University of Sydney Law School and the Elton Mayo School of Management at the University of South Australia. He holds a S.J.D. degree from Harvard University; a LL.M. degree from the University of Chicago; and B.A. (with honors), Dip. Ed., and LL.B. (with honors) degrees from the University of Adelaide.

Mr. Nagel is admitted to practice in the District of Columbia and Massachusetts. He is a member of the American Bar Association Section on International Law and Practice and the International Bar Association. In addition, Mr. Nagel has published articles in a variety of U.S. and international journals, including *The Yale Law & Policy Review* and *The Harvard International Review*. His recent publications include: "Copyright Protection of Compilations and Other Fact-Based Works in the United States After *Feist*" in *Computer und Recht* (1994); "Convergence of Technologies and Complex Transfer Structures" in *International Technology Transfers* (Harry Rubin ed., 1995); and "Structuring Technology Outsourcing Relationships: Customer Concerns, Strategies and Processes" in *International Journal of Law and Information Technology* (1996). Mr. Nagel is a frequent speaker at business and legal conferences on information technology and outsourcing issues.

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tel. 845.452.0600 · fax. 845.452.6988 · www.CorbettAssociates.com
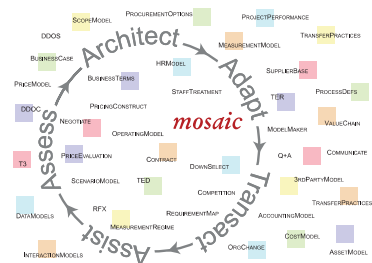
- Outsourcing defined: The delegation to a third party of responsibility for performing a significant function
- The basic commercial proposition: The outsource supplier will do:
  - what the customer currently does
  - at the same or a better level of performance
  - for the same or a lower price
- The major corollary: Do not tell me how to perform, tell me at what level you want me to perform
- Requirements for model to be successful
  - supplier needs customer's people and assets to perform
  - supplier investments that produce economies of scale
  - works best for centralized, repeatable functions
- Benefits of the model (to the supplier)
  - little need to know what you do $\longrightarrow$ transferred personnel know
  - little need to know how you do it $\longrightarrow$ transferred personnel know
  - but, need to know at what level you do it and what it costs you $\longrightarrow$ to develop supplier price

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- Focuses on issues that do not produce value
  - historical costs
  - existing service levels
  - yesterday's scope of services
- The unique aspects of an outsourcing contract
  - long term, fixed unit-price relationship
  - description of the services and service levels
    - difficulty in *determining* what is in-scope and what is out-of-scope
    - difficulty in *describing* the in-scope services and service levels
    - continual *evolution* and *change*
    - *variability* of demand
  - "exclusive" nature of relationship

- Salesmanship works best when customer is confused about the cost drivers behind the model
- Results in "unsolved" issues
  - server pricing, especially for hardware and software
  - extent of technology refresh
  - characteristic of changes for which the supplier is entitled to additional compensation
- Produces complex transactions, lengthy deal cycles and adversarial negotiations

- Term is typically 7 to 10 years
  - multiple "lifetimes" in the information technology industry
- The Supplier's justification for a long term
  - large, up-front costs to market and establish relationship
  - time needed to accomplish necessary changes to
    - make significant investments in "new" technology
    - implement productivity improvements
    - achieve "cultural" change
  - customer-desired financial engineering
- The Customer's revenge for a long contract
  - need for the "perfect" contract
  - complex, burdensome specificity *and* broad, over-generalized principles
  - large "cost savings"
  - right to terminate for convenience

---

- Exclusivity
  - de jure -- suppliers seek to establish an exclusive relationship
    - customer will purchase its *requirements* for the services from vendor
  - de facto -- practical issues facing the customer
    - lack of expertise once people transfer to supplier
    - desire to focus on other issues (attention to "core competencies")
    - little appetite to again be managing complex, operational issues
    - limited rights to the necessary people, hardware and software ("golden handcuffs")
- *Perceived* difficulty of terminating the relationship
  - termination for cause is almost always impossible to prove
  - operational risks from termination for convenience
- Is the outsourcing relationship like
  - a marriage?
  - living with your teenager?
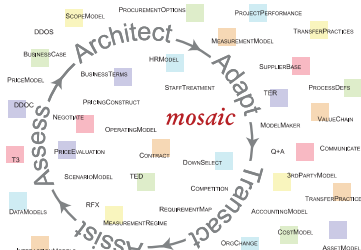
The Method of:
*VALUECHAIN*

*Structuring Delivery Roles and Linkages*

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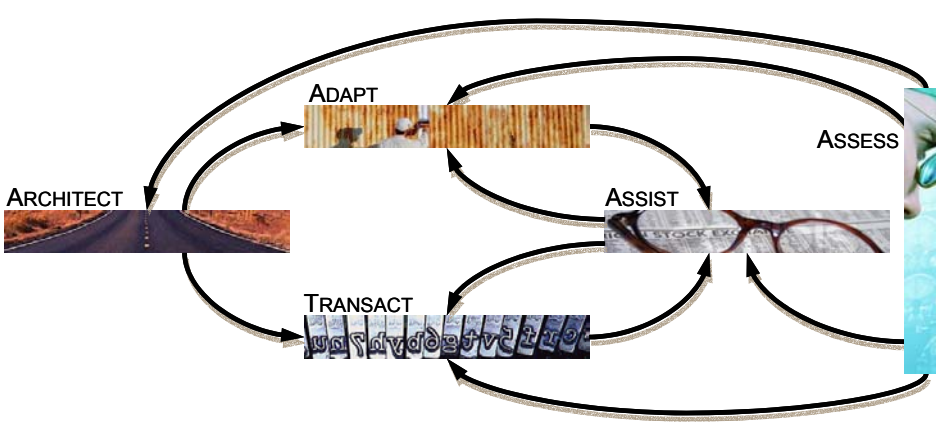


The MOSAIC framework • Services

■ The MOSAIC framework of services are designed to provide front-to-back coverage on an integrated basis

The MOSAIC framework • Sourcing evolved

By radically shifting the focus of the sourcing activities from the classic model, MOSAIC addresses the issues that have plagued the outsourcing industry since its inception

| | Classic Approach | Next Generation Approach |
|---|---|---|
| Sourcing Answer | Outsource! | Strategy Driven |
| Expected Benefits | Cost Reduction | Value Creation |
| Sourcing Perspective | Towers | Processes |
| Statement of Work | Amorphous | Wall-to-Wall |
| Supplier Solution | Prescribed | Requested |
| Customer Change | Minimal | Change Management Program |
| Performance Measurement | Point-specific | End-to-End, Coverage-based |
| Customer/Supplier Alignment | Governance | Defined Interfaces |

The MOSAIC framework • ROUTEMAPS

ADAPT

| Communi-cations | Measurement Regime | Customer-Supplier Interfaces | Organization Change | Enterprise Governance | Supplier Relationship |
|---|---|---|---|---|---|

ARCHITECT

| Objectives | "As-Is" | Operating Model | "To-Be" | Sourcing Strategy |
|---|---|---|---|---|

TRANSACT

| Deal Structuring | Requirements Package | Supplier Proposal Review | Term Sheet Negotiations | Supplier Selection | Contract |
|---|---|---|---|---|---|
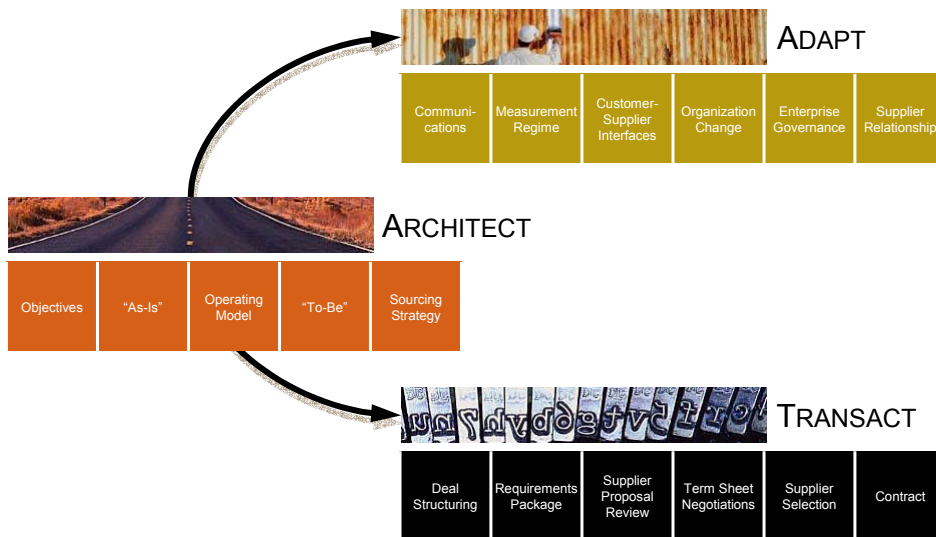
The MOSAIC framework • METHODS

Interoperate with one another

Ensure consistency of SPGS's delivery

Adapt to customer-specific circumstances

Each used only as needed

SCOPEMODEL
PROCUREMENTOPTIONS
PROJECTPERFORMANCE
DDOS
TRANSFERPRACTICES
MEASUREMENTMODEL
BUSINESSCASE
HRMODEL
SUPPLIERBASE
PRICEMODEL
BUSINESSTERMS
STAFFTREATMENT
PROCESSDEFS
TER
DDOC
PRICINGCONSTRUCT
VALUECHAIN
NEGOTIATE
OPERATINGMODEL
mosaic
MODELMAKER
PRICEEVALUATION
CONTRACT
Q+A
COMMUNICATE
T3
DOWNSELECT
SCENARIOMODEL
TED
3RDPARTYMODEL
COMPETITION
TRANSFERPRACTICES
DATAMODELS
RFX
REQUIREMENTMAP
ACCOUNTINGMODEL
MEASUREMENTREGIME
COSTMODEL
INTERACTIONMODELS
ORGCHANGE
ASSETMODEL

Architect
Adapt
Transact
Assist
Assess

- 10 -

SP GS

ShawPittman LLP

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VALUECHAIN • Evolution from lessons learned

■ Establishes the scope of a transaction as a function of processes and elements

■ Provides an operating model for the entirety of the operation (retained and sourced)

■ Provides a complete mapping of the areas of interaction between the customer and its suppliers

■ Facilitates the capture of data (people, equipment, applications, third party contracts, etc.) using a process and element approach

■ Provides a mechanism to design optimal service level coverage

■ Enables the linking of price to the scope of the services – thereby resolving some of the more heated customer / supplier discussions

1 Reduce the likelihood of failure

2 Identify and create value

3 Build lasting solutions

4 Improve the transactional format

ValueChain
PATENT PENDING

SP GS

- 11 -

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■ As the structural underpinning of a transaction – the objectives come first…

| A. **Strategic** Relationship Expectations | B. **Tactical** Sourcing Expectations | C. **Operational** Delivery Expectations |
|---|---|---|
| ▸ Interim Services<br>    Let the supplier fix it, then we'll bring it back in-house<br>▸ Medium-Term Services<br>    Let's figure out if this really works or what we really want to do<br>▸ Partnership Services<br>    We want a relationship that is not expected to dissolve… ever! | ▸ Status quo<br>▸ Cost reduction<br>▸ Immediate access to more products, services, change<br>▸ Continuous access to leading edge processes, products, services, etc.<br>▸ Cross-sales opportunities<br>▸ Integration capabilities | ▸ Improve end-user transaction response time<br>▸ Improve product quality<br>▸ Improve time to money<br>▸ Accommodate shift to thin-client applications<br>▸ Move to CMM level n<br>▸ Accommodate constant on-site workforce mobility<br>▸ Simplify experience of working from home |

*Examples*

■ … But are tempered by the constraints

*etc.*

| Operational | Financial | Audit |
|---|---|---|
| Legal | Cultural | Geographic |

---

■ The customer's objectives + best practice guiding principles enable architecting the scope of a transaction

| Strategy Development | Transaction Production |
|---|---|
| ▸ Any required change initiative must be of manageable size and capable of being completed within an acceptable time frame<br>▸ Services provided must be aligned with the ultimate users' needs<br>▸ Operational risk of change initiatives must be acceptable (end-to-end)<br>▸ Benefit stream must outweigh the cost of change and the level of risk | ▸ Services must be commercially available<br>▸ Services must be negotiable in a competitive process<br>▸ Sufficient scope must be provided for service delivery success<br>▸ Scope of service must be designed to reduce the "sole source" effect<br>▸ Price performance must be acceptable |

*Guiding Principles*

- The value chain has been the business process reengineering tool of choice to identify and create operational value for over a decade
  - Value creation
    - Cannot be understood by looking at an organization as a whole
    - Stems from the many discrete activities each organization performs in designing, producing, marketing, delivering and supporting its services
  - A value chain model
    - Examines activities (in a systematic way) and how they interact
    - Disaggregates the organization into its strategically relevant business processes to better understand where opportunity for improvement exists
    - Builds the bridge between strategy formulation and implementation
  - Optimization and value creation are a direct result of focusing on linkages between activities

| Relate | Develop | Contact | Fulfill | Operate | Advise | Manage |

---

- A **Value Chain** catalogs naturally partitioned groups of activities in an organization
- The **Business Processes** of an operation are disaggregated along the value chain to understand the
  - Mechanisms and resources used to accomplish the activities
  - Relationships and interactions needed for inter-operability

IT

| Relate | Develop | | | | | | | Contact | Fulfill | | | Operate | | | | | | Advise | Manage | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Relationship Management | Requirements | Enterprise Architecture | Domain Architecture | Standards | Infrastructure Engineering | Application Engineering | Application Maintenance | Quality Assurance | Service Desk | Acquire | Deploy | Maintain | Server Operations | Network Operations | Service Support | Service Delivery | Security Management | Procurement Management | Logistics | Advisory Services | Business Office | Govern | Program Management Office |

HR

Level 2
Business Processes

| Relate | Develop | | | | Contact | Fulfill | | Operate | | | Advise | Manage | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Relationship Management | Requirements | Enterprise Strategy | Domain Strategies | Plans | Policies and Procedures | Service Desk | Materials | Staffing | Performance | Domain Operations | Procurement Operations | Event Coordination | Advisory Services | Business Office | Govern | Program Management Office |

- A sourcing causes the introduction of a supplier value chain
- Processes necessary to fulfill the objectives are pushed to suppliers
- Pushing processes to a supplier converts "intra-actions" into "interactions"

**Customer Value Chain**

| Relate | | Develop | | | Contact | | Fulfill | | Operate | | | Advise | | Manage | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Process 01 | Process 02 | Process 03 | Process 04 | Process 05 | Process 06 | Process 07 | Process 08 | Process 09 | Process 10 | Process 11 | Process 12 | Process 13 | Process 14 | Process 15 | Process 16 | Process 17 |

**Supplier Value Chain**

| Process 01 | Process 02 | Process 03 | Process 04 | Process 05 | Process 06 | Process 07 | Process 08 | Process 09 | Process 10 | Process 11 | Process 12 | Process 13 | Process 14 | Process 15 | Process 16 | Process 17 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Relate | | Develop | | | Contact | | Fulfill | | Operate | | | Advise | | Manage | | |

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- A customer-specific span can be built to depict all factors of production by geography, business unit, etc.

Collectors

**Company ABC**

North America

U.S.

Specific ABC Location

| Middle Boxes | Link and Link Devices | Environmental Equipment |
|---|---|---|
| Router, LAN Switch, Ethernet Hub, Token Ring Hub, FEP, Security Device, Gateway, PAD, Cache, Terminal Controller, Interconnect Controller, Load Balancer, Terminal Server, Address Server, Name Server, Proxy Server | Modem, CSU and DSU, PSU, Link Encrypter, Multiplexer, Fiber Mux, Channel Extender, Balun, WAN Circuit, Vertical Cable, Horizontal Cable, MAN Circuit | Backup Generator, UPS, HVAC, Equipment Rack, Electrical |

Span

Elements

■ Linking Processes and Span in a matrix enables articulation of Scope by Actor – a fundamentally different view

| | Company ABC | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | ••• |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | North America | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | San Francisco | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Middle Boxes | | | | | | | | | | | | | | | | | | | Link and Link Devices | | | | | | | | | | | | | | |
| Company ABC (teal) | Router | LAN Switch | Ethernet Hub | Token Ring Hub | FEP | Security Device | Gateway | PAD | Cache | Terminal Controller | Interconnect Controller | Load Balancer | Terminal Server | Address Server | Name Server | Proxy Server | Modem | CSU and DSU | PSU | Link Encrypter | Multiplexer | Fiber Mux | Channel Extender | Balun | WAN Circuit | Vertical Cable | Horizontal Cable | MAN Circuit | | | | | | |
| Supplier 1 (gold) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Supplier 2 (red) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |

| | | Router | LAN Switch | Ethernet Hub | Token Ring Hub | FEP | Security Device | Gateway | PAD | Cache | Terminal Controller | Interconnect Controller | Load Balancer | Terminal Server | Address Server | Name Server | Proxy Server | Modem | CSU and DSU | PSU | Link Encrypter | Multiplexer | Fiber Mux | Channel Extender | Balun | WAN Circuit | Vertical Cable | Horizontal Cable | MAN Circuit |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Relate** | **Relationship Management** | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Process 01 | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Process 02 | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| **Develop** | **Requirements** | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Process 03 | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Process 04 | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Process 05 | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Process 06 | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Process 07 | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | **Enterprise Architecture** | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Process 08 | | | | | | | | | | | | | | | | | | | | | | | | | | | | |

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■ Following the value chain approach, scope is defined in two parts

| | | |
|---|---|---|
| Separate → | **Process** ▸ Operational Activities | ▸ Incorporation of best practices from standards-based organizations ▸ Identification of areas of important client / supplier interaction ▸ Creation of a lingua franca for pushing responsibility to suppliers |
| → | **Span** ▸ Technologies ▸ Geographies ▸ Business Units | ▸ Disaggregation of technology, geography, business unit, etc. ▸ Increased visibility of responsibilities in transaction documents ▸ Modular handling of change as it occurs over time |

■ Decomposing the description of scope into its constituent components
  ▸ Increases readability by customer management and subject matter experts
  ▸ Eliminates the cover-to-cover reading necessary to fully understand a process
  ▸ Helps ensure full coverage of each process

- Documentation that flows seamlessly from the sourcing strategy to physical contract documentation
  - Reduces re-work
  - Keeps the parties on the same page

- Supplier Proposal Presentation
- Proposal Review
- Q&A
- Customer Due Diligence
- Down-Select (4 : 2)
- Discussion / Negotiations
- Supplier Due Diligence
- Down-Select (2 : 1)

| Requirements Package | Supplier Response | Contract Documents |
|---|---|---|
| Term Sheet | Yes, No + Comments | Terms and Conditions |
| Scope Model | Yes, Recommendations | Statement of Work |
| TER | TED | Statement of Work |
| Service Measure Model | Yes, No + Comments | Service Measures / Levels |
| Pricing Instructions | Pricing | Pricing |
| Interaction Models | Yes, No, Recommendations | Statement of Work |
| Due Diligence Data | Due Diligence Requirements | Miscellaneous Schedules |
| Questions | Answers | |

---

- The format historically used to document scope is inherently complex as it deals with many degrees of freedom

| Processes | Technologies | Geographies | Business Units |
|---|---|---|---|

**Typical Contract Language**

Network Service Management:

A. Supplier's responsibilities to provide the Services will include:

| | Actual Processes |
|---|---|
| i. Managing and reporting on the capacity and configuration of the Network. | Network Operations, Capacity Management, Configuration Management, Service Desk Reporting |
| ii. Acting as a single point of contact for the management of the Network. | Network Operations |
| iii. Maintaining Equipment inventories, locations lists, Network diagrams and other Network documentation and information. | Configuration Management, Infrastructure Architecture, Network Engineering |
| iv. Providing such information to Client in an online, self-service, electronic Web format available to Authorized Users. | Service Desk Reporting, Operational Interaction |

■ A definition is established for each process

| Relate | Relationship Management |
| | Process 01 |
| | Process 02 |
| | **Requirements** |
| | Business Requirements Development |
| Develop | Implementation Requirements Development |
| | Solution Development |
| | Time and Resource Estimation |
| | Solution Approval |
| | **Enterprise Architecture** |
| | Process 08 |

**Definition**

The purpose of the **"Business Requirements Development"** process is to identify and document the business input, output and schedule requirements, and the actors providing input or receiving output from the requirements. The Business Requirements Development process includes the following activities:

1. Identifying and documenting business stakeholder needs, expectations and constraints;
2. Identifying and documenting business drivers and business interfaces (both internal and external);
3. Identifying and documenting schedule and business case requirements;
4. Transforming stakeholder needs, expectations, constraints, and interfaces into business requirements;
5. Defining constraints for verification and validation; and
6. Providing business requirements to the Implementation Requirements Development process.

---

| Organization | | Standard | Focus |
|---|---|---|---|
| OGC | **OGC** Office of Government Commerce (UK) www.ogc.gov.uk | **ITIL** **IT Infrastructure Library** | Process Management for IT Infrastructure |
| PMI | **PMI** Project Management Institute www.pmi.org | **PMBOK** **Project Management Body of Knowledge** | Project Management Methodology |
| SEI | **SEI** Carnegie Mellon Software Engineering Institute www.sei.cmu.edu | **CMM** **Capability Maturity Models** | Software Development Methodology |
| NCMA | NCMA National Contract Management Association www.ncmahq.org | **CMBoK** **Contract Management Body of Knowledge** | Contract and Supplier Management |
| ITGI | **ITGI** IT Governance Institute www.itgi.org | **CᴏʙɪT** **Control Objectives for Information and related Technology** | IT Governance |

■ A definition is also established for each element, as well as relevant technology-specific attributes

| Middle Boxes | | | | | | | | | | | | | | | | Link and Link Devices | | | | | | | | | | | ••• |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Router | LAN switch | Ethernet Hub | Token Ring Hub | FEP | Security Devices | Gateways | PAD | Cache | Terminal Controller | Interconnect Controller | Load Balancer | Terminal Server | Address Server | Name Server | Proxy Server | Modem | CSU and DSU | PSU | Link Encrypter | Multiplexer | Fiber Mux | Channel Extender | Balun | WAN Circuit | Vertical Cable | Horizontal Cable | MAN Circuit |

**Definition**

**"FEP" or "Front-End Processor"** means a device that is connected to an Enterprise Application Server that manages the routing of data between such Server and input and output devices. A Front End Processor includes network interfaces.

**Attributes**

▸ Refresh Rate

▸ Warranty Status

▸ Software Currency

▸ •••

---

■ Interactions are created by partially sourcing the processes associated with an intra-action

■ Interactions can be

**Simple**
Statement of the expected interaction

▸ Attend the weekly XYZ meeting

▸ Send an e-mail listing of _____ each morning to _____

▸ •••

**Complex**
Where assignment of responsible actor is not enough

| ••• | Develop | ••• |
|---|---|---|
| | Requirements | |

| Business Requirements Development | Implementation Requirements Development | Solution Development | Time and Resource Estimation | Solution Approval |
|---|---|---|---|---|

| | Business Requirements Development | Implementation Requirements Development | Solution Development | Time and Resource Estimation | Solution Approval |
|---|---|---|---|---|---|
| **Customer** Value Chain | ■ | | | | ■ |
| **Supplier** Value Chain | | ■ | ■ | ■ | |
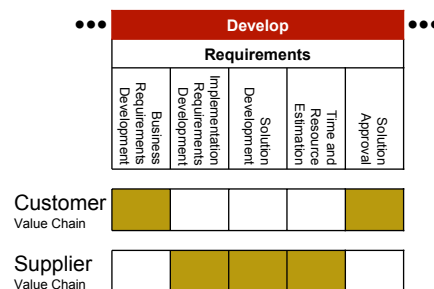
■ As a one-size-fits-all approach does not work, customer-specific models for complex interactions provide the content behind the relationship

**Process Maps**

Customer:
- Submit Business Requirements
- Receive Time Estimate
- Receive and Review Solution and Business Case
- Acceptable? → Yes ●●● / No

Supplier:
- Review Requirements and Develop Time Estimate
- Submit Time Estimate
- Develop Solution and Associated Business Case
- Submit Solution and Business Case

**Templates**

| Description | ▶ Description of the interaction |
|---|---|
| Direction | ▶ Supplier → Customer<br>▶ Customer → Supplier<br>▶ Customer + Supplier |
| Relevant Actors | ▶ Client (names and/or positions)<br>▶ Supplier (names and/or positions) |
| Contents | ▶ Description of document (e.g., text, sample forms, table of contents)<br>▶ Description of meeting (e.g., agenda) |

| Format | ▶ Document (e.g., paper, electronic)<br>▶ Meeting (e.g., telephone, video, in-person) |
|---|---|
| Frequency of Occurrence | ▶ Recurring (e.g., weekly, monthly, etc.)<br>▶ Ad-hoc |
| Iterations Expected | ▶ One<br>▶ Multiple (provide number) |
| Service Measures | ▶ Description of measures (e.g., temporal, availability, quality) |

---

■ Plotting the service measures along the value chain helps
  ▶ Identify areas with inadequate, redundant or inappropriate coverage
  ▶ Articulate where service levels need to differ
  ▶ Eliminate measurement of *intra*-actions

| | | Enterprise | Retail Deposits | Mortgage Banking | Investment Banking | Insurance |
|---|---|---|---|---|---|---|
| **Relate** | **Relationship Management** | | | | | |
| | Process 01 | | | | | |
| | Process 02 | | | | | |
| **Develop** | **Requirements** | | | | | |
| | Business Requirements Development | | | | | |
| | Implementation Requirements Development | | | | | |
| | Business Solution Delivery Time Accuracy | ≥ 98% | | | | |
| | Solution Development | | | | | |
| | Time and Resource Estimation | | | | | |
| | Solution Approval | | | | | |
| | **Enterprise Architecture** | | | | | |
| | Process 08 | | | | | |

- Establishes the scope of a transaction as a function of processes and elements
  - ▸ Describes the underlying work activities across the entire spectrum (i.e., a value chain)
  - ▸ Specifies the customer-specific elements on which the processes are to be enacted
  - ▸ Defines processes and elements from sources of best-practices (i.e., standards-based organizations)
  - ▸ Reduces integration risk associated with sourcing by traditional service towers
- Provides an operating model for the entirety of the operation (retained and sourced)
  - ▸ Facilitates end-to-end accountability
  - ▸ Provides the context from which broad-based sourcing strategies and/or transactional decisions can be assessed
- Provides a complete mapping of the areas of interaction between the customer and its suppliers
  - ▸ Supports the reallocation of processes / elements
  - ▸ Identifies where interaction models need to be developed pre-contract
- Facilitates the capture of data (people, equipment, applications, third party contracts, etc.)
- Provides a mechanism to design optimal service level coverage
- Enables the linking of price to the scope of the services – thereby resolving some of the more heated customer / supplier discussions

| ✓ | 1 | Reduce the likelihood of failure |
| ✓ | 2 | Identify and create value |
| ✓ | 3 | Build lasting solutions |
| ✓ | 4 | Improve the transactional format |

ValueChain

PATENT PENDING

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**Creating Successful Sourcing Relationships**

| | | | | |
|---|---|---|---|---|
| *Serving sourcing customers* | Private | Public | | |
| *Services for the sourcing lifecycle* | Strategy ARCHITECT | Change ADAPT | Transaction TRANSACT | Operate ASSIST | Diagnose ASSESS |
| *Over 100 professionals* | Lawyers | Consultants | | |
| *Operating globally from four sites* | Washington DC | New York NY | Los Angeles CA | London UK |

A SAMPLING OF WORLDWIDE CLIENTS ■ AC NIELSEN AETNA ■ AIR CANADA ■ ALCOA ■ AMERICAN EXPRESS AMTRAK ■ AOL TIME WARNER ■ APPLE COMPUTER ASTRAZENECA ■ AVENTIS ■ BANK ONE ■ BASF BHP BILLITON ■ BRISTOL-MYERS SQUIBB ■ CABLE & WIRELESS ■ CNA INSURANCE ■ CANADIAN TIRE CONTINENTAL AIRLINES ■ DELTA AIR LINES DEUTSCHE BANK ■ DIAGEO (SEAGRAM) ■ DUN & BRADSTREET ■ ELI LILLY ■ EQUANT ■ FANNIE MAE FEDERATED DEPARTMENT STORES ■ FIREMAN'S FUND FORD MOTOR ■ GAP ■ GENERAL ELECTRIC ■ GE CAPITAL ■ THE HARTFORD ■ HERSHEY FOODS ■ IMF J. CREW ■ JPMORGAN CHASE ■ LLOYDS TSB MCDONALD'S ■ MERRILL LYNCH ■ METLIFE ■ MORGAN STANLEY DEAN WITTER ■ NESTLÉ ■ NEW YORK TIMES NIKE ■ PFIZER ■ SOLECTRON ■ STARWOOD HOTELS & RESORTS ■ U.S. OLYMPIC COMMITTEE ■ UNOCAL VIVENDI UNIVERSAL ■ WORLDCOM ■ XEROX ■

*The most experienced firm in the business – architecting the largest outsourcing projects and strategic alliances*

*Over 450 transactions across a premier client base*

*15 years' experience in complex sourcing transactions – since the birth of those arrangements*

*More than US$350 billion in completed transactions*

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**Producing the milestone transactions in the outsourcing industry**

**1988** FIRST
LARGE-SCALE IT OUTSOURCING
First City Bank

**1991** FIRST
MULTI-BILLION DOLLAR IT TRANSACTION
Continental Airlines

**1994** FIRST
NETWORK JOINT VENTURE AND IT OUTSOURCING
Air Canada

**1995** FIRST
WHOLE-OF-GOVERNMENT IT OUTSOURCING
State of South Australia

**1996** WATERSHED
IT ALLIANCE-BASED TRANSACTION
J.P. Morgan (Pinnacle Alliance)

**1998** LANDMARK
SALE OF OUTSOURCING BUSINESS
GE Capital

**1999** FIRST
LARGE-SCALE PROCURMENT BPO TRANSACTION
ANZ Bank

**1999** LARGEST
IT AND NETWORKING OUTSOURCING (US$12 BILLION)
WorldCom

**1999** FIRST
GLOBAL HR BPO TRANSACTION
Exult (BP Amoco)

**2000** LARGEST
PUBLIC SECTOR OUTSOURCING PROGRAM
Commonwealth of Australia

**2001** LARGEST
MANAGED SERVICES NETWORK TRANSACTION
Equant

**2002** TWO LARGEST
FINANCIAL SERVICES "UTILITY-TYPE" IT OUTSOURCING
American Express (US$4 Billion) / JPMorgan Chase (US$5 Billion)

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# Insourcing, Outsourcing, Smartsourcing – A New Paradigm for Innovating Supply Chain

Wednesday, February 25, 2004                    2:10 – 3:00 PM

Mike Nevin
*Chairman*
ASAP Europe Ltd.

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**Mike Nevin**
**Chairman**
**ASAP Europe Ltd.**

Mike Nevin is a highly experienced international business alliance and strategy consultant with extensive development experience and a strong track record in delivering sustained profitable growth and organisational efficiencies through business alliance formation and management. He has over 20 years of consulting experience gained from a broad range of internal and external roles. Mike was one of the founders and is the inaugural chairman of the European Chapter of The Association of Strategic Alliance Professionals (A.S.A.P.) a professional association for alliance executives and practitioners.

His areas of particular alliance skill, knowledge and experience include:

❖ Developing new channel business

❖ Developing and implementing alliance programmes

❖ Reviewing / auditing alliance programmes

❖ Modeling alliance programmes to establish alliance improvement programmes

❖ Reducing cost in alliance / partnership functions

❖ Alliance mediation at the highest level

❖ Developing and implementing an alliance / partnership IT platform

❖ 'Smartsourcing' best use of supplier management resources

❖ Alliance deal making

Mike is married with two teenage girls and lives in the small village of Hampton-in-Arden near Birmingham, England. Mike's leisure activities revolve around the twin passions in his life namely competitive chess and his favourite football team, Everton FC. He has yet to fathom any natural alliance between the two!

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# Insourcing, Outsourcing, Smartsourcing
## *A new paradigm for Supply Chain Management*

Mike Nevin
Chairman ASAP Europe Ltd.

**The 2004 Outsourcing World Summit**
**February 23-25, 2004**
**Lake Buena Vista, Florida**

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## Where Does it fit?

❑ Traditionally Alliances have been used for the following reasons
  1. Developing New Business
  2. Developing new products or services
  3. Reducing costs

❑ Intriguingly 'Smartsourcing' covers both 1. And 3.

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## Where has it come from?

- There's a lot of 'hot air' about Smartsourcing, Strategic Sourcing, Partnership Sourcing and BPO
- From organisations like Gartner, Economist Intelligence Unit, McKinsey, Butler, Forrester, and the HBR
- However there is very little tangibility to the concept that is not proprietary and expensive!
- ASAP Smartsourcing involves utilising strategic alliances in your supply chain.
- Clients have tried insourcing and found that they could not be world class and outsourcing and found that they lost control.
- What they needed was a standard manner of employing supplier resource throughout the organisation without losing control

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## What is it?

- The Smartsourcing Methodology:-
  - Combines best practice approaches to the formation and management of partnerships and alliances with a Total Cost of Supply (TCS) procurement methodology
  - Co-ordinates seamlessly with existing organisational standards of project delivery
  - Is a 6 stage process which can be simply taught
  - Is underpinned by extensive manuals, workbooks, tools, models and document templates

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# Where is it applicable?

## Core

❑ Mission *Centric* – The Function is essential to the success of the organisation

❑ One of the Key Market Differentiators

❑ Essence of the organisation's competitive advantage

❑ Absolutely integral to support the business Mission

## Shared Core

❑ Mission *Critical* – The Function is fundamental to the organisation's success

❑ Closely Tied to the core business functions though not one of the organisation's key market differentiators

❑ Not the essence of the organisation's competitive advantage

❑ Highly Integral – Must maintain organizational connectivity and tight connection to the Organization and Core Competencies

❑ Cannot and must not split the provider functions away from mainstream business

## Non Core

❑ Mission *Peripheral* – The Function is secondary to the organisation's success

❑ Useful but not Essential

❑ Usually a Support Function

❑ Can be provided by a variety of specialists Easily Separated away from the Organisation

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# What does it look like?

| Phase 1 | Phase 2 | Phase 3 | Phase 4 | Phase 5 | Phase 6 |
|---------|---------|---------|---------|---------|---------|
| Develop Strategy During phase 1 the nature of the intended future relationship with the supplier and the existing relationship are reviewed. Objectives are established. | Analysis & Selection Potential partners are informed of our process for creating alliances. We ensure that the expectations of the client and supplier are shared. | Value Creating Negotiations How we will work: governance-processes and deliverables, escalation processes, risk management, project milestones and arrangements for termination of the alliance are agreed. | Operational Planning Negotiation, finalising contracts, communication (internal and external.) | Alliance Formalisation Training, tracking, corrective action, review, change control, reporting KPI's, issues and register management, reassessing risks. | Manage & Innovate Review, document, compare alliances and partnerships (external and internal) and use a methodology for continuous improvement. |

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## How does it break down?

**Phase 1 – Develop Strategy**
1. Identify Key Strategic Issues
2. Strategic Drivers
3. Map Value Migration
4. Alliance Stratagems
5. Breakthrough Value Proposition

**Phase 2 – Analysis & Selection**
1. Preconditions for Success
2. Candidate Research and Due Diligence
3. Fit Analysis
4. Risk & Business Case Analysis
5. Metrics: Strategic Return on Investment
6. The Strategic Spectrum

**Phase 3 Value Creating Negotiations**
1. Champion and Negotiation Team,Teambuilding
2. Co-Creative Negotiations/Chemistry
3. Creating the Win – Win
4. Documentation and Comprehensive Due Diligence
5. Memorandum of Understanding and Principles

**Phase 4 – Operational Planning**
1. Operational Business Plan
2. Management Issues
3. Customer Relationships
4. Integration, Empowerment, and Control

**Phase 5 – Alliance Formalisation**
1. Governance, Integration and Control
2. Organizational Structure and Support
3. Win – Win Business Analysis
4. Legal Agreements

**Phase 6 – Manage / Innovate**
1. Operational Team
2. Leadership and Management
3. Breakthroughs
4. Performance Measurement
5. Adapting to Change

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## How can Organisations use it?

### Internally
- ❑ Reduce the costs of its existing suppliers (individually)
- ❑ Reduce the cost of its total supply chain (collectively)
- ❑ Identify value add and non value add suppliers

### Externally
- ❑ Develop a better (deeper and longer) relationship with your customers
- ❑ Pitch for business you wouldn't otherwise get
- ❑ Defuse 'political' situations with other suppliers

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## Why is it special?

Smartsourcing provides breakthrough opportunities because:-

- ❑ It uses a high degree of synergistic leverage to achieve its goals therefore payback is measured in factors of 400% - 700% rather than 10%-50%
- ❑ It is based on open, proved, industry standard approaches which have been shown to work in practice
- ❑ It is applicable in a wide range of non core and shared core functions (i.e. Information technology, human resource management, financial accounting, supply chain, logistics, distribution, and product development)
- ❑ It doesn't threaten anybody!
- ❑ It is 10 years worth of formalised common sense!

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## Case Studies

- ❑ International Food, Clothing and Household goods retailer
- ❑ One of the World's largest producers of paper
- ❑ Fortune 500 Telecommunications Company
- ❑ A $78 Billion Bank

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## International Food and Household Retailer

- **Problem** – It was taking this organisation too long to develop projects with key IT suppliers. They were losing ground against their competitors and were the target of unwelcome outsourcing bids.

- **Solution** – The company initiated a smartsourcing assignment on a specific project which was to roll out Windows XP to 7,000 desktops. They measured the Smartsourcing approach against their own internal 'best practice' approach.

- **Results** – Project time was reduced from 23 weeks to 10 weeks. The overall costs of the project were reduced from £200,000 to £148,222. Client costs reduced from £125,556 to £94,222. Supplier costs reduced from £68,000 to £64,000. Client time used reduced from 26 weeks to 14 weeks. Supplier time used reduced from 9 to 8 weeks. The quality of the solution improved drastically.

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## World's largest producer of paper

- **Problem** - The XYZ Paper Company is one of the world's largest producers of paper, with 20 paper mills in nearly twenty countries. Each mill has 4 paper machines. They didn't know if they were receiving value from their existing suppliers.

- **Solution** – The company concluded that they needed a standard approach to measuring value in the entire supply chain based on an understanding of the part that alliances could play. After extensive research the approach that they selected was the ASAP best practice approach.

- **Results** – The company discovered that they were losing $12m per year in lost production time. The company eliminated $20m worth of inventory. They discovered the tangible 'gap' between themselves and the 'best in class' organisations which was costing them $587,000 per month.

## Fortune 500 Telecommunications Company

❑ **Problem -** The realization of a range of benefits from a merger initiative had slipped 18 months due to conflicts with the internal staffs of the four companies involved and with the supporting supply chain vendors of the four companies.

❑ **Solution -** Implemented a smartsourcing approach to assess the current hurdles being encountered from the separate functions and then fast time/fast tracked an accelerated project that removed and implemented the solutions within three-month windows for each phase that was self funding.

❑ **Results -** The organisation was able to consolidate three IT data and communication centres into one central site within four months. In addition, the organization was able to remove 40% of its legacy equipment and software, reduce over licensing by 35%, retain 90% of its staff and develop a new enterprise outsourcing contract that saved them $10 million a month for the next five years.

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## A $78 Billion Bank

❑ **Problem -** The organization had outsourced all of its back office, communication support and related technical personnel without understanding or applying a strong cross-functional strategic partnership approach to the structure.

❑ **Solution** - Applied selective smartsourcing programmes generating a realistic architecture of what the institution should expect from its supplier vendors, at what cost, with realistic expectations of return.

❑ **Results -** The institution, through guidance and mediation, developed new strategic partnerships with multiple, large vendors for its back office requirements and brought back in-house its core competencies that leveraged the institution's competitive edge within the marketplace. The total process was performed in 18 months and generated an additional 12% in savings using outsourced functions for the client. Moreover, the client increased its transaction rates by 45%, and reduced its transaction costs from $1.65 to .84c per transaction, while gaining state-of-the-art architecture and e-commerce capabilities.

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# International Quick Service Restaurant Chain

- **Problem -** This Quick Service Food Retailer had multiple manufacturing plants throughout North America. A benchmarking analysis showed that none of the plants were competitive compared to best in class manufacturers. A strategic review indicated that manufacturing was not a necessary core competence.

- **Solution -** A smartsourcing partnership deal was negotiated with a major competitor who had world-class competencies in manufacturing. Key issues were negotiated, including a long-term global strategy, logistics, supply management, coordination of investments, and integration of information services.

- **Results -** The rollout programme proceeded rapidly. After 12 months, the programme was nearly six months ahead of schedule. Manufacturing costs were reduced by almost 15%, logistics were substantially improved, and ROA increased dramatically by closing some plants, and shifting ownership of some older manufacturing plants to the strategic sourcing partner, who proceeded with major upgrades to the facilities.

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# Conclusions – Lessons Learned

- Standard 'best practice' approach based on over 10 years of common sense experience.
- A process that delivers projects quicker, faster, cheaper.
- Scaleable from very small to very large.
- A method of strategically redefining the client's supply chain.
- A method of prioritising multiple projects into programmes.
- A way of leveraging supplier involvement to achieve cost reductions.
- A compelling marketing message that delivers results.
- More than just 'hot air'!

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# How do I get more details?

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