

# Achieving Business Value Transformation Through Smarter Sourcing



## Introduction

Today’s demanding economy has driven the need for a level of information, speed, and flexibility unforeseen in the business world. As a result, every process from customer interaction to supply chain logistics is increasingly technology-based and information enabled. This has resulted in technology evolving from simply a back-office enabler of strategy and innovation to a direct client experience touchpoint and — in an increasing amount of industries — a strategy and execution vehicle unto itself.

At the heart of this technology-dependency is applications development and management. Applications development and management (ADM) has never been more critical than it is in today’s highly networked, fast-paced, globally distributed environment in which businesses seek new ways to respond to the marketplace.

To respond to this ever changing and demanding world, a new way of performing collaborating, measuring and incenting teams is required. As detailed in our recent white paper “Driving Productivity through Smarter Sourcing,” (available at [ibm.com/services/applications](http://ibm.com/services/applications)), a new approach to address these challenges has been introduced. It is known as Smarter Sourcing.

This approach integrates and improves onshore and offshore capabilities while preserving critical expertise to ensure high quality results. It includes the continual introduction and integration of new techniques, methods, tools, and world class resources while re-engineering the overall application development process. And its focus on driving long-term productivity and value realization comes from effective re-use planning and execution. Within this model, companies are going beyond traditional outsourcing and wage arbitrage to drive improvements in quality and cycle time and savings.

## The Business Impact of Outsourcing

According to recent AMR research, over half of large enterprises “are considering out-sourcing as a vehicle for reengineering their business process. Many firms have used the recession as an opportunity to focus heavily on eliminating waste and streamlining poor processflows.”<sup>1</sup> In addition, enterprises are often able to use outsourcing initiatives to free up resources to focus on core business value drivers, gain from economies of scale, liberate cash to be used for additional investments, and mitigate business and IT risk.

Although the benefits of outsourcing have been outlined theoretically and supported by a number of empirical studies understanding the business impact of outsourcing in financial terms that both CIOs and CFOs appreciate can be a challenging task. This motivated scientists at the IBM T. J. Watson Research Center in 2009 to investigate the long-term impact of IT, application and business process out-sourcing on companies’ financial performance. Using a rigorous statistical approach, the IBM Research team analyzed the financials of 244 publicly traded companies that entered into a large-scale outsourcing program between 2001 and 2006. That analysis revealed a correlation between outsourcing and significant improvement in business performance. The results of the IBM Research study demonstrate that outsourcing clients consistently outperform their peers on key financial metrics, including Selling, General and Administrative (SG&A) expenses, Earnings Before Taxes (EBT), Operating Income and Return on Assets (ROA). The results also demonstrate that companies that choose to outsource experience significant improvements in their financial performance compared to their performance levels prior to outsourcing.

The IBM Research team focused its investigation on SG&A, EBT, Operating Income and ROA. Two analyses were completed—the first compared the performance of outsourcing clients against their industry sectors, while the second analysis compared individual company performance before and after outsourcing. The results were impressive.

## Analysis 1: Average company financial performance metrics compared to the average of sector peers

When compared to industry sector peers, outsourcing clients outperformed on every financial metric. Table 1 summarizes these results.

Metric	Change In Growth	Performance Highlights
SG&A	-2.9 points	<b>Lower growth in SG&amp;A</b> One year following the start of the engagement companies that outsourced had 2.9 points lower, SG&A growth than their sector peers.
EBT	+4.3 points	<b>Higher earnings growth</b> Two years following the start of the engagement companies that outsourced had 4.3 points higher earnings growth than their sector peers.
Operating Income	+3.2 points	<b>Higher income growth</b> Two years following the start of the engagement companies that outsourced had 3.2 points higher operating income growth than their sector peers.
ROA	+0.13 points	<b>Better growth in ROA</b> Two years following the start of the engagement outsourcing clients grew their ROA 0.13 points, better than their sector peers.

Results are statistically significant with 95% confidence interval.

Table 1. Financial performance metrics of outsourcing clients versus sector peers.

## Analysis 2: Average company’s financial performance pre- and postoutsourcing

Across all metrics analyzed, outsourcing clients have demonstrated significant improvements compared to their performance in the preoutsourcing period. Of the four metrics analyzed, two produced statistically significant findings, as shown in Table 2.

Metric	Change In Growth	Performance Highlights
SG&A	-3.5 points	<b>Lower growth in SG&amp;A</b> Companies that outsourced were able to reduce the rate of their annual SG&A growth by 3.5 points in the first year of the engagement.
EBT	+4.5 points	<b>Higher earnings growth</b> Companies that outsourced were able to increase the rate of their annual earnings growth by 4.5 points in the second year of the engagement.

Results are statistically significant with 95% confidence interval.

Table 2. Financial performance metrics pre- and postoutsourcing.

## Benefitting from Smarter Sourcing

A Smarter Sourcing approach combines the attainment of process improvement while capitalizing on wage differentials to help produce better desired results at lower costs. As a result, companies not only are reporting significant gains in predictability, productivity, quality and returns based upon these improvement and efficiencies but also greater success of their internal management of globally distributed work. Another benefit of Smarter Sourcing is the reuse of assets which further reduces costs and assists global teams to quickly achieve and tailor results to new circumstances in order to meet new requirements.

Often, a Smarter Sourcing approach will start with a comprehensive assessment of in-house processes, resources, skills and tools to identify areas for improvement. Gaps can also be identified so as to prevent simply relocating broken processes and organizational deficiencies to an offshore location where issues are even harder to identify and resolve.

Teaming with a trusted sourcing provider partner on a Smarter Sourcing approach derives other additional benefits. Organizations gain improved insight into the progress, status and risks of in-flight projects. They are also able to leverage their partner’s best practices acquired from having executed similar projects around the globe with comparable enterprises.

Finally, organizations also experienced enhanced staff morale as a result of transitioning from a staff augmentation model to a Smarter Sourcing model. When fully enabled to perform their jobs more efficiently, employees realize greater job fulfillment. Additionally, consistent processes and methodologies ensure greater precision in the employee assignments, as well as improved identification of the required level of resources, tools and environment needed to realize optimal performance.

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### IBM is partnering with a large global product lifecycle solutions firm on their Smarter ADM journey, resulting in:

- A delivery model of global communities aligned by enterprise process
- A talent management process that manages professional staff through digital reputations
- Global, collaborative-based practices driven by outcome-based measurements and integrated on Web 2.0 applications

Client benefitted with immediate cost savings and productivity improvements and expects to continue to reduce costs by up to 33%.

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### Smarter Sourcing in Action

Today's business demands that rapid paced changes are met head-on and handled, that ever-shortening deadlines are met, and that solutions are built in time and within budget. Reusing assets, re-factoring and modernizing parts of existing application environments helps global teams quickly achieve and tailor results to new circumstances in order to meet new requirements.

To bring these elements together, a new perspective in incenting teams is also being utilized. Developing a reward system that not only recognizes reuse but also allows those team members with the greatest patterns of reuse to grow their reputations among their peers is fostering an atmosphere that companies need to meet these business challenges.

If the methods of achievement are different, then traditional methods of assessing that achievement must also change. Relying on input measures, such as time spent in developing applications, is no longer enough. The contribution from IT must be determined and priced in business terms, based on the outcomes within the business that are achieved. IT must be active partner in providing business value, such as profit and return on assets (ROA).

Enterprises deploying the Smarter Sourcing approach are particularly impressed by how the approach successfully embraces, leverages and aligns the business and human resource environments existent in today's business world.

Two of the Smarter Sourcing components responsible for driving these results are Smarter ADM Communities (achieved through Web 2.0 collaborative communication capabilities) and Smarter ADM Value Realization (achieved through the adoption of a transformative outcome-based performance model).

### Smarter ADM Communities through Web 2.0 Collaborative Communications

Web 2.0 was born out of the need to meet the rapid demands of today's global business environment as well as incorporate the skills, interests and capabilities of today's new workforce. The demand for collaboration across global teams means that older communications techniques such as e-mail and file transfer must evolve into newer methods of communications that can easily involve multiple team members.

This suite of web-based services and communities is characterized by participation, collaboration and the sharing of information among online users. Web2.0 applications include wikis, blogs and social networking sites which encourage user-generated content (USG) and social interaction online. It enhances and captures critical knowledge that in the past was trapped inside individual employees.

Transforming a well established IT function into a process-centric, technology-enabled, multi-geographical organization that is positioned to respond quickly and economically often seems daunting to those embarking on the Smarter Sourcing journey. The recent expansion of social networking (i.e. Facebook, My Space, etc.) has dramatically changed how people interact globally.

Groups of friends are linked together and can share common interests and goals working in near "real time." IT can capitalize on this kind of information exchange in properly designed "communities" using the facilities of Lotus Connections or other socially oriented business applications.

The key is to organize the communities across all process areas of a particular business unit. A proven partner with the proper breadth and depth of experience and global reach can quickly take an enterprise from e-mail oriented communications to an advanced platform rooted in multi-geography business process community-based networking.

Once the connection environments have been established, the actual work must be organized differently. Traditional "waterfall" development and maintenance approaches give way to more collaborative, time constrained efforts. Waterfall development includes separate phases for requirements, design, build, test and implementation. An "agile with discipline" method brings the user community closer to the development while controlling costs through time limited build periods. Most importantly, the active participation of end users in the development and testing processes lowers the cost and accelerates the speed of development of applications. Less rework is required to repair defects and users are more satisfied with the finished product.

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### In order to meet the demand for collaboration across global teams, a client is teaming with IBM to build an integrated Web 2.0 application environment consisting of:

- A community-based social networking application that shares information about individual efforts in an enterprise group and toward project goals rather than individual profiles and activities (using Lotus Connections)
  - A workflow and work element management application that focuses on element re-use and testing project task completions (using Lotus Rational Team Concert)
  - A digital reputation application that maintains profiles of professional contributors and tracks individual achievements in re-use, testing, and deadline management
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In conjunction with development method change, the tools which store the information about work require transformation. While the predictability of a standard project plan is comforting, the information about the individual tasks within it, limits interaction and collaboration. Rational Team Concert and Rational Access Manager, for example, provide functions to assist the collaborative, multi-geographic model to understand and manage the work elements and they enable automated workflow processes, such as enhanced approval processes, exception handling, and escalations.

### Smarter ADM Value Realization through an Outcome-based Performance Model

Once the communities and work aligned, the next step enterprises are taking on the Smarter Sourcing journey is to enable the transformation of the people.

Their orientation is thus changed from that of an "hours-based contribution" to a "task completion contribution."

This Digital Reputation approach is a patented software-enabled approach initiated by developing a profile for each contributor and allowing them to build their individual reputations through specific accomplishments. It finds and rewards top performers based on actual work performed on the associated projects. This is an important change from utilization-based measurements. No longer are the resources focused on "billing time" but rather on "creating outcomes". With the incentive system in place and the technology to support it- the model essentially frees high performers to perform by aligning rewards to outcomes.

IBM itself recently achieved this transformation through the implementation of "Blue Cards." As a result, cycle times were reduced by more than 30% because resources were no longer tied to task completion estimates and could reach out for additional tasks when they finished a previous assignment through a concept called "Free Cycling."

**A Fortune 50 life sciences giant partnered with IBM to develop a structure of support that used problem tickets as a basis for measurements and payments. Using outcome-based objectives in the areas of cost, continuous improvement, flexibility and service quality, the client could then evolve their portfolio and be assured of consistent resources and responses.**

Another concept behind Digital Reputation (and a major contributor to cycle time reduction) is the linkage of resources' reputation to reuse. This is the glue that ties together the productivity gains expected from a Smarter Sourcing approach.

When utilized effectively, the elements of Digital Reputation elements helps capitalize on existing functions and resources, focusing on the shortening of development time and providing more consistency within the environment. This model recognizes top contributors, while assessing the individual quality of the work. Over time, the systematic reuse not only shortens development time but has also significantly reduced maintenance, as well.

This component-based approach also helps prevent the interwoven complexity of legacy applications that can throttle rapid changes in the future. When coupled with integrated platform design and sound architectural structure, the precepts behind Digital Reputation, Free Cycling and reuse can greatly improve the results in any traditional IT organization.

### Where to Begin the Journey – Business Value Assessment

Optimizing the performance of the IT function in these business terms does require a fresh perspective and a fresh approach. A thoughtful, comprehensive analysis of the interlock between IT and its host business organization is a recommended starting point. From there, a plan can be developed and implemented to fine tune the points of connection that IT functions use to stay in tune with C-Suite executives and make sure that the business's opportunities are well supported.

The most important critical success factor of this Smarter Sourcing approach is the implementation of a completely different governance mindset. Because the work is being performed differently and the individual contributors incented and measured differently, both the governance structure and daily execution need to change.

A comprehensive Business Value Assessment, which carefully examines current governance elements in relation to the desired end state of governance is a powerful catalyst towards achieving success. This Assessment can also be used to measure periodic progress, so long as it isolates the individual elements and provides tangible maturity change indicators. This is often the first step organizations take before any transformative journey can be begun.

**A Fortune 50 global delivery and logistics company with more than 800 IT resources around the world had not been able to take advantage of global support and reduced resource costs. Working with IBM on an 8-week in-depth study of the processes in multiple client locations, ratios of technical and project management resources at various skill levels, and the risk/reward ratios of individual applications within portfolios, the client was able to determine were the greatest global sourcing benefits lay and how to develop an array of state-of-the-art processes to manage its global workforce.**

A Business Value Assessment of the current overall environment typically contains at least three main elements:

- A process assessment to determine both the health and adequacy, in a global environment, of the key processes for development and maintenance in the IT environment. The comparison between the existing processes and industry standards, such as those from the Software Engineer Institute's CMMI provides a solid basis to determine required improvements in processes.

- A staffing assessment that examines ratios of the various types of positions found in IT functions relative to peers in the industry. This is particularly effective in companies that have either grown through acquisition or have discrete, self governed business units.
- An application assessment that examines the risks and rewards of implementing a global approach. By determining which applications or complete portfolios have the best risk/reward ratios, decisions can be made about a course of action to address expanded coverage of business days through strategically placed global support and the resulting lower costs.

With a modest investment of time for interviews and the examination of existing documentation by a trusted partner, an organization can then be provided a roadmap for process improvements, as well as a strategy for global applications support.

### Smarter Sourcing Summary

As detailed above, companies are going beyond traditional outsourcing and wage arbitrage in order to embark on a more strategic Smarter Sourcing approach.

This approach ultimately integrates and improves onshore and offshore capabilities while preserving critical expertise to ensure high quality results. It requires the re-engineering of the application development process. It relies on the continuous improvement through introduction and integration of new techniques, methods, tools, and the best resources available to use them. And real enterprise-wide, bottom-line value is achieved when the approach revolves around a close collaboration with a trusted sourcing provider partner.

For those enterprises looking for a wide array of benefits - not just lower labor costs - Smarter Sourcing provides companies of all sizes with a comprehensive, transformative, value-realizing solution.

The benefits include — but extend far beyond — savings. Greater productivity through Digital Reputation and a focus on re-use can significantly improve the responsiveness and capacity of the IT organization to a rapidly changing business climate. The focus on outcome-based results and the building up of the reputations of individual team members within the staff keeps motivation high and provides an excellent means of recognizing top contributors, even in a geographically diverse workforce. Institutionalizing outcome based pricing and results helps to ensure that IT contributions are aligned with business needs and garners the respect of the business community. In today's environment, every aspect of the business is expected to deliver; Smarter Sourcing does just that.

### For More Information

To learn more about IBM Global Business Services, please visit: [ibm.com/services/ams](http://ibm.com/services/ams)



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