

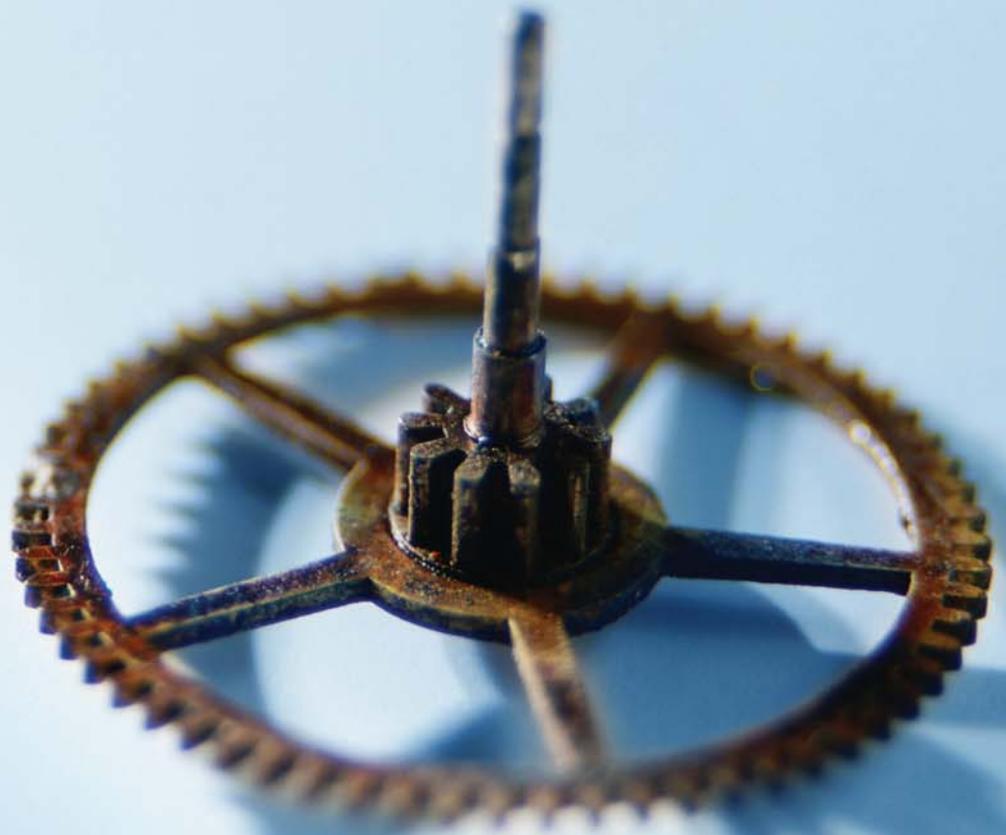


IT ADVISORY

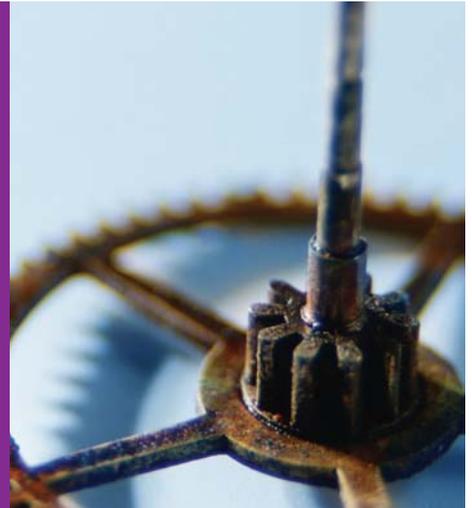
Strategic evolution

A global survey on sourcing today

ADVISORY



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Introduction



Egidio Zarrella

Global Partner in Charge, IT Advisory

Today's globally competitive business environment is forcing organizations to take a harder look at their operations in order to compete effectively. As a result, it is no surprise that senior executives are looking at their business functions with an eye to achieving business objectives faster, reducing costs, and improving service and process effectiveness and quality.

Companies and governments around the world now recognize sourcing as a global game – strategically placing business operations offshore or onshore, driving the achievement of these key business objectives.

While sourcing is utilized by many organizations as a key mechanism for achieving business goals, it often suffers from negative publicity. Outsourcing failures are often heavily publicized and offshoring is still a politically sensitive topic globally.

Unlike most global research, this survey examines both the customer *and* supplier perspective. Through this survey, KPMG's IT Advisory practice aims to examine the different elements of a sourcing contract and the effect of each of these on the success of the relationship and resultant business outcomes.

The results of our survey disprove the common myth that sourcing is a 'failure plagued' phenomenon from both the customer and service

provider perspective, with sourcing here to stay.

This is not to say that everything is perfect. A number of key themes and opportunities for improvement emerged from our discussions and research, notably:

- The monitoring and management of sourcing benefits is often sub-optimal
- The sourcing service provider selection process is often unwieldy and takes too long
- The importance of involving the 'right people' and aligning the cultures of the organizations involved is as critical as ever.

We hope that the insights contained in this survey will open up productive discussions with both customers and service providers around current practices and helping to ensure sourcing remains a key tool in the achievement of strategic business objectives.

Pradeep Udhas

Global Partner in Charge, Sourcing Advisory

Globalization, increased competition, and a challenging economic environment are driving many organizations to re-evaluate their business models in an effort to enhance performance. Companies feel the need to focus on their core business activities and are therefore looking to outsource their non-core tasks.

Today, sourcing is as important as selling for organizations, as it not only impacts profitability, but also makes it much more nimble in today's dynamic environment.

When one hears of more than a billion dollars worth of offshore outsourcing deals today, it is obvious that global organizations are keeping the 'criticism' about outsourcing in proper perspective.

Even conservative organizations, the so called 'late majority', are considering sourcing as an integral part of their strategy. This has given a greater impetus to the sourcing industry, which has recently shown a compound annual growth rate of 28 percent. Executives now understand that outsourcing is a business-related decision and are therefore regarding it more strategically.

This survey is intended to help organizations leverage the experiences of top management executives who are at the epicenter of major outsourcing initiatives, in order to gain valuable insights into how to manage successful outsourcing relationships.

This is perhaps one of the largest global sourcing surveys, interviewing over 650 organizations, from both the customer and service provider perspectives.

KPMG recognizes that like any growing industry, the sourcing industry too has challenges that need to be addressed. This survey attempts to highlight some of these opportunities for improvement, which we believe is half the battle won.





Now more than ever, organizations are looking to sourcing¹ to provide tangible business benefits.

The evolution of sourcing as a key strategic tool continues to create advantages for businesses that deploy and manage it well. It may grab headlines to speak of outsourcing deals as 'failing' – but can success or failure be defined in such black and white terms in the more sophisticated and complex outsourcing environment of today?

Or is such a way of viewing the market too simplistic?

Despite media coverage to the contrary, service providers and their customers around the globe appear positive about their sourcing relationships.

However, is having a positive attitude enough to ensure that sourcing contracts will deliver promised benefits?

Differences in the way organizations are approaching and managing their contracts help to explain why some are experiencing wider and deeper benefits than others. Promises of potential cost savings often become a primary driver to outsource internal processes. Organizations often ignore or have less focus on critical components of the sourcing process.

Current sourcing practices are working, but how well are they delivering on the benefits being sought?

While challenges are present, it appears that outsourcing will remain a key element of business strategy. The continuing evolution of sourcing practices is required to ensure it remains a valuable and effective business strategy.

The perception of value

In return for what is often a large-scale investment, organizations are looking for the real business benefits of outsourcing functions and processes, however:

- More than 40 percent of sourcing contracts are not supported by a formal strategic measurement framework beyond management of service level agreements (SLAs).

Significant opportunities exist for organizations to capitalize on the strategic value of sourcing. This potential is often unlocked by more consistent measurements of contract provisions and other metrics about the relationship with service providers.

This measurement process, while challenging, can be instrumental in protecting the bottom line. It also helps consolidate the alignment of expectations among both customers and service providers, enhancing overall corporate governance and ensuring that money is well spent.

Sourcing the outsourcer

Improving the efficiency and effectiveness of the procurement process is critical for every organization. If the process of sourcing the outsourcer is costly, protracted, inefficient or not aligned to meet business requirements, the sourcing initiative may fail from the outset.

- More than 50 percent of respondents said they take more than six months to complete the request for proposal (RFP) process. Thirty percent said they take longer than nine months.

1 For the purpose of this survey, 'sourcing' refers to the outsourcing of IT, business and knowledge processes and function (including farshoring, nearshoring and onshoring).



- Seventy-nine percent of respondents did not accurately know the costs of selecting a sourcing provider.

With corporate governance requirements traditionally influencing the procurement process, there is a clear need to move towards more flexible practices that reflect the objectives of each stage of the selection process and aligning these to the most appropriate selection method.

Relationships or technical capability and competence

For the majority of organizations, the most important aspects of the service provider selection process are industry knowledge and technological capabilities of the potential service provider. People and the right cultural 'fit' are often regarded as a secondary issue or sometimes not considered at all. As such there is often a misalignment of expectations of the relationship between the service provider and the customer.

- Sixty percent of respondents said problems with their sourcing service provider relationships are almost always people related.

Effective sourcing is often about creating cultural fit and aligning expectations of the service provider and the customer. These goals then need to be clearly agreed between the parties and measured on an ongoing basis.

Evolution of sourcing

What is the best approach to optimizing the value organizations can acquire from their sourcing contracts?

The continued evolution of current practices will largely drive the success of sourcing in the future. Sourcing practices should evolve if they are to remain effective in achieving business objectives.

Based on survey results, the following approach summarizes the characteristics of those organizations, which ranked first in terms of their satisfaction with their service provider, and the level of benefit being delivered.²

Region	These organizations can be from any region but are most likely to be found in the Americas.
Industry	Most likely to be in financial services or, to a lesser extent, consumer markets.
Process outsourced	More or less equally likely to be outsourcing helpdesk or research and development and, to a lesser degree, IT and telecommunications.
Selection process	Selection process tends to be shorter than many other organizations.
Business buy-in	Clear and consistent view of the purpose of the contract is shared across the impacted parts of the business.
Governance	Board level involvement is limited to a single contact at quarterly intervals.
Contract flexibility	Focus in the contract appears to be on building flexibility to allow for changing situations.
Innovation and creativity	Tend to be particularly happy with the level of innovation the service provider has brought to the contact.
Measurement of delivered benefits	Processes, up front, generally appear less bureaucratic than most, but the service provider's performance is monitored closely using a variety of measures outside of service level agreements (SLAs) and financial metrics. The net result is that these businesses feel the service provider has very closely matched their expectations, and that the business has experienced tangible benefits.

Source: KPMG International February 2007

² Segmentation and behavioral analysis was conducted by an external, independent market research company to explain differences in behavior and attitude of a meaningful group of segments. This data was defined scientifically using variables that can be shown to drive behavior.



KPMG's *Strategic evolution – A global survey on sourcing today* examines the global sourcing marketplace focusing on the current trends in the design, development and management of sourcing initiatives and the way in which performance and effectiveness of these contracts are measured.

Both customers and service providers were interviewed, and the survey examines issues from a demand and supply perspective.

KPMG member firms globally conducted face-to-face interviews between July and November 2006, using two surveys – one for customers of sourcing services and one for providers of sourcing services. The questionnaires were developed by a global team of KPMG sourcing professionals, and both questions and responses were validated by an external independent market research company. Responses were analyzed by KPMG member firm professionals and extensive insights have been gained, providing a clear platform for more effective practices for both customers and service providers of sourcing services.

Participation

More than 650³ organizations in 32 countries participated in this survey providing an extensive basis for the analysis of results.

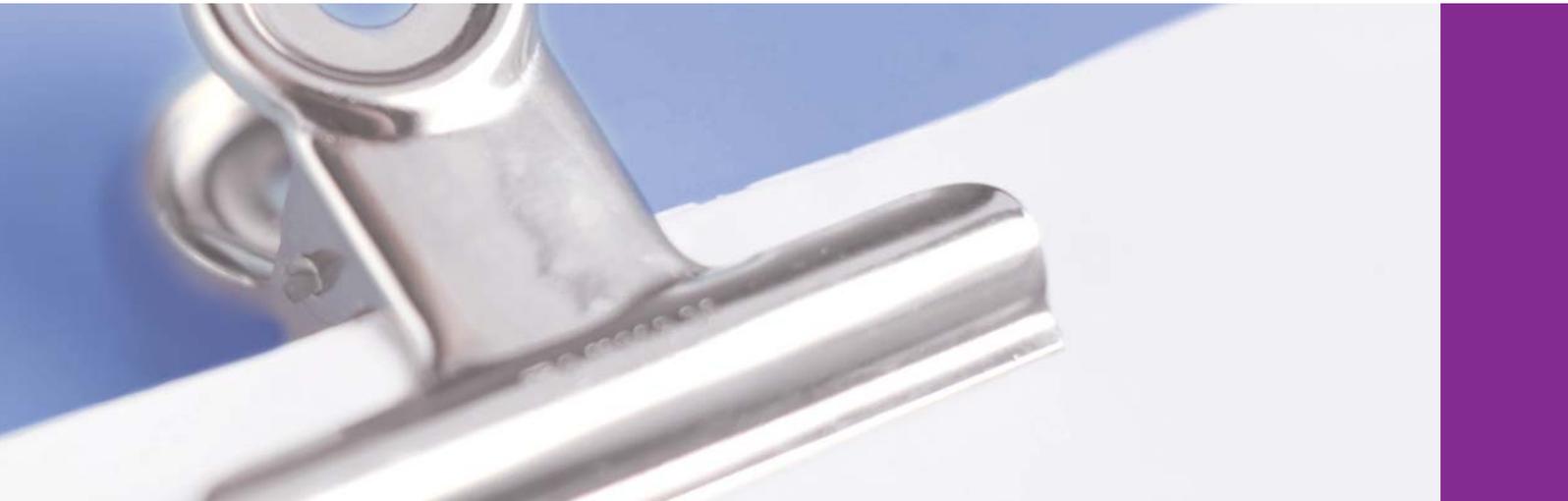
Over 60 percent of respondents were C-level executives, with the survey providing a unique view into the mindset of this group.

Nearly half of all respondents have an annual turnover of more than \$1 billion USD.

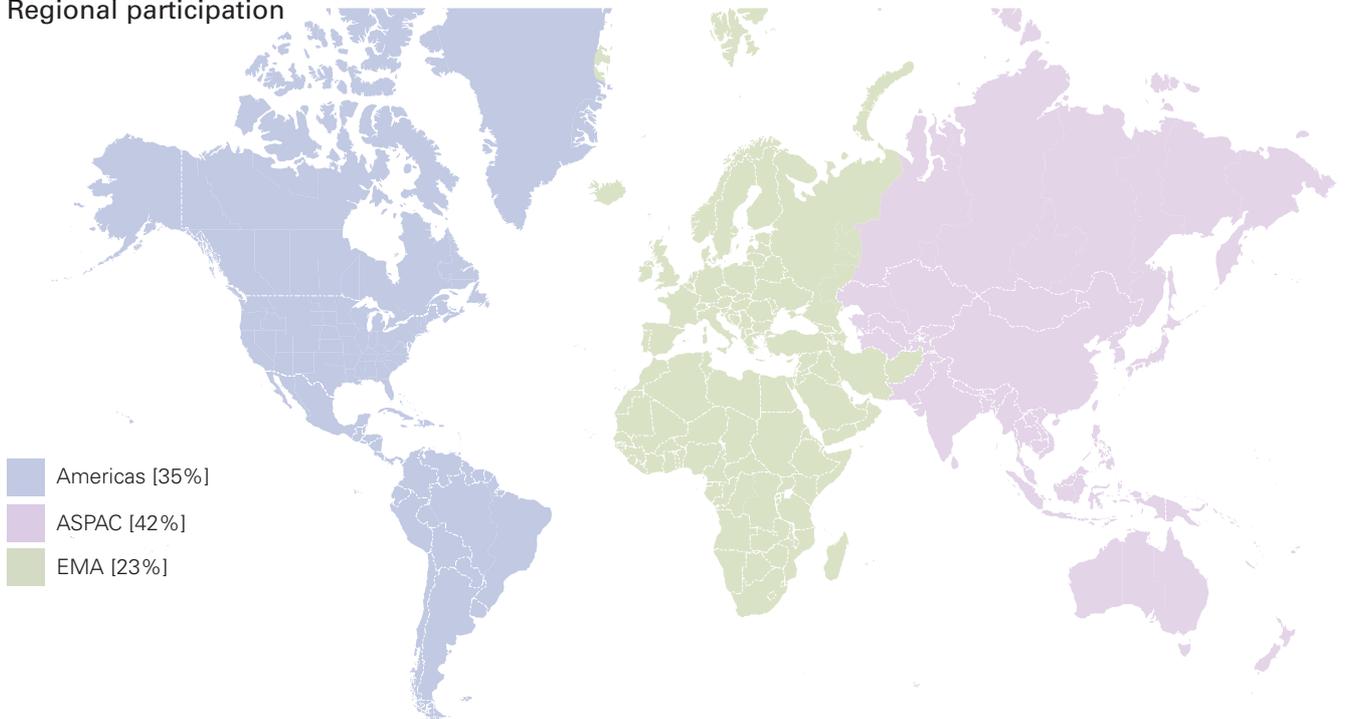
Over 80 percent of the contracts refer to information technology outsourcing (ITO), 18 percent to business processes outsourcing (BPO), and two percent to knowledge processes outsourcing (KPO).

For the purposes of this survey, global regions have been defined as Asia Pacific (ASPAC), Europe, Middle East and Africa (EMA) and the Americas. Participants are from a wide range of industries as noted on the following page.

³ This figure includes 559 customer organizations and 99 service provider organizations.

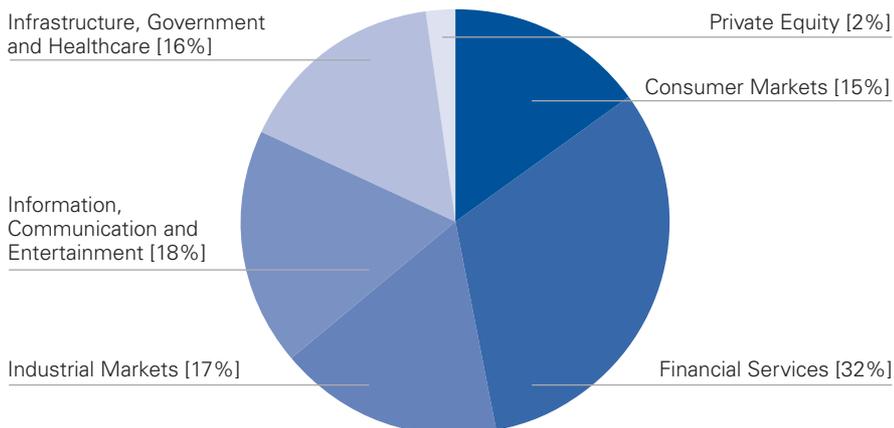


Regional participation



Source: KPMG International February 2007

Industry participation



Source: KPMG International February 2007

Success or failure?

Despite significant challenges, the majority of organizations believe their sourcing service provider contributes positively to their organization's overall success.

Only 14 percent of respondents said they had a significant misalignment of financial and commercial expectations with their service provider.

Eighty-nine percent of organizations plan to maintain or increase their current level of sourcing.





Sourcing perceived as successful

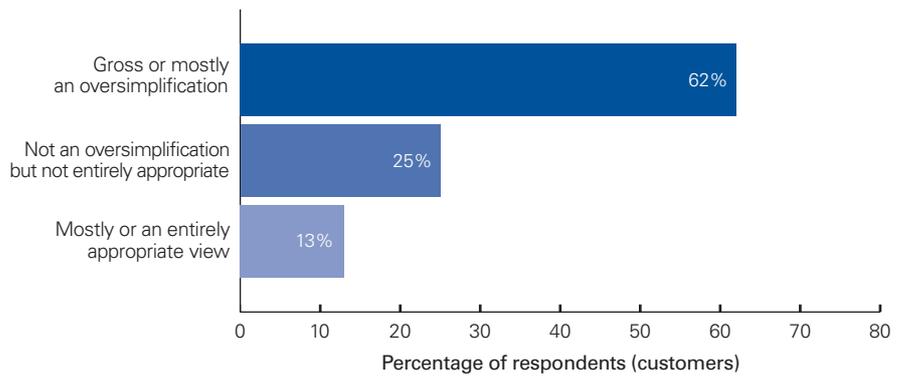
In almost every paper about the status of sourcing, the chances are good that a sentence similar to the following will appear: 'As many as half of all sourcing deals fail'. This view is so pervasive that many simply accept it to be accurate. But is it correct?

The survey results indicate that only 13 percent of customers believe this is a mostly or entirely appropriate view, with 86 percent of service providers stating they thought this was mostly or a gross simplification.

Over the last decade, the maturity and complexity of the global sourcing market has grown significantly, requiring a more sophisticated view of sourcing relationships. Regarding the market in a more sophisticated way means accepting that we are dealing with a continuum of varied degrees of success or failure, rather than an overly-simplistic, polarized view of 'success' or 'failure'.

There are significant opportunities for organizations to increase the value their sourcing contracts deliver – it is imperative that black and white views of success and failure should not be allowed to cloud judgment around the value these contracts bring to organizations on a daily basis.

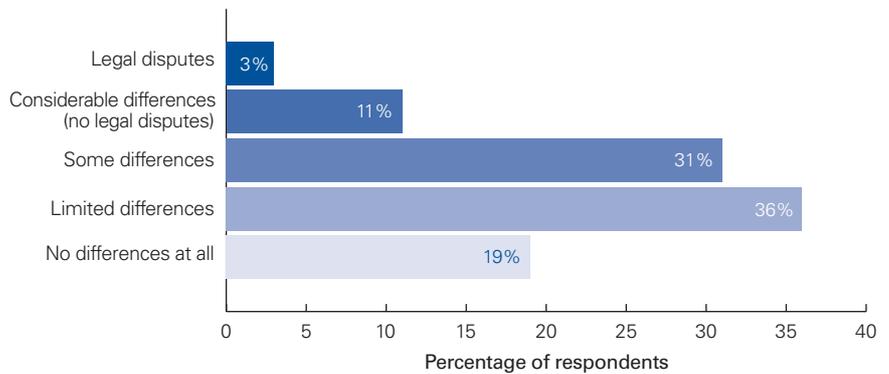
To what extent do you agree with the statement that up to 50 percent of outsourcing contracts fail?



Source: KPMG International February 2007

Only 14 percent of customers felt a misalignment of financial and commercial expectations with their service provider. Of the 14 percent, only three percent of respondents reported legal differences and only 11 percent reported considerable (but not legal) differences with their outsourcing service provider.

Alignment of financial and commercial expectations with suppliers



Source: KPMG International February 2007



With respondents overwhelmingly content with their sourcing arrangements, while acknowledging significant challenges, respondents said they believe service providers generally make positive contributions to the success of their organizations. These findings seem to suggest the commonly held view, that sourcing often fails, is far from reality.

The results clearly indicate that sourcing is regarded as a key process underpinning overall business strategy and is used widely and effectively by companies around the globe.

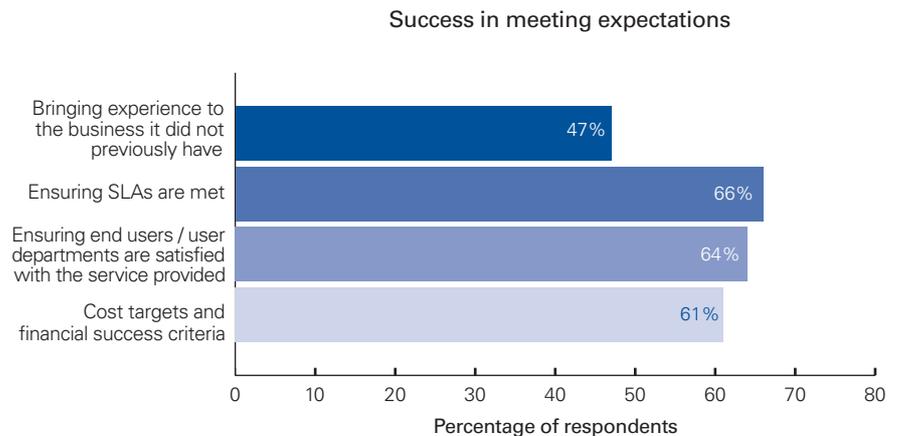
Sourcing on the increase

Not only did respondents say their sourcing relationships are working, an overwhelming majority (89 percent) state they planned to keep their current level of sourcing or increase it.

Generally representative across all industries, this is a very encouraging statistic. For many organizations, sourcing is a transformational initiative focused on the achievement of a variety of key business objectives, including quality improvement, cost reduction, delivery improvements, innovation, and responsiveness.

Building better relationships

Along a number of dimensions, customers of sourcing services generally appear to have a positive working relationship with service providers, with the clear majority of customers reporting their service providers meeting expectations across a number of variables as demonstrated by the following diagram.



Source: KPMG International February 2007

Service providers also agreed with this view, and believed that the appropriate balance was being placed on these critical elements.

However, some results indicated that the potential benefits of sourcing are not being realized in all situations. Specifically, half of respondents considered their service providers to be moderately or very ineffective in responding to their business changes, and only 47 percent believed their sourcing service providers brought experience to their business that they previously did not have.

Positively, some service providers recognize these problems, with 48 percent agreeing they placed too little emphasis on innovation and on actively seeking ways to improve the service.



Are benefits not being delivered or are organizations not accurately defining benefits and tracking their realization?

Benefits delivered?

While many organizations regard the relationship with their service provider positively, many do not definitively know the extent to which benefits have been delivered. While most organizations are reticent to describe their outsourcing initiative as a failure, there is some difficulty in describing what success has been achieved.

In particular:

- 42 percent of organizations believe their sourcing contract has definitely improved financial performance
- Only 27 percent said it has definitely improved their competitiveness.

Difficulty in identifying and accurately measuring benefits should be seen as a real concern, as improved financial performance and competitiveness are often key drivers of sourcing initiatives. While many organizations view the relationship with their service provider positively, this positive relationship should be matched with tangible benefits.

Measuring the strategic value of sourcing



Forty-four percent of customers and 42 percent of service providers said they do not undertake formal strategic reviews of the benefits delivered to their business from sourcing contracts.

Seventy-two percent of customers reported that they do not have, or do not share with their service providers, criteria for measuring the success or failure of their sourcing arrangement.

Although many organizations measure the financial and operational benefits, most are not measuring the softer, less immediately tangible benefits (customer satisfaction and other such benefits) of their sourcing arrangement.

The strategic purpose of sourcing may be compromised if benefits are tracked only on a narrow tactical level and without a broad view into the effects on the employees, business and clients.

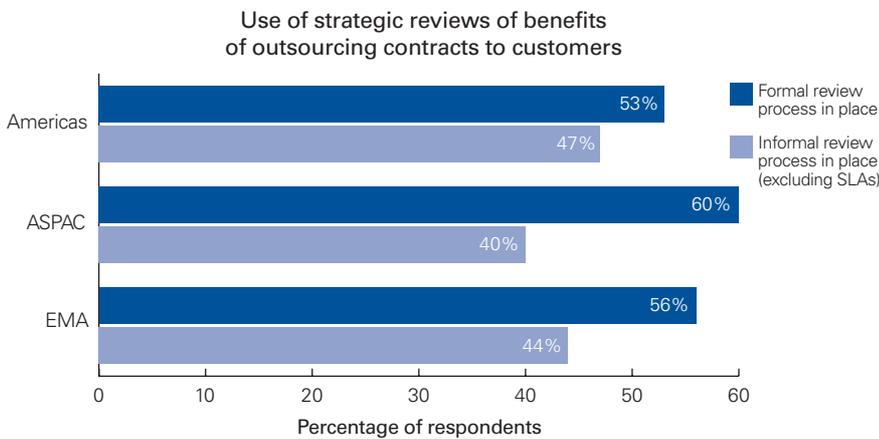
Many organizations seem to only have a perception or a limited view of what constitutes 'failure' or 'success'.



Is ignorance bliss?

How did respondents know their sourcing relationships were actually working? Did they come to that decision using a formal process or method, or was it based more on perceptions?

The survey results indicated that 44 percent of customers and 42 percent of service providers did not undertake formal strategic reviews of the benefits to their business or sourcing contracts. This lack of rigor contributes to the loss of millions of dollars for organizations across all global regions.



Source: KPMG International February 2007

These findings appear to indicate clear opportunities to increase business benefits if customers establish regular and structured reviews of their sourcing relationships. These reviews should not solely focus on SLAs but assess multiple measures including (but not limited to):

- Innovation
- Business alignment
- Competitor performance
- End-user department satisfaction
- External client satisfaction
- Employee attitudes
- Productivity improvements
- Operational performance measurements (non-financial)

These benefits bring strategic value to organizations and strengthen the case that sourcing is and should be a strategic enterprise initiative.

However:

- Do customers know if they are receiving the strategic benefits promised by the sourcing providers?
- Have the softer benefits of sourcing beyond the financial business case been achieved?
- Is there a clear understanding of the main inhibitors to improving the performance of the sourcing relationship on a sustained basis?

Survey results indicate that amongst many buyers of sourcing services the answer to these questions is 'no'.

These trends are consistent with those identified in KPMG's *2005 Global IT Project Management Survey – How committed are you?* Results from this survey suggest that as many as 59 percent of organizations interviewed either tracked benefits for IT projects at an elementary level, or did not track benefits at all.



Did you say 'benefits'?

While organizations feel they are accruing benefits from sourcing, most organizations do not define or track either success or failure in their sourcing arrangements.

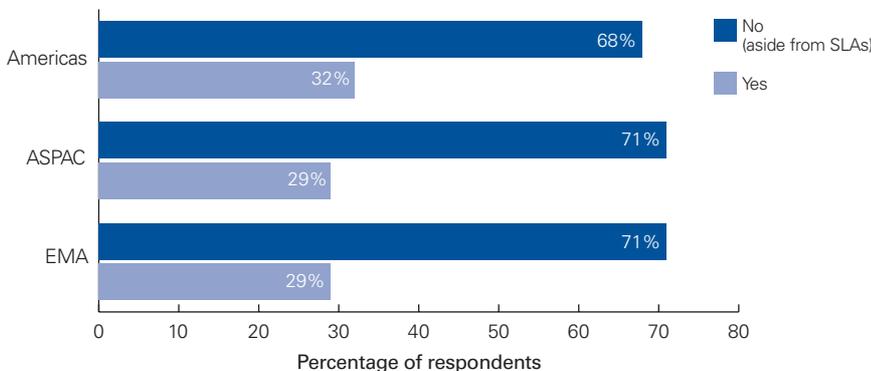
Beyond compliance with service levels and tracking against the initial business case, many organizations seem to have a limited view of what constitutes failure or success.

"The benefits of sourcing were never defined."

COO, financial services organization

Seventy-two percent of customer organizations do not have a published list of criteria that defines the success or failure of a sourcing arrangement. Where defined success criteria do exist, they are often not shared fully with the service provider, potentially leading to further misalignment.

Incidence of formal published criteria defining success or failure



Source: KPMG International February 2007

The reality of performance measurement

Considering that most respondents say they believe sourcing improves their financial performance, shareholder value and competitiveness, the survey results show that a large percentage of sourcing relationships are not strategically monitored.

"Success is ill-defined. Measurement of business benefits is difficult, and there is a tendency not to measure."

CEO, manufacturing organization

It is highly plausible that 44 percent of respondents who do not have a formal benefits measurement and realization process in place may be exposed to strategic, commercial and compliance risks. Our research indicated that even those organizations that do have a formal benefit management process, and are measuring the overall 'strategic' benefits, are doing so only partially or conducting largely tactical reviews.

Sourcing the outsourcer



Over one third of organizations did not know their labor and time cost spent on the sourcing selection process.

Fifty percent of respondent organizations took longer than six months to complete the sourcing selection process. Thirty percent of respondents took longer than nine months.

While many organizations are looking to outsource internal processes to reduce costs and increase efficiencies, often the process of sourcing the outsourcer is protracted, costly and does not yield tangible benefits either through increased value for money or lower risk.



Not accurately identifying the costs of the selection process detracts from the commercial viability of sourcing and erodes margins.

Sourcing selection costs not known

In most key business areas, the costs (actual and opportunity) of potential projects are identified and tracked against budgets and estimates. In most cases, cost is often a major determinant of the success or failure of a project. In the case of sourcing, cost efficiency is often a major reason for outsourcing business and IT processes.

Results indicate that 79 percent of all customer organizations could not accurately quantify the internal financial cost of the sourcing selection process (cost in terms of the number of hours spent on the selection process).

Furthermore, 90 percent of all customer organizations did not accurately understand the opportunity costs of the selection process.

For responsible governance, tracking of costs should be applied to the sourcing selection process, and form part of the return on investment (ROI) calculation. Involving the service providers in unnecessary processes will also reduce the ROI of the sourcing contract and may result in a protracted and lengthy service provider selection and transition process.

Eighty-five percent of respondents stated that they could have predicted most or all of the short listed service providers at the start of the sourcing selection process.

Process takes too long

With over half of all respondents taking over six months to select a sourcing service provider and 30 percent of respondents taking over nine months, the opportunity cost for organizations is significant.

- Sixty-one percent of respondents took longer than three weeks to develop a request for information (RFI).
- Fifty-four percent took longer than a month to develop an RFP.
- Forty-three percent of organizations took longer than one month to evaluate the service provider response to the RFP.

Service providers also agree this process is lengthy and cumbersome. Sixty-two percent of service providers agree or strongly agree that the service provider selection process took too long, and was too focused on the process itself rather than the end result.

The length of the acquisition cycle should be adjusted to reflect the type and complexity of service being bought so that time and money is not wasted during this phase.

Indeed, nearly half of all respondents stated that they could have predicted most or all of the short listed service providers at the start of the sourcing selection process, which begs the question: why undertake a lengthy selection process if the outcome was known from the start?



“When client requirements are unclear, the process can become overly complex and inefficient”

COO, service provider organization

Wrong reasons, wrong way – tradition versus efficiency

Results suggest that traditional steps in the selection process are often conducted because of rigidity in the process rather than developing a tailored approach based on an evaluation of what benefits each step brings to the overall selection process.

The following table outlines the purpose of each of the main steps of the selection process.

Process	Purpose
Request for information	To understand market capability
Request for proposal	To understand the optimal solution
Best and final offer	To understand the commercial offer

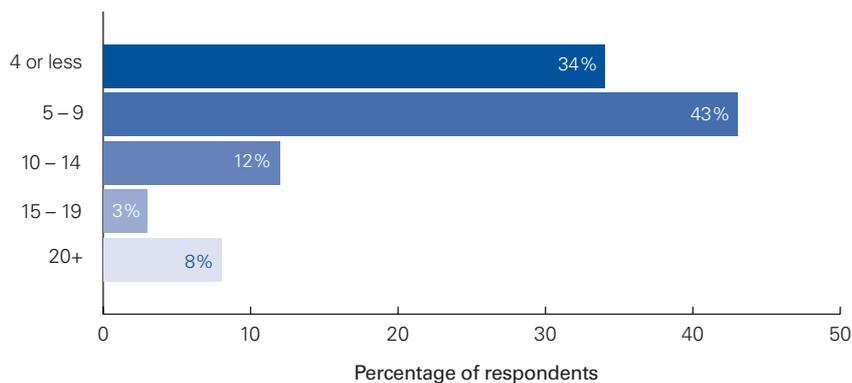
Comments from respondents suggest that protracted RFI and RFP processes are often used purely as a tool for risk management, and that its relevance to the actual technical and commercial contractual process is limited.

In the case of the RFI:

- 50 percent of respondents issued an RFI as a step before publishing an RFP to a limited set of service providers. The decision to issue an RFI did not appear to depend on the type of services being outsourced
- 34 percent of respondents who issued an RFI only did so to four or less service providers rather than using the RFI process to understand the market’s full capabilities
- Nearly half of all respondents believed they could have identified the short list of service providers at the start of the selection process.



Number of service providers sent an RFI



Source: KPMG International February 2007

Although the preferred strategy and likely short listed service providers are sometimes known from the start, the RFI stage is at times required for risk management or legal policy reasons. However, this step often creates unnecessary inefficiencies. Customers should recognize its purpose as initial information gathering of market capability, rather than expecting it to yield any specific commercial or technical benefits.

Customers also appeared confused as to the true nature of the RFP in the overall selection process, with nearly a quarter using the process to market their requirements in the best light.

Only 41 percent of the respondents appear to use the RFP for its given purpose – to better understand the potential service providers' solutions and capabilities.

If properly implemented, the RFP process can not only assist in understanding the potential service providers' solutions and capabilities, but can help to align the technical capabilities and cultural fit of the service provider to that of the client.

People: the forgotten component for success



Only 12 percent of customer organizations report problems as being technology related.

Sixty percent of customers and 59 percent of service providers believe problems encountered throughout the sourcing process are related to the people involved in managing the project.

The RFP process is generally too focused on the technical aspects of the sourcing process with little consideration given to cultural alignment.

Outsourcing is a major, and often dramatic, change to any organization. It often incorporates the development and implementation of new processes, controls, transformations, transitions, procedures, solutions or strategies. To successfully implement the level of change brought about by outsourcing, the importance of people cannot be underestimated.

The source of the problem – technology versus people

Underscoring the idea that clear, concise communications regarding expectations is a foundation for a well-functioning sourcing relationship, only 12 percent of customer organizations report problems are technology related. Sixty percent said problems with their sourcing service provider relationships almost always, or mostly are 'people related'.

This is also strongly supported from the service provider perspective, with 59 percent stating that problems encountered during the course of an

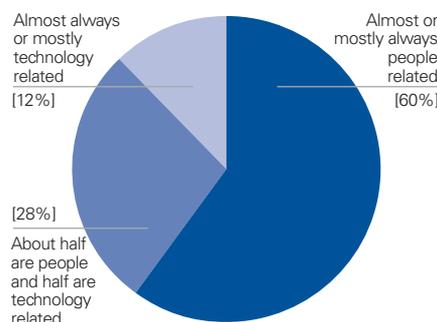
outsourcing arrangement are almost always, or mostly 'people related'.

"Alignment of maturity levels and culture are the most critical success factors. This is not widely understood and often downplayed / overlooked, especially in the RFI / RFP and negotiation stages"

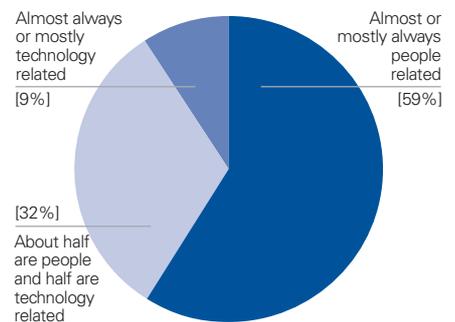
CIO, industrial markets organization

This finding also provides strong evidence that the RFP process is generally too focused on technical capability at the expense of the key differentiator between service providers – their people. In almost all cases, a sourcing provider possesses the technology to handle a contract, and is often able to do so within a small price differential; yet the differentiator in this highly competitive business almost always will be the people involved - both on the supply and on the demand side of the equation.

Sources of problems in outsourcing contracts (customers)



Sources of problems in outsourcing contracts (service providers)





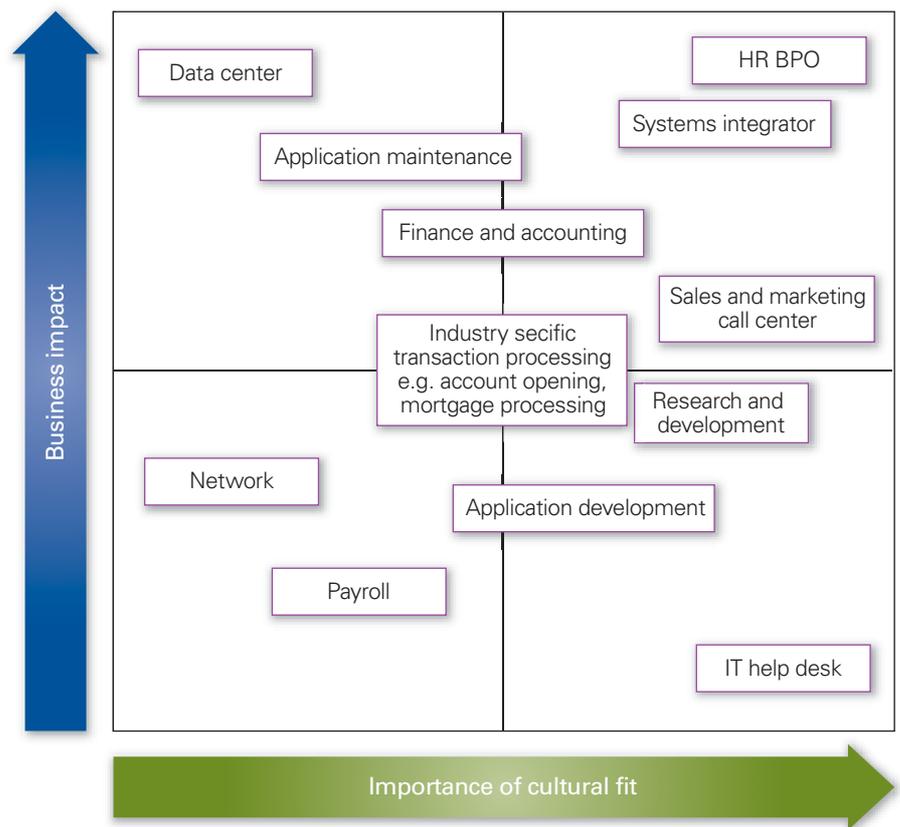
Importance of cultural fit

The following matrix suggests the dynamic that is always in play between the importance of 'cultural fit' of a customer and provider of sourcing services, and the 'business criticality' of the services being supplied. For example, sourcing of the human resources function often has a high degree of business criticality, and because of the constant interaction between service providers and customers, a tight cultural fit is imperative.

On the other hand, while outsourcing a data center is business critical, a degree of cultural mismatch between the service provider and customer is sometimes manageable, as the service is often largely hidden from customers and is well commoditized in the market.

By understanding the relative positioning of an outsourced service on the matrix shown, a buyer can potentially optimize the effort it expends on the 'softer' elements of service provider evaluation and management versus the purely technical and commercial.

Cultural Analysis



Source: KPMG International February 2007



Evolution

The findings from this survey confirm that sourcing has become a key business tool for large and small organizations across all major market sectors. Increasingly, the decision and strategies around outsourcing are determined or approved within the boardroom.

With an increased focus on the strategic success of sourcing contracts, the question of whether a better way (pre and post contract) exists is critical.

In an environment where evolution is critical to the long term success of sourcing, KPMG's IT Advisory practice is looking at how certain practices may be changed or improved.

Clarity around benefits realization

Overall, sourcing is perceived as successful, but tangible support for this perception is often lacking.

An increasing emphasis will need to be placed on the use of a broad range of quantifiable measures to evaluate success against the original business objectives, and where necessary, to periodically review the objectives. Additionally an increased emphasis should be placed on the people issues that have a significant impact on meeting business objectives.

Strong practice in the effective measurement of strategic value brings an holistic approach, including service levels, and softer, but highly important areas such as quality of people and customer satisfaction.

One global telecommunications organization reported that evaluation of both hard and soft measures, resulted in the realization of tangible benefits far greater than anticipated.

Specific financial metrics (including SLAs and benchmarking against competitor performance) were used in combination with external client satisfaction and end-user department surveys. As a result, the organization was able to more accurately measure the performance and acceptance of the outsourced functions of payroll, IT helpdesk and customer sales (call center).

The organization adopted a highly collaborative approach with its service provider, linking performance targets to compensation-based performance incentives.

More accurately measuring the performance of the service provider led to reduction in abandoned calls and a resulting increase in sales.

Impact on the organization's bottom-line was significant.

Customer organizations that are second or third generation outsourcers tend to include softer measurements in their strategic value measurement framework, and are generally more successful in determining overall benefits sourcing brings to their organization.

Success versus failure

Criteria for success and failure should be defined to include qualitative and quantitative measures that are tracked on a regular basis.

Service providers should be made active partners in tracking strategic and operational benefits. The table on the following page indicates the main objectives and possible methods for measuring contract success throughout the main phases of the sourcing contract – planning, procurement and operations.

“Unless your IT organization is very mature in its processes, you will not know how to adequately measure success of outsourcing efforts”

CIO, industrial markets organization

A critical supporting element will be a clear alignment between the customer and service provider's view of success.



Sourcing Phase	Measurement Options	Method
Planning	<p>Production of a comprehensive and reliable business case.</p> <p>Identification of key success factors for potential outsourcing (e.g. lower cost, increased productivity, improved innovation).</p>	<p>Business case which is realistic and achievable. Net present value (NPV) calculations that inform future financial planning.</p> <p>Accurate estimation of 'cost of procurement' of outsourced services.</p>
Procurement	<p>Effective assessment of the supplier commercial and technical offerings (against competing suppliers and / or the market).</p> <p>Effective evaluation of non-commercial / technical aspects – e.g. cultural fit, quality of people and innovation.</p> <p>Embodiment of the measurement principles as commercial binding practices.</p> <p>Assurance the elements that will bring success are clear between supplier and customer.</p>	<p>Evaluation of supplier offerings (RFI, RFP, presentations, best and final offer) using agreed templates.</p> <p>Balanced scorecard.</p> <p>Benchmarking of suppliers' commercial offers against market pricing.</p>
Operations	<p>Implementation of a measurement framework jointly with the supplier which tracks the contract's key success factors from the SLA and beyond.</p> <p>Framework and method for external benchmarking of value and quality of service provided.</p>	<p>Scorecard capturing both hard measures of success / failure (e.g. SLA compliance) and softer issues (e.g. people / quality).</p> <p>Scorecard can be developed over life of contract to match changing requirements.</p> <p>Scorecard measures both supplier performance and elements of customer behavior that can enable / inhibit success.</p> <p>Scorecard linked to benefits or bonus payments.</p>

“Misalignment would not occur if due processes were followed in selecting the service providers”
CIO, consumer markets organization

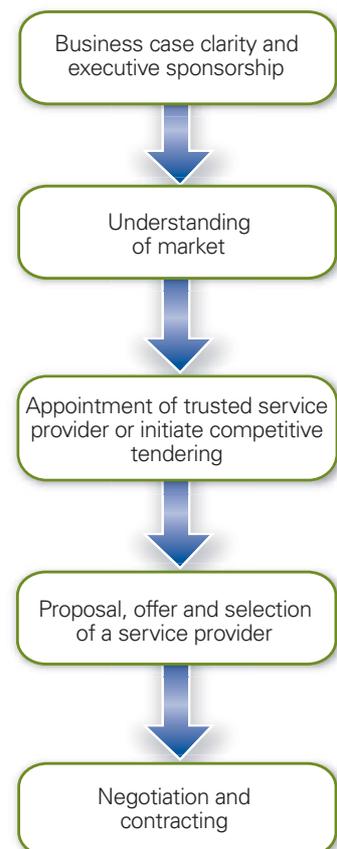
Flexible selection processes

Speed of decision making is becoming increasingly important and procurement processes for sourcing should adapt to reflect this. Change will be required to focus on evaluating the objectives of each stage of the process and then aligning these outcomes to the most appropriate method.

The method chosen at each stage will vary based on a number of factors – principally but not exclusively:

- The maturity of the service being procured
- The scope and scale of the services being procured (e.g. global, regional or local, BPO or IT)
- Whether there is a ‘compelling event’ in play (e.g. a merger or acquisition) that drives the procurement to a fixed deadline.

The following illustration sets out the major stages in the procurement process regardless of the service being bought.



Source: KPMG International February 2007



If an RFI is judged to be necessary it should focus on uncovering information from service providers that would not otherwise be available in the public domain.

Fast tracking selection

In many cases it seems that the traditional procurement process could be far more efficient. Indeed, some leading organizations have already identified this process improvement, especially in comparison to the pace of merger and acquisition transactions – which are often larger in scope, value and risk, and yet are usually completed in less than four months.

While the processes of mergers and acquisitions and sourcing are very different, lessons can be learned – the pace of contracting for sourcing services could be improved without compromising quality or value.

The following table outlines the optimal length of time for each step in the selection process.⁴

Process	Optimal time
Overall sourcing selection process	6 months
Development of request for information	2 weeks
Development of request for proposal	2 weeks
Evaluation of request for proposal	1 month
Best and final offer	2 weeks

Source: KPMG International February 2007

This research indicated that many of the traditional steps used in the selection process can often be replaced by a more efficient and targeted process.

For example, ‘understanding the market’ which is traditionally achieved through the publication of a formal RFI, can often be done through other, faster and cheaper means. In markets that are mature and generally well understood, such as the provision of desktop support or payroll services, there is rarely the need to publish a public RFI since information on the capabilities of service providers in the market is generally available either in the public domain or through relatively low cost proprietary research.

If an RFI is judged to be necessary, it should focus on uncovering information from service providers that would not otherwise be available in the public domain.

Similarly, a service provider can sometimes be chosen either through initiating a formal tendering process, or through leveraging an existing trusted relationship. Where a market is well understood and the customer has good experience in that domain already, a good proposition can be achieved through early negotiation with a single or limited set of service providers. Time and energy can then be focused on tuning the solution rather than the formalities of traditional selection processes.

⁴ Optimal length of time is dependent on individual circumstances and can be affected by the complexity of the services being outsourced, or the maturity of the market providing those services.

Optimizing the procurement process

The table below illustrates how the selection process might be optimized according to the type of service being procured. Depending on what is outsourced, our experience indicates that most contracts can be finalized using this approach in between eight and 23 weeks depending on scope, scale and domain.

Selection process → Design ↓	Investigate (1 – 3 weeks)	Formal tendering process (2 – 6 weeks)	Proposal, offer and select (2 – 6 weeks)	Negotiate and contract (2 – 8 weeks)
IT Operations e.g. IT helpdesk	Market is well understood and usually does not require an RFI. Market intelligence or internal research usually sufficient.	Issue RFP to suppliers with best fit to requirements. OR Begin working with single trusted supplier to develop solution.	Compare offers and benchmark against market pricing and service levels.	Negotiate contract using standard terms and conditions. Longer contract term likely.
Application Development e.g. systems integration	Market is well understood and usually does not require an RFI unless solution required is non-standard or there are multiple offshore options.	Issue formal RFP to no more than six suppliers with established capability. OR Validate single trusted supplier.	Leverage industry standard measurement models (e.g. Function point analysis) to compare offers on a like for like basis.	Negotiate contract using standard terms and conditions. Break into clear work packages and quality targets linked to payment milestones. Contract term aligned to application deliverables.
Application support e.g. application support and maintenance	Market is well understood and usually does not require an RFI unless solution required is non-standard or there are multiple offshore options.	Issue formal RFP to no more than six suppliers with established capability. OR Validate single trusted supplier.	Leverage industry standard measurement models (e.g. Function point analysis) to compare offers on a like for like basis.	Negotiate contract using standard terms and conditions. Base contract on clear SLAs and quality targets (not time and materials). Short contract term likely.
Business process (mature) e.g. payroll	Market is well understood and usually does not require an RFI unless solution required is non-standard or there are multiple offshore options.	Issue formal RFP to no more than six suppliers with established capability. OR Validate single trusted supplier.	Compare offers and benchmark against market pricing and service levels.	Negotiate contract using standards terms and conditions. Longer contract term likely.
Business Process (immature) e.g. knowledge management	RFI is usually required to understand market maturity and capability, especially where multiple solutions to the requirement are possible.	Issue formal RFP. OR Workshop potential supplier solutions with suppliers. Also validate different commercial approaches e.g. joint venture.	Evaluate offers and compare approach for value and risk. Re-validate approach with business. Be prepared to back away from BPO if the offers present significant business risk and / or benefits not measurable.	Likely to require non-standard contractual terms and innovative benefits measurement model. Short contract term likely.

Source: KPMG International February 2007

The more traditional selection processes will likely have a continuing role to play, but organizations are starting to use fast track methods to shorten the process and attempt to drive earlier achievement of stated business objectives. It is likely this approach will become increasingly common in the marketplace going forward.



Stronger and more transparent relationships

The survey clearly identified that post contract, the success or failure of the relationship is often dependent on people rather than technology issues.

People and cultural issues need to be considered both pre and post contract in order to increase the chances of success. This is particularly important where offshore sourcing models are being considered as these sometimes present more serious challenges from a cultural fit perspective.

The types of issues to be considered with respect to cultural fit include:

- Attitude towards privacy and confidentiality compared to openness and transparency
- Leadership and management style
- Methods for problem resolution and governance
- The balance between service provider flexibility and strict adherence to process
- Language and communication.

People related issues that have a significant business impact should be given greater attention during the selection process. This will assist in

selecting a culturally compatible service provider. Cultural differences often become increasingly visible during the negotiation phase.

Cultural issues play an important role, not only during the selection process, but throughout the lifetime of the contract. Buyers of sourcing services need to pay careful attention to a number of issues to ensure that they appropriately contribute to cultural alignment. These contributions can include placing appropriate emphasis on:

- The structure and objectives of the service provider
- Providing clarity in measurement of success
- Designing, implementing and operating the governance and problem escalation process
- Training of employees transferred to the service providers (if applicable).

This is not to say that price and solution are not important, but in order to gain more value from a sourcing relationship, it is important to recognize a key differentiator between success and failure – people.

Both customers and service providers will increasingly seek better ways to support outsourcing as a successful business model.



There will likely be a greater focus on achieving leading practice as outsourcing becomes increasingly strategic, and therefore attracts more boardroom attention.

Leading practice outsourcing

As organizations around the world aim to improve sourcing practices, insight into organizations achieving the specified objectives of their sourcing contracts may be useful in assisting others enhance the delivery of measurable benefits.

The research identified eight key clusters of customer organizations, defined primarily by their attitude towards sourcing and the way in which they choose to interact with their service providers. These differing approaches to outsourcing have led to a variety of outcomes – sometimes positive, sometimes negative and sometimes a mixture of both. It is a complex picture rather than a simple case of dividing people into those with ‘unsuccessful’ or ‘successful’ relationships.

In our analysis we have looked at how actual outcomes relate to each of the identified segments. ‘Outcomes’ are defined in two main ways:

The extent to which the customer feels satisfied that their contractor places the appropriate emphasis on a number of key areas, namely:

- Cost targets and financial success criteria
- Ensuring all the SLA targets are met
- Bringing experience to the business that they did not previously have
- Innovation and actively seeking ways to improve the service and / or processes
- Ensuring end users / user departments are satisfied with the service provided.

The extent to which the customer believes that the contract has delivered measurable benefits to their business in terms of:

- Improved financial performance
- Improved competitiveness
- Impact on shareholder / stakeholder value.

Based on this analysis⁵, the results highlighted customers adopting leading practices, and those where practices could be further improved.

Characteristic	Leading practice organizations	Underperforming organizations
Region	These organizations can be from any region but are most likely to be found in the Americas.	Found evenly across the regions.
Industry	Most likely to be in financial services or, to a lesser extent, consumer markets.	More likely to be infrastructure, government and healthcare.
Process outsourced	More or less equally likely to be outsourcing helpdesk or research and development and, to a lesser degree, IT and telecommunications.	Just as likely to be research and development, security and maintenance, or IT and telecommunications.
Selection process	Selection process tends to be shorter than many other organizations.	Lengthy, and generally concede that the selection process was too long and introspective.
Business buy-in	Clear and consistent view of what the purpose of the contract is across the parts of the business.	Different functions in the business disagree with regard to the purpose of the outsourcing contract.
Governance	Board level involvement is limited to a single contact at quarterly intervals.	Significant, frequent, board level contact with different board members but no real central point of contact at board level. Highly likely to be in dispute with their suppliers over financial and commercial terms in the contract – therefore the high level of board involvement might simply reflect these disputes.
Contract flexibility	Focus in the contract appears to be on building in flexibility to allow for changing situations.	It is feared that the contract did not make particularly good provision for the business / technology to change over the life of the contract.
Innovation and creativity	Tend to be particularly happy with the level of innovation the service provider has brought to the contact.	Unhappy with the level of innovation that the supplier was able to bring to the business. Also feel supplier has failed to bring news skills and capabilities to the business that they did not previously have.
Measurement of delivered benefits	Processes, up front, generally appear less bureaucratic than most, but the service provider's performance is monitored closely using a variety of measures outside of SLAs and financial metrics. The net result is that these businesses feel the service provider has very closely matched their expectations, and that the business has experienced tangible benefits.	Purely reliant on SLAs to monitor the benefits delivered.

Source: KPMG International February 2007

This survey aims to encourage discussion around ways to improve current sourcing practices.

It is critical that both customers and service providers seek better ways to ensure outsourcing continues to be a successful business model. Examining and evaluating characteristics of stronger performing organizations will assist others in developing and implementing more robust practices.

With a greater focus on issues and opportunities around outsourcing, evolution of current practices is vital to the long term viability of this key strategic tool.

5 Segmentation and behavioral analysis was conducted by an external, independent market research company to explain differences in behavior and attitude of a meaningful group of segments. This data was defined scientifically using variables that can be shown to drive behavior.





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