Purpose Driven Outsourcing™: Putting The Horse Before The Cart In Outsourcing Strategy

White Paper

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VERSION CONTROL NOTE

This version supercedes prior versions by updating and expanding research on outsourcing dissatisfaction in the commercial sector and on Government outsourcing statistics, and by refining and expanding on the points made in the body of the paper. The graphics have also been enhanced and expanded. The essence of the methodology and the outline of the paper remain the same. This most recent version was done as part of an assignment to write a chapter for a book on contract risk management to be published by the National Contract Management Association (NCMA) in Summer 0f 2009.

Introduction

Deloitte's 2008 report on global outsourcing, "Why Settle for Less?",[1] garnered a large response among many commentators, ranging from the Wall Street Journal to industry blogs. In sum, results from the survey by Deloitte of 300 business and IT executives showed that 83% of global IT outsourcing deals achieve 25% cost savings. For two thirds of outsourcing deals, price was the key driver, according to the survey. This is not surprising data. Other recent surveys put even more distance between price and all other outsourcing business drivers. In a 2007-2008 Duke University Offshoring Research Network survey, almost all respondents regarded labor cost savings as very important to their formal outsourcing strategies. Cost savings from outsourcing "other [than labor]" received the second highest response among respondents in the Duke survey.[2]

Despite the predominance of price as an outsourcing driver, the discussion in "Why Settle for Less?" turned towards the one third of respondents who said that off shore outsourcing relationships are not innovative or transformative enough. Moving the discussion away from price, despite the data, is not a surprising response from a service provider like Deloitte. Selling partnering and relationship management services is better business for providers than mere labor arbitrage. Off shore service providers especially would like to move up the value chain by offering professional and management services, both for improved revenue and to stand out from among their competitors. The industry term for this kind of service offering is "next generation" outsourcing.

Tension between the customer goal of price/cost savings, and the provider goal of introducing value added services into outsourcing, can be found in other surveys. At a May, 2007, Alsbridge conference in Dallas attended by 17 leading global outsourcing providers, an in person survey showed that the two greatest challenges for the outsourcing providers in attendance were 1) an agnostic attitude among clients towards making innovation a goal of outsourcing, and 2) the widespread tendency among clients towards "transaction oriented" outsourcing relationships that focus solely on cost.[3]

Frustration about outsourcing deals resides on the customer side as well. Besides identifying the reasons companies outsource, the Deloitte survey revealed widespread disappointment among respondents with

[1] "Why Settle for Less?: Deloitte Consulting 2008 Outsourcing Report" (Deloitte Consulting LLP, December. 2007)

[2] "Global Sourcing – A Key Business Strategy: Findings from the Duke ORN 2007-2008 Annual Survey" (IAOP, Central America Chapter Kickoff, September 11, 2008). Contact Prof. Arie Y. Lewin at the ORN for exact survey results. The other drivers identified in the survey included competitive pressure, growth strategy, and access to qualified personnel.

[3] Outsourcing Leadership Article "Outsourcing Industry Challenges" (Sponsored by Alsbridge, Inc., Undated). The survey was conducted at the Outsourcing Leadership Forum's 2007 Provider Conference, May 24, 2007, Intercontinental Hotel, Dallas, TX.

how outsourcing deals are put together: a whopping three fourths of respondents felt their outsourcing contracts suffered from poor vendor selection and lack of service levels; more than two thirds had terminated at least one outsourcing contract and transferred it to another vendor; and almost two thirds said problems had been escalated to senior management in year one of the contract. Other surveys contain similar data. In a 2006 member survey by the International Association of Outsourcing Professionals (IAOP), only 11% responded that their outsourcing deals generated value.[4]

The takeaway from these surveys is that businesses and service providers need to come up with better ways of outsourcing. A method for more successful outsourcing needs to address the entire outsourcing life cycle, including development of the strategic sourcing plan, the transaction and performance phases, and the final disposition of the services. It needs to be more than managing smoother outsourcing relationships, or negotiating issues more advantageously, or offering a formula for crediting back service fees for poor performance. Specifically, what is needed is a method of outsourcing that will better serve the goals of customers, price being chief among them, while also making both value-added partnership outsourcing, and low cost transaction-oriented outsourcing, attractive business opportunities for providers.

The real question many businesses need to answer when outsourcing is not "why" they should outsource—they already know they want to lower costs—but "how" should they outsource. Likewise, providers need to look more at both why and how business is being outsourced, instead of marketing value added service offerings regardless of the particulars of a given outsourcing opportunity or passing up opportunities that don't look rich enough.[5]

A Price-Centric Approach to Outsourcing

Government Outsourcing. A price centered sourcing model does exist for outsourcing. It is called "sealed bidding" and it can be found in the procurement regulations of the US Government.

The US Government is the world's biggest outsourcing institution and arguably the most knowledgeable authority on outsourcing as a management strategy. The US spent over $100 billion on professional, management and support services in 2007 and through 3Q 2008.[6] IT

[4] "Navigating the US Outsourcing Market Over the Next 12 Months" (IAOP, Beijing Chapter Launch, June 17, 2008)

[5] Small and medium size businesses (SMBs) worldwide, though they account for the majority of business-to-business commerce, have largely not been penetrated by outsourcing providers. The major obstacles are the sizes of deals are inadequate to support provider account management costs, and SMBs are unwilling to strategically outsource their more important operations. Seeking Alpha Article "Time for India's Outsourcers to Focus on SMB Client Segment," (April 4, 2008)

[6] USAspending.gov Web Page "Federal Contracts by Type of Product or Service" (Office of Management and Budget, November, 2008). This category of spending most resembles

outsourcing by the Government is expected to grow at a rate of 8%, from $12.2 billion in 2005 to $17.6 billion in 2010.[7] Outsourcing of remotely hosted and managed IT systems by the Feds is predicted to grow at 7% over the next five years, from $6 billion in 2007 to $8 billion.[8] Government IT-supported business process outsourcing (BPO) and the latest evolution in IT outsourcing, Software-as-a-Service (SaaS), are predicted to grow from $13.3 billion in 2007 to $17.7 billion by 2011.[9]

In addition to dollars spent, the Government's weight as an authoritative source on outsourcing can be attributed to the intense scrutiny of governmental outsourcing. Outsourcing has been a political hot potato for many years, especially when the economy fairs poorly; in these environments outsourcing cases must be convincing. The Government's internal auditor, the General Accounting Office (GAO), regularly reports to Congress on poor contracting practices among agencies. The Office of Management and Budget (OMB) Circular A-76 even gives federal employees legal standing with GAO to protest the outsourcing of their jobs.[10] Analogs to these hurdles exist in the commercial business world, albeit to a lesser degree. Corporations are concerned with public relations. They also have boards of directors and internal auditors who look to maintain compliance with internal policies and accounting practices. Most analogous are the corporate workforces who want to protect their jobs.

Sealed Bid Sourcing Model. Sealed bidding is described in Federal Acquisition Regulation (FAR) Subpart 6.4 and Part 14.[11] In a nutshell, when price is the only deciding factor, and there are multiple providers interested in the work, by law Government agencies must contract for services through sealed bidding.[12] Sealed bidding requires the Government to document all of its work requirements and to put them in a standard invitation for bid (IFB) form, then publicize the opportunity. In response, providers quote a fixed price and provide other specified information, in essence filling in the blanks. The buying organization within the Government publicly opens the bids and awards the contract based, again by law, only on price and price-related factors.

The important point here is not the quaint practices of handing in sealed envelopes or officials reading each bid out loud, but rather how sealed bidding works and why. Its rules are not

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contracting for business services and does not include automatic data processing (information technology).

[7] INPUT Press Release "Federal IT Outsourcing Market to Reach Nearly $18 Billion by FY10" (INPUT 01/12/06)

[8] Computerworld Article "Federal outsourcing helps spur data center land rush outside DC" (February 11, 2008)

[9] Federal Computer Week FCW.com Article "Software on tap" (April 16, 2007)

[10] Federal Times Article "Employees fail in challenging outsourcing decisions before GAO" (September 7, 2008)

[11] See http://www.acqnet.gov/far/index.html

[12] FAR 6.401

arbitrary: Sealed bidding represents a well-rationalized commercial trade off designed to zero in on price and to minimize transaction costs on both sides.

Provider Side Advantages. The financial and managerial relief sealed bidding affords business development and sales people is easy to overlook.

With sealed bidding, providers are relieved from having to figure out technical "solutions" and winning "themes" they need to propose in order to win the bid. Rather, providers only need to determine within themselves that they can meet the requirements and calculate simple pricing for the work. Sealed bidding makes it clear up front what the planned work is. All providers are asked to do is work the plan. If the provider can't meet some bid requirements, it only need team with other providers who can, and disclose the team members in the bid.

The "cost of doing business" savings that are realized by providers under this sourcing model are substantial and numerous. Providers aren't faced with expending resources writing proposals and assembling teams. They aren't faced with weighing the time and expense of the cost of pursuing the opportunity with their chances of winning the business ("bid/no bid decision"). Also they aren't looking to recoup proposal costs through loaded pricing.

Contract negotiation is another significant cost of doing business, and a potential disruptor to business, that is avoided by sealed bidding. The IFB, the standard form used to solicit bids, discloses the customer's requirements as well as all commercial and legal contract terms, with the intent of minimizing discussions between the parties. The overall effect of the sealed bidding model is to open up the competitive field to include outsourcing providers whose business model does not possess advanced business development or contract negotiation competencies. The "leaner and meaner" the provider, the better its chances for success.

Customer Side Advantages. By making it easier for providers to quote a single price for all of the work, sealed bidding protects customers from cost overruns. Although Government regulations require a fixed price, what is important is the concept underlying sealed bidding, that of reducing financial risk to the customer through a total price for all of the work. In the commercial world, sealed bidding's fixed price requirement can be broadened to include any pricing term that prohibits unanticipated costs, such as a Not-to Exceed (NTE) amount for labor hours and rates.[13]

Like the provider, with sealed bidding

[13] The Government's requirements for sealed bidding include analyzing bid pricing for reasonableness in sealed bidding (FAR 15.404-1(b)). The concern behind price analysis is that contractors will "low ball" bids in order to develop incumbency and a record of performance. Commercial parties by custom rely on profit motive and the potential for litigation for assurances of reasonableness.

the customer company avoids numerous outsourcing transaction costs that most often go unmeasured in outsourcing transactions but are nevertheless costly, such as supplier vetting, proposal evaluation, contract negotiation, governance of the outsourcing relationship and management of services, e.g., performance metrics. Customers have greater control over value added services that providers might seek to adhere to them because they are explicitly not part of the outsourcing unless they are somehow specified in the IFB. Customers also have greater control over transfer of ownership of the business—e.g., assets, personnel, processes—which impacts both price and risk.

Another advantage inures to customers. Sealed bidding is more amenable to advertising in media including the Web, and to on demand electronic commerce services, contract management dashboards and enterprise resource planning (ERP) systems.

Bidding Threshold Qualifications. Besides definite pricing and meeting requirements, providers must affirmatively show in their bids that they are "responsible."[14] Responsibility is a Government acquisition term of art. It means simply having the capability of delivering the services. This approach is different than requiring a services provider to meet across-the-board industry certifications and standards that are agnostic to the particulars of a given outsourcing transaction.

Responsibility can be determined using many sets of criteria. For the Government, responsibility must address the following: adequate financial resources; ability to deliver given existing contracts; a satisfactory performance record; necessary facilities, management and personnel for performing the work; and compliance with applicable laws that would otherwise prevent doing the work.[15] The showing can be made part of the bid or it can be addressed by the customer in a "pre-award survey" prior to bidding.

Once again, the sealed bidding model minimizes outsourcing transaction costs, this time by imposing a threshold qualification requirement in lieu of ongoing management of performance, which is labor intensive and necessitates a commitment of resources by both parties. The showing can be as simple as a self-certification by the provider or as extensive as a third party audit prior to contract.

Challenge of Gathering Customer Requirements. The major logistical challenge and cost presented to customers by sealed bidding is sufficiently capturing work requirements and documenting them in the IFB.

There are two variations on the sealed bidding model that are used by the Government when requirements prove problematic: 1) "two step" bidding in which interested providers complete the task of developing the requirements and, if selected, then quote price and

[14] FAR Subpart 9.1

[15] FAR 9.104-1

make a responsibility showing[16]; and 2) "multi-sourcing" the outsourcing process itself by engaging an independent provider to gather and relay the requirements. In both cases, the customer relies on external resources for purposes of requirements gathering, while preserving the overall streamlined character of the model.

Purpose Driven Outsourcing Methodology

To many companies, sealed bidding may sound like a good idea in some circumstances, but not in others. What about longer term, wholesale outsourcing of IT infrastructure? Or outsourcing core business processes like R&D that cannot be defined? Or reorganizing into a virtual business model with tightly integrated management?

In response, it should be remembered that we are not making the case for streamlined models like sealed bidding in all outsourcing. All we are saying is that where the "bottom line" is the sole or primary motivation to outsource, outsourcing providers should be solicited and managed in a way that best achieves a better bottom line. This approach is called Purpose Driven Outsourcing ™.[17]

Simply put, Purpose Driven Outsourcing is aligning sourcing models with the business goals behind outsourcing to optimize the chances for outsourcing success. Once a company determines why it is outsourcing, it can then best decide how it should outsource.

Figure 1 provides an overview of the Purpose Driven Outsourcing methodology.

[16] FAR Subpart 14.5

[17] Purpose Driven Outsourcing is a service mark of James River Consulting LLC.

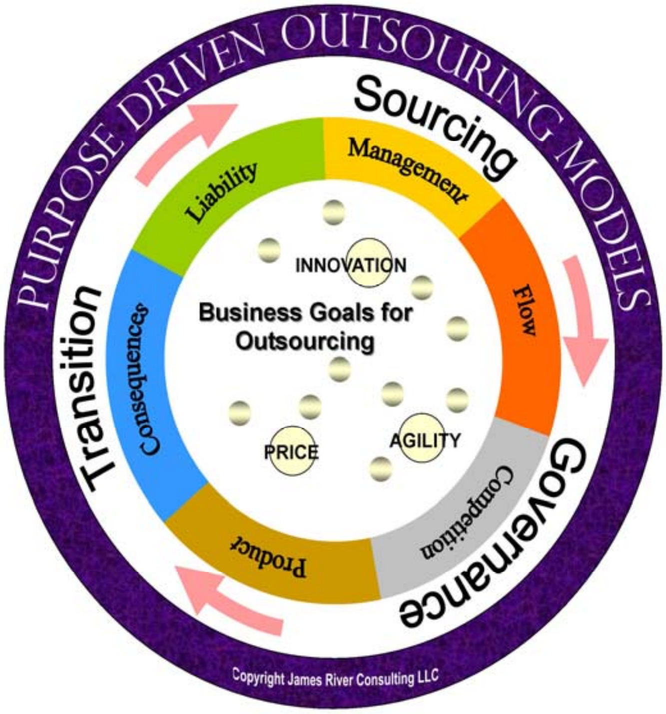

Figure 1 Overview of Purpose Driven Outsourcing

Outsourcing Life Cycle. Purpose Driven Outsourcing views outsourcing as a life cycle made up of three phases: 1) evaluation and selection of outsourcing providers (Sourcing); 2) governance of the service performance and delivery (Governance); and 3) sharing, ending and transitioning outsourcing services (Ending/Transition).

For example, we have seen a description of how sealed bidding streamlines the first phase, Sourcing. By reducing the usual supplier vetting and negotiation process down to a unilateral setting of contract terms and service requirements and consent to them by the provider, overhead is reduced. Sealed bidding also minimizes the second phase, Governance, by relying on adherence to the provider's proof of performance related qualifications, instead of ongoing, interactive management of services. The third phase, Ending/Transition, is also made more cut-and-dry under sealed bidding when compared to other sourcing models. If a provider fails to meet requirements, the customer will allow the provider an opportunity to correct the deficiencies. If the provider proves unable to correct, the contract is by its terms subject to termination and, legally speaking, the customer doesn't owe the provider the contract price. A settlement fee is negotiated and the work is transitioned to another provider. In many failed outsourcing relationships the divorce is much messier, because decisions about service delivery are made by joint management teams and because service is dependent on customer responsibilities.

Figure 2 illustrates the streamlined workflow and lower level of effort of sealed bidding compared to a commonly followed approach to outsourcing, that of soliciting proposals and negotiating service terms including SLAs. The number and the radius of the arrows illustrates the volume of activity required by each approach, while the thickness of the arrows indicates the required administrative resources.

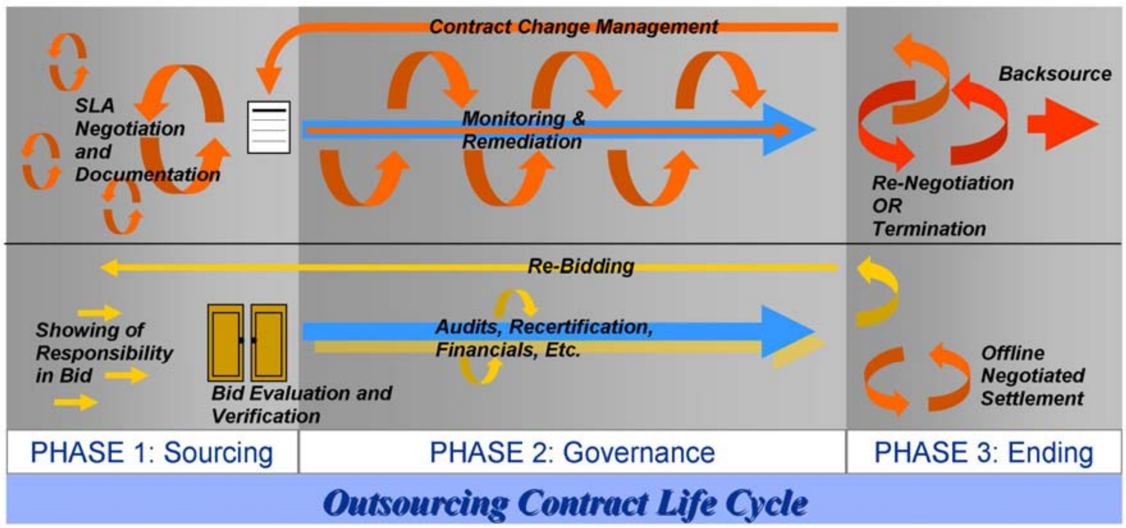

Figure 2 Comparison of Solicited Proposals and SLA Approach with Sealed Bidding and Threshhold Qualifications Approach

One of the sharpest points of contrast between the two approaches occurs at the very beginning of the Sourcing phase. SLAs are a highly negotiated term. There can be huge discrepancies between what individual suppliers will offer or agree on. Customers have limited power to precast SLAs in the Sourcing phase. A commonly occurring scenario is for two stages of pre-sales SLA negotiation to take place: the first on a one-to-one basis with each supplier to generate proposed SLAs, followed by a second negotiation of SLA targets along with the other terms of the outsourcing contract (A third renegotiation stage follows during the Governance phase.). Standard solicitation documents containing final terms, like the IFB used in sealed bidding, and the concept of threshold qualifications, minimize this negotiation overhead.

Non-Price Driven Outsourcing. As we have seen, Government sealed bidding is a good example of how a streamlined, highly competitive, requirements-based method of sourcing does an excellent job of outsourcing to a qualified provider for the best price and with a minimum cost of doing business.

What if cost savings is not the sole reason for outsourcing? What if quality is also important? Following the Purpose Driven Outsourcing methodology, we would turn to other ways of contracting for outsourcing that are more effective in getting quality services.[18]

For a non-price based goal like quality, we would certainly look at "best value" solicitations that incorporate proposal and negotiation processes. However, we would only be interested in moving away from the price driven sourcing model as far as is needed to attain quality. At a minimum, we would require a more comprehensive threshold showing of passive quality assurances like maturity models. We would also require some percentage of transparency into the provider's service delivery, which is a more active quality assurance and takes place after contract execution. Proposal evaluation criteria would judge the likelihood of receiving good quality services, and a proposal scoring system would trade off between price and quality. If quality greatly outweighed price, we would implement more complex and active performance measurements like business impact metrics, and we might further dedicate management personnel to measure and report on quality. By modifying the model in these ways, we would be extending the evaluation and negotiation processes from beyond the Sourcing phase and into the Governance phase of the outsourcing life cycle for the purpose of achieving quality.

What if the goal of the outsourcing is divestiture of operations in order to create agility in operations and remove assets from the balance sheet? Here, negotiation of commercial terms and definitizing the transaction become the centerpiece of the sourcing model. In outsourcing driven by transfer of ownership, besides negotiation of price there are complex issues of obtaining capital financing, valuing assets, benchmarking service, and executing legal transfers. Both parties must incur sizable transaction costs in the form of outside legal and accounting fees. A Purpose Driven Outsourcing model here could altogether omit the competitive, evaluative features of sourcing found in the price and quality centric models. Because getting the parties to the table is the main objective, competition would need to be leveraged in other ways. For example, a checklist or milestones could be used to measure progress in negotiations. At a predetermined point, a decision either to continue the negotiations until completion or to end

[18] Government regulations prescribe sourcing models other than sealed bidding when price is not the only basis for awarding a contract. FAR 15.101 authorizes trade offs between price and technical evaluation criteria where requirements are less definitive, development work is required, or there is greater risk of not completing performance. FAR 6.302-1 authorizes sole negotiation with a supplier who possesses unique capabilities or where the need is urgent. In Government contracting there is a clear relationship between goals and how sourcing is conducted.

them and restart negotiations with another provider would be made.

Purpose Driven View of Existing Outsourcing Methods. Figure 3 is an x-y chart, divided into quadrants, locating popular sourcing models and methods within the relationship of outsourcing "how's" and "why's" that are the premises of Purpose Driven Outsourcing. The *x* axis of the chart represents business goals as a range of price and non-price driven outsourcing, without enumerating the individual non-price benefits or representing outsourcing for multiple benefits. The y axis represents the cost, scale and difficulty level of the outsourcing model. Each dot or "epicenter" represents an outsourcing model or method.

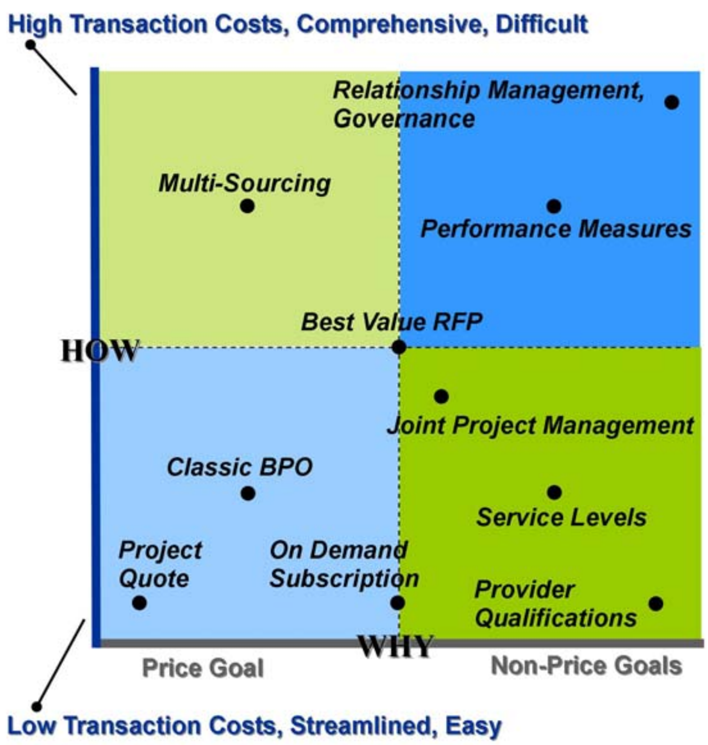

Figure 3 Purpose Driven Outsourcing View of Popular Outsourcing Models and Methods

For example, Classic BPO represents an outsourcing model in which one or a couple providers are approached to negotiate outsourcing of a department-wide operation. The providers have some awareness that other negotiations are taking place, but there is no formal proposal evaluation process to compare the providers. It is made clear that the outsourcing is for purposes of cutting costs and nothing else. The services to be performed are not described in any detail and there are no service levels set other than what the provider already offers. The final contract contains terms like a long performance term and an exclusive supply relationship. In exchange for the guarantees of business the provider offers lower labor rates.

Contrast this model with Multi-Sourcing. Using the same example, the customer contracts out different pieces of the operation to several of the providers and managed their coordination. Or the customer contracts with multiple providers to perform the entire operation but in different geographic areas, again coordinating the services. In Purpose Driven Outsourcing's thinking, this more burdensome sourcing model would be more justified if goals other than price are at stake, such as agility. Otherwise following a multi-sourcing model would be financially and operationally inefficient.

Six Discriminators Between Purpose Driven Sourcing Models

Purpose Driven Outsourcing models look and work differently from each other depending on the goals they serve. Differences between models are the product of the logic of the methodology. Purpose Driven Outsourcing draws from resources like Government contracting practices, from scholarly and professional books and papers on commercial outsourcing and related management sciences, and from professional experience, to fashion and guide sourcing through the entire outsourcing life cycle so that it optimally serves business goals. By looking at the methodology in reverse, starting with the differences in the models, we can better understand how Purpose Driven Outsourcing works.

There are numerous features of outsourcing models that can change according to the business goals being sought. For purposes of discussion, let's group these features into the following categories: 1) Competition; 2) Visibility-Management; 3) Product; 4) Flow; 5) Ownership-Liability, and 6) Consequences. The chances of an outsourcing deal achieving its goals depends in part on how the sourcing transaction addresses issues within this taxonomy.

1. Competition. Competition is the single most effective tool for obtaining best price. Competition also imposes direct, up front transaction costs on the parties, depending on the formality and complexity of the manner in which it is used. Besides creating costs, competition can have other less apparent costs, such as exposing internal processes and data to providers who are also employed by competitors.

Competition can be a very effective method of obtaining provider commitments to other goals, but not necessarily. If the outsourced work is R&D, no amount of competition can ultimately cause a provider to achieve break through results. Further, for non-price goals, the actual field of providers in the marketplace capable of performing may be limited, diminishing competition's value.

2. Visibility-Management. Visibility and management of service delivery create transaction costs in the beginning and middle of the outsourcing life cycle, again depending on depth and complexity, and raise relationship issues such as division of responsibility. Visibility is passive observation of provider performance; often it is a function of whatever data and access the provider is willing to make available. Management by the customer, either total or in concert with the provider, moves beyond visibility towards controlling performance itself.

Quality of service, benchmarking, uptime, disaster recovery, scalability and satisfaction within the customer organization (e.g., internal SLAs) are just a few of the methods and tools with which customers monitor and manage provider services. None of these tools or methods determines price. They do, however, determine how much value—the combination of price with other non-price goals—that is being received by the customer.

For goals like agility, innovation or security, management may be deemed necessary regardless of cost.

3. Product. Describing services in terms of staffing—positions descriptions and minimum personnel qualifications—is an example of indirect service description. Standard processes like IT Infrastructure Library (ITIL), in which the means of delivering the work are being defined and not the work itself, are another kind of indirect service description. There are practical reasons for taking this approach, such as business process reengineering (BPR), where no work specifications yet exist. Describing work in terms of personnel qualifications or standard processes affords no mechanism for controlling price.

The opposite approach is to describe outsourcing services as projects with deliverable products. Service work products are much easier to price, to put out for bid, and to review for completeness, quality and return on investment (ROI). Productizing reduces costs throughout the outsourcing life cycle. On the other hand, productizing services as a matter of contract becomes unwieldy and expensive when outsourcing large business operations with many moving parts, such as BPO.

4. Flow. Flow is the way that work and payment are exchanged between customer and provider. Services can be tasked and paid for by the customer on a formal ordering basis. Or services can be solicited and provided on a time and materials basis, without connection to any defined scope or milestone, such as staff augmentation. In subscription type agreements a fee is paid regardless of whether services are used or not. In project management, flow protects against scope creep, unnecessary work, and run away budgets. The concept of Flow also includes the transition of outsourcing work to third party providers or the customer.

Flow does not cause the contractual price term for services to go up or down. Nor does flow directly help achieve better quality or higher service levels. What flow control does do is achieve agility, e.g., scaling demand on an actual usage basis. In turn, best price and other outsourcing goals are indirectly served, e.g., decreasing spend based on changes in market prices or unsatisfactory performance. Increased flow control in outsourcing incurs increased contract and project management costs, however, which are contrary to best price.

5. Ownership - Liability. Outsourcing work may be performed using either customer or provider owned processes, technology systems and data. As a general maxim, ownership and control by one party of the outsourced services, including the processes, technical systems and data used to perform the work, increases both financial and operational risk for the burdened party, and may or may not decrease risk for the other party. The employment status of service personnel—i.e., employees of the customer, independent contractors to the customer, or employees of the provider-- also creates risk for one party or the other. Express contractual liabilities by their terms create risk. Liabilities include breach of warranties, consequential damages, and infringement of intellectual property rights.

A greater share of ownership of the services by the provider, and greater exposure of the provider to potential liabilities, results in higher prices for the customer. It stands to reason that sourcing models that provide the best ways of defining ownership of services and liabilities will be more effective at achieving best price. Sourcing models that focus on the end results of services, and leave ownership and liability open to proposal or negotiation, are less effective.

Saying that ownership and liability increase outsourcing price may sound like a paradox. Isn't the purpose of outsourcing to have another party perform work that the customer would otherwise do itself because doing so is more beneficial? To be precise, we are referring to price as a contractual term for work to be performed. Price is different from total cost of ownership (TCO) or savings through economies of scale. Two examples from the information technology industry illustrate. Infrastructure outsourcing adds the purchase of existing customer IT assets and personnel to the price of the deal, but it reduces customer TCO. Remote infrastructure management, where the provider owns or leases the facilities and equipment used to monitor customer systems and for which the customer direclty or indirectly pays, may duplicate assets already owned by the customer, but because the provider performs the same service for many other customers, the provider can do it cheaper.

Risk can constitute a major piece of an outsourcing business case. Risk reduction in itself can be an outsourcing goal. Looking at outsourcing goals on a spectrum, risk could be thought of as more towards the price only end. A sourcing model that can effectively define and manage ownership and liability is better at achieving risk management.

At the other end of the outsourcing goals spectrum, ownership and assumption of liability, in themselves, don't have any direct impact on quality, innovation, agility, or other non-price goals, unless one is undertaking ownership and liability for purposes of achieving these goals.

6. Consequences. The simplest and most extreme example of a consequence in an outsourcing contract is termination for non-performance. In price driven outsourcing, consequences are limited to termination and non-payment and other common law contract remedies, because consequences do not determine the bargained for price, unless the consequences are linked to payment terms. In non-price driven outsourcing, other types of consequences are employed to influence performance; these consequences can be both positive as well as negative for providers. Examples of positive/negative consequences include incentive payments, service level credits, increased scope and volume, favorable references and press releases, and shared rights in development work. The concepts of Flow and Consequences work together closely. Appropriately, Flow and Consequences have great weight in non-price driven models and less weight in price driven models. [19]

[19] Consequences are an unappreciated and underutilized feature of outsourcing acquisition because utilizing consequences in sourcing requires competency in supply chain management science and incurs costs. The US Government implemented Performance Based Service Contracting (PBSC) in 1998, but the approach has been underutilized. US GAO Report to the Chairman, Subcommittee on Technology and Procurement Policy, Committee on Government Reform, House of Representatives, "Guidance Needed for Using Performance Based Service Contracting," GAO-02-1049. On the commercial side, a February, 2007, KPMG world wide survey of outsourcing customers found that almost two thirds of the respondents either tracked benefits at an elementary level or did not track them at all.KPMG Press Release "Businesses in the dark over value of their own outsourcing deals: KPMG Global Survey," 7 February 2007.

Figure 4 shows a sliding scale comparison of the weight of each of these key features in sourcing models that are most effective in achieving price and non-price goals under Purpose Driven Outsourcing. Note that the graphic should not be interpreted as saying price based sourcing cannot implement performance measures, or all non-price driven sourcing must include them. It should be read to say in Purpose Driven Outsourcing performance measures are less imperative to achieving best price than are methods of sourcing that maximize competition or define services as work products.

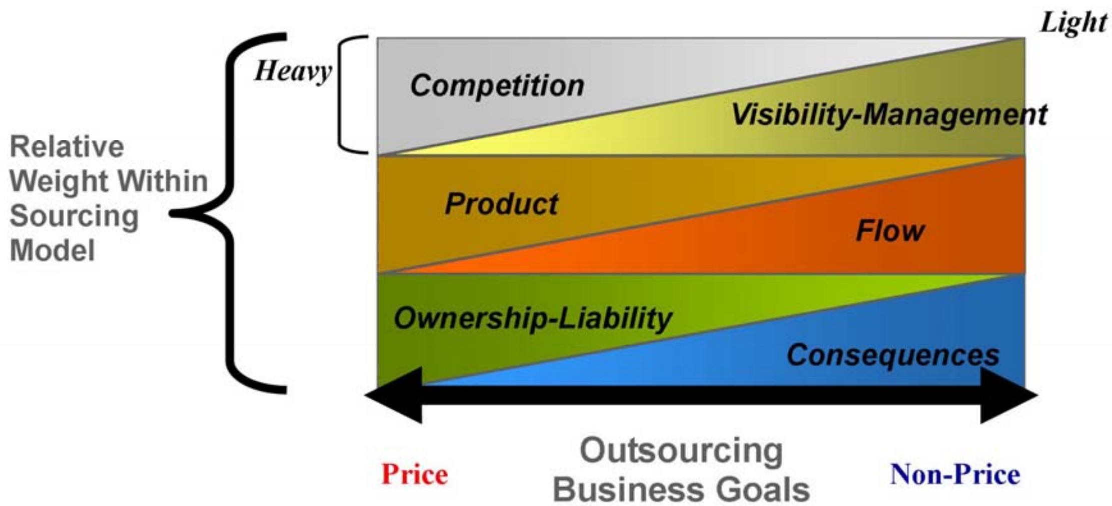

Figure 4 Key Discriminators Between Price and Non-Price Based Outsourcing Models

Practical Considerations for Purpose Driven Outsourcing

The principles in Purpose Driven Outsourcing should be equally applicable to outsourcing in all industries and for all business activities, because they are based on common business goals like cost savings and innovation. Nevertheless, there are inherent differences in outsourcing among vertical industries, and issues endemic to certain outsourcing services, that impact how outsourcing is best conducted overall. Supplier side issues such as the availability of qualified workers, compliance with laws, business strategies regarding ownership of outsourcing, and services marketing strategies also come into play.

For example, sealed bidding works very well for outsourcing work that can easily be tasked out in units, such as projects, blocks of usage, number of transactions, and work product deliverables like reports. Information technology projects such as independent verification and validation (IV&V) of application code development, and paralegal level projects such as tier one review of discovery documents, are popular examples of outsourcing that lend themselves to sealed bidding. Further, the number of providers in the marketplace for both application development and legal support services is sizable, creating another advantage in using sealed bidding.

Strict sealed bidding is not as easily applied to ongoing, unpredictable, indefinable, or dynamic outsourcing work. Using our two examples, sealed bidding would be more difficult to apply to outsourcing entire mission-critical business processes like customer relationship management, or outsourcing more professional legal work like assigning probative weight to discovered documents. In these situations, accurately specifying how outsourcing work is to be performed and to determining its scope within the larger whole of the function and the enterprise become more difficult. There may be external factors impacting the sourcing as well, such as governmental trade regulations. Generally speaking, gaps in the supply chain management competencies of the customer become exposed. For outsourcing creative operations like marketing, sealed bidding would most likely be impractical regardless of the goals.

But Purpose Driven Outsourcing is not an all-or-nothing proposition. It is entirely feasible, and an effective furtherance of a good business plan, in our marketing example to solicit subcontracts or multi-source some of the marketing work using a streamlined, price driven sourcing process, despite the existence of overarching goals other than price that are served by an underpinning contract. Hierarchies of business goals in an outsourcing strategy can be supported by layered outsourcing models.

Purpose Driven Outsourcing At Work

Working through the entire Purpose Driven Outsourcing methodology using hypothetical scenarios is the subject of a follow up article. A formal process for setting goals needs to first be taken up. A business case with an ROI and other metrics may be included in the goal setting process; these metrics may become part of the sourcing process. Next the logic or “magic” of Purpose Driven Outsourcing needs to be implemented. Customer sourcing competencies and marketplace conditions are also factored in, as are the nature of the work and external industry considerations, while staying true to the premises that all sourcing decisions must seek to achieve goals. Management systems and processes must be disciplined to stay true to goals. As already discussed, Purpose Driven Outsourcing also guides decision making about transition of work and multiple vendor arrangements.

Here are some guiding principles to follow when putting together a streamlined, price-based off shore outsourcing strategy:

- Develop a basic transaction model for all outsourcing deals
- Look at outsourcing as delivery of an end product that is subject to acceptance testing
- Solicit and evaluate multiple bids, be prepared for vendor push back
- Be prepared to transition projects when things go wrong
- Establish that feedback and change orders are in scope as long as they don't change requirements
- Outsource smaller, self contained projects of limited duration as much as possible

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