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BUSINESS VIEWPOINT

**Take Home Points:****Smartsourcing Defined:**

Leveraging the competencies of service providers in order to achieve a significant increase in total innovative capacity.

Smartsourcing achieves the objectives of lower costs and shorter cycle times while delivering agility and innovation throughout all of an organization's processes.

Smartsourcing is founded on a trusted relationship between the organization and its service partner that supports operational and strategic excellence.

Smartsourcing answers the key question for every organization: not how to be better at what they do, but how to be great!

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Smartsourcing

Doing More With Less

Executive Summary

Can the seemingly contradictory mandates of cost cutting and innovation be integrated? The view presented in this white paper contends that they must be integrated through the use of an innovative strategy called Smartsourcing, which *leverages the competencies of service providers in order to achieve a significant increase in total innovative capacity.*

With economic confidence building once again, business leaders are presented with a unique opportunity to recast their organizations for the next wave of growth.

Technology developments in supply chain, logistics, self-service, marketing, and e-commerce have driven down transaction costs. Coupled with the cost savings realized from the globalization of work and M&A consolidation, it's now realistic to expect enormous efficiencies in supply-side economics, which will drive down the cost of production and delivery for nearly all goods and services.

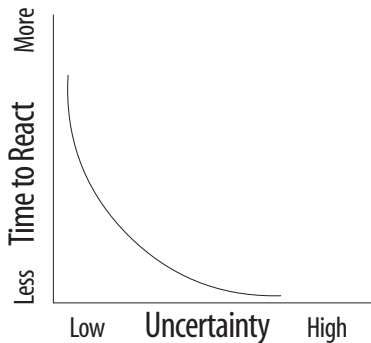
What will this mean for your organization? Managers first need to realize that driving down costs is not an episodic phenomenon. Instead, there is and will be a continuing and accelerating pressure to drive costs down. The mantra of "more for less" was never far from the lips of the CFO, but it is now a manifesto for deep-rooted change.

The answer to hurdling this ever-rising benchmark of productivity and cost reduction lies in a new approach to business process and innovation excellence, that includes:

1. A global view of managing the movement of work within tightly orchestrated business processes;
2. A new smartsourcing model for partnering with service providers that creates higher levels of accountability, innovation, and trust;
3. A sustained focus on shedding non-core activities in order to invest profitability into core competencies; and
4. The development of a new competency and science for Innovation Management.

Our objective in this white paper is to frame this challenge and to describe how *smartsourcing* can take organizations beyond outsourcing to decrease obvious costs and substantially increase business process excellence and innovation through a collaborative partnership—a partnership that responds rapidly to evolving corporate objectives and changes in economic, political, and competitive environments.

Organizations are faced with a quandary. How can costs continue to be reduced while innovation and agility are increased?



The Uncertainty Principle: As uncertainty increases the time to react decreases.

A Moment of Crisis and Opportunity

If the greatest advance in 19th and 20th century enterprise came from the ability to fuel manufacturing and increase productivity by moving workers to where the work was, the greatest advance in the 21st century will come from the ability to fuel innovation and reduce the cost of production by moving work to where the workers are. This is the foundation of the recent move to outsourcing. However, it is only the start of a much deeper revolution that we are calling smartsourcing. Smartsourcing looks at how organizations will need to partner with service providers to integrate competencies in order to achieve substantial innovations across the full spectrum of their business.

To realize the promise of this shift, fragmented business and technology processes must be integrated seamlessly into agile, global enterprise networks - and all of this must happen against an economic backdrop that has created intense ongoing pressure to cut costs.

Organizations are faced with a quandary. How can costs continue to be reduced while process excellence, innovation and agility are increased?

The unfortunate reality is that in a climate of uncertainty and cost scrutiny the natural tendency of most people and businesses is to adopt an overly conservative attitude towards all decisions.

Additional time is typically spent evaluating alternatives and over-scrutinizing investments. In short, every decision gets dragged out. The irony is that uncertainty actually decreases the window of opportunity within which to make decisions. Innovation suffers at a time when it most needs to shine.

As uncertainty and market opportunity accelerate, the time to react shrinks dramatically. Information systems and management methods must reign in the tendency towards conservative decision making by synchronizing the time to react with the window of opportunity.

Accelerating innovation and increasing agility requires management and business systems that keep pace with the velocity of uncertainty coupled with a relentless focus on process excellence across the organization, from core competencies to administrative and operational processes.

By improving the transparency of

Outsourcing	Smartsourcing
CUT COSTS Focuses on cutting costs	CUT COST+ INCREASE INNOVATION Combines cost cutting with increased innovation
STREAMLINE OPERATIONS Focuses on operational areas	STREAMLINE THE VALUE CHAIN Considers the entire value chain
PARTNER ON WHAT YOU KNOW Works well with defined processes	PARTNER TO DEFINE WHAT YOU DON'T KNOW Helps to define all processes from major to obscure
COMMODITIZE Creates homogeneous processes that lack differentiation	DIFFERENTIATE Innovates processes to increase differentiation
TACTICAL IMPROVEMENT Used when markets are predictable	STRATEGIC EXCELLENCE Used to align with shifting markets
DISCONTINUOUS Changes in technologies and architecture are disruptive to the business process	CONTINUOUS Thought leadership combined with constant innovation buffer the business process from technology change
ARMS LENGTH PARTNERSHIP Creates yet another enterprise silo	TRUST-BASED PARTNERSHIP Engenders trust and collaboration leading to greater value

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Business process excellence not only reduces costs, but also increases the speed and integrity of an organization and the quality of the relationships it has with outside parties.

business processes, an organization not only reduces costs but it also increases its speed of execution and quality and integrity of the relationships it has with suppliers. The question, of course, is how can an organization achieve this sort of excellence around all of its processes—those where it has core competency and those where it does not.

Smartsourcing is a comprehensive and integrated effort across the organization's value chain to understand, evaluate, and coordinate the benefits of partnering. From strategic innovation to operational outsourcing, the intent is to leverage the value of partnering through an integrated philosophy rather than to compartmentalize and isolate outsourcing partners.

The Many Faces of Innovation

In every organization there are three fundamental types of innovation: creating new products, services or markets; extensions or feature improvements to existing products, services or markets; and increased efficiencies in existing products or services.

Organizations experience innovation in all three functional areas but typically have a core competency in only one of these areas. Dell Computer is not known for innovating new products, but is world-renowned for the efficiencies of its supply chain operation. Apple Computer is known for its innovative product design, not its manufacturing. Many pharmaceutical companies outsource everything from product development right on through to clinical trials, and innovate solely in marketing and sales.

One of the first mandates for any organization attempting to achieve process excellence is to clearly identify which of these three types of innovation represent their core competency (i.e. separate the core innovative differentiators of the business from those that are the operational outliers).

An interesting outcome of this analysis for most organizations is that while the areas of core innovative competency may be the source of top-line growth, it is often the non-core areas that consume the largest percentage of your precious resources and management time. Non-core areas consume resources and starve the innovation of your company and are responsible for shrinking or stunting bottom-line growth

Take the classic case of healthcare. While diagnostics and patient care may be the core competency of most healthcare providers, it is the support and maintenance of facilities and administrative functions that are often the linchpin for holding down costs and achieving near-term profitability and process excellence. The predicament for a healthcare provider is how to leverage innovation in their area of core competency (diagnostics and patient care) while also being best-of-class in the support of their patient facilities and processes.

Smartsourcing enables an organization to focus on its core competency while its outsourcing partner takes responsibility for innovating change

An interesting outcome of this analysis for most organizations is that while the area of core innovative competency may clearly be the source of top-line growth, it is the non-core areas that are most often identified as the cost centers of the organization, responsible for shrinking or stunting bottom-line growth.

and cost control in non-core operations. For example, at Harvard Pilgrim Health Care, Inc., a not-for-profit New England health plan with 800,000 members and 22,000 physicians, smartsourcing was used to create innovations in how claims were processed. In addition, creative IT initiatives were used to develop a secure Web application that allows members to enroll, select physicians, view benefits and eligibility information, update family information, and order ID cards online.

By focusing the service partnership specifically on core strategies and processes, the result was an overhaul of Harvard Pilgrim's claims processing systems as well as its overall IT operations. While traditional outsourcing may emphasize replacing systems and bodies, smartsourcing focuses on the core areas of innovation in which an organization must excel to differentiate itself. Through smartsourcing Harvard Pilgrim achieved excellence across its entire spectrum of innovation.

The Smartsourcing Decision

The greatest risk in traditional outsourcing is ignoring a concurrent innovation initiative - this is simply being short-sighted. While outsourcing will often deliver reduced costs, the focus of outsourcing is too often replicating the status quo. Improving process excellence and promoting innovation are not prime objectives of the outsourcing process, although a good partnership may yield dramatic improvements. Smartsourcing, on the other hand, is accompanied by a renewed attention on excellence and innovation among the organization's core process initiatives. This sort of partnership not only achieves cost savings, but it also establishes preeminence and differentiation. We see the combination of these capabilities as being central to the shift from outsourcing to smartsourcing.

The fundamental questions that need to be answered at this point in order to begin understanding where smartsourcing can be of potential value to an organization are:

1. How core is each aspect of your business to your unique strategic differentiation?
2. How good or innovative is your organization at each of these business areas - or, simply put, what is your core competency?
3. How cost effective are you at the activities in each business area and how much customer value do these processes add?

The answers to these questions offer a great deal of insight into those areas that are best suited for outsourcing and those that must be the focus of internal innovation. A smartsourcing partner should help in all of these areas.

There is, however, an important caveat to this exercise, which has been often ignored at the peril of organizations pursuing outsourcing, namely that outsourcing implies absolutism. Conventional wisdom favors shedding

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Focus on Innovation

Every organization must answer these questions about its processes in order to understand the full impact and benefit that smartsourcing can have:

Customer Value

How much value does the process add to your customer relationships, lifetime customer value, and market responsiveness?

Differentiation

How critical is the process to your competitive advantage as a distinct provider of this product or service in the marketplace?

Competency

How core is the process to your specialized skills, culture, and market brand?

Un-Awareness

In a study conducted by Delphi Group, 50% of respondents indicated that a good idea had more chance of ending up in a startup or with a competitor.

Ignoring good ideas doesn't kill them - it just drives them to competitors.

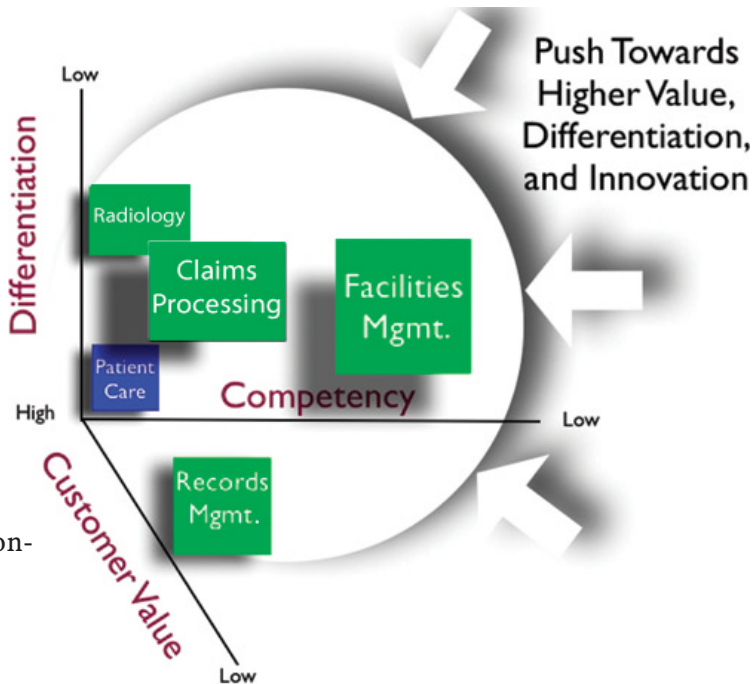
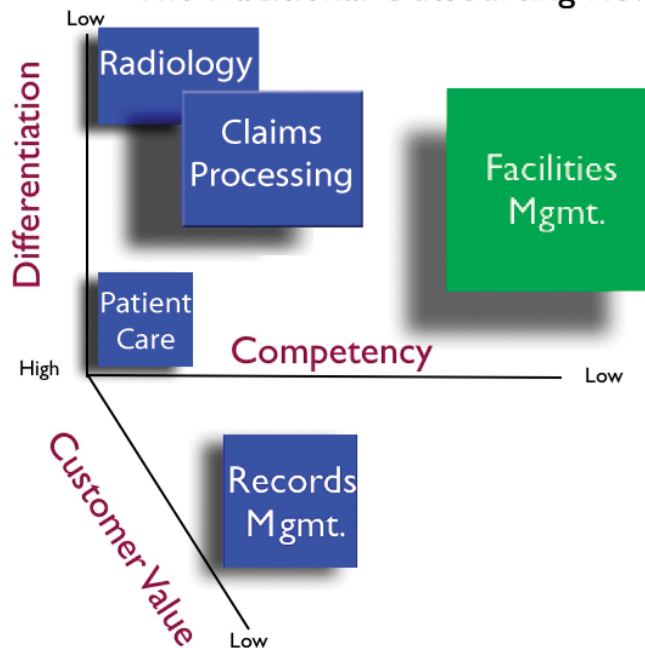
Smartsourcing allows organizations to focus on these good ideas and manage their core strategic innovations with higher levels of awareness while working closely with a service partner to identify innovation for their operations.

Many organizations who pursue an outsourcing relationship operate under the premise that there are a core group of distinct and separate processes (shown here in green) that are candidates for outsourcing. While this can result in dramatic cost savings, it limits the ability of an organization to fully focus on its core

competencies, since much of its time and effort is still expended on peripheral processes that do not add high customer value or differentiate the organization in its industry. For example, in this illustration, the health care provider should focus on the core competency of Patient Care.

A smartsourcing strategy creates a much more intimate relationship between the organization and its service partner. Smartsourcing increases innovation throughout the range of process from core to non-core, allowing organizations to focus on critical areas of differentiation and customer value, while also achieving high levels of innovation in non-core operations.

The Traditional Outsourcing View



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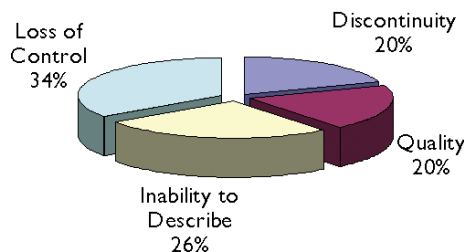
An open collaboration and a high level of transparency are critical to establishing the sort of communication, trust, and long-term understanding of the benefits smartsourcing can bring to the table.

messy and expensive processes to third party experts, who will operate in a black box. Nothing is further from the truth. In fact smartsourcing requires a much more intimate bond of trust, collaboration, and accountability between the organization and its smartsourcing partner. This partnership may result in higher levels of innovation in core as well as non-core processes. In many ways the smartsourcing partner becomes a watchdog for operational excellence and cost reductions, while off-loading the organization of this burden allows it to refocus attention on core innovative activities.

In addition, this sort of partnership opens the doors to new opportunities for outsourcing processes that otherwise may not have been considered as candidates for outsourcing.

Savvy smartsourcing partners not only encourage this sort of relationship but work collaboratively on an ongoing basis with their clients to identify the areas that are best suited to outsourcing. An open collaboration and a high level of transparency in this exercise are critical to establishing the sort of communication, trust, and long-term understanding of the benefits that smartsourcing can bring to the table. In many cases this means complete disclosure on the part of the smartsourcing provider of the costs and business models used to determine the pricing and performance benefits for an engagement.

Reasons Not to Outsource



But transparency of this sort requires a solid appreciation for the business process being outsourced and a methodology by which to adequately describe, monitor, and manage the outsourced process candidates.

Trust at Center Stage

If the first step in business process excellence is understanding the process, then the final step must be developing a new level of trust and intimacy between organizations and their outsourcing partners. Innovation requires intimacy, and it is inherently a trust-based process that demands exceptional integrity of the participants.

In this respect smartsourcing is a sea change from the traditional model of outsourcing that has been heavily commodity-based. Smartsourcing must achieve a level of intimacy and integration with the core business processes, philosophy, and culture. While this may seem to obviate the need for partnering, it instead changes the model from a pure commodity outsourcing to a critical partnership integrated at the highest level of the organization. For many organizations taking this approach blurs the line of demarcation between partner and enterprise. In the words of one CIO, the service provider becomes a “true technology teammate.”

The role of the smartsourcing partner in this context is that of a trusted advisor and executive-level team member with shared values and shared integrity, rather than simply that of a contractor for-hire. In some cases

A recent Delphi study found that the two top reasons cited for not using outsourcing were loss of control over the process and an inability to describe the process.

Business process excellence through smartsourcing provides a much better understanding of the organization’s processes, performance metrics, failings, and nuances.

If the first step in business process excellence is understanding the process, then the final step before succeeding must be developing a new level of trust and intimacy between organizations and their outsourcing partners. Innovation requires intimacy; it is inherently a trust-based process that demands exceptional integrity of the participants.

Smartsourcing helps you to refocus your business on its core mission and competencies, objectives which may have been long obscured by the fog of technology but which have always been the core that separates the leaders from the laggards in any industry.

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DELPHI
G R O U P

10 Post Office Square, Boston, MA 02109-4603
V: (617) 247.1511
F: (617) 247.4957

www.delphigroup.com

this is taking the shape of actually outsourcing the CIO or CTO role as part of the BPO initiative.

A Turning Point

There are, of course, wild cards in all of this. For example: global labor costs could go up faster than productivity headcount reductions. Government behaviors, with respect to outsourcing, could become more protectionist, limiting globalization. Slow ramp-up of offshore infrastructure needed to support outsourcing could limit globalization. And, counterintuitive economic effects could drive deflation resulting from intense cost-based competition among high productivity suppliers. Still none of these should stop an organization from pursuing a smartsourcing strategy any more than they should stop it from pursuing any other competitive mandate.

Your organization is in a competitive arms race to build the fundamental enterprise information technology architecture that will allow you to deliver on the promise of productivity. But at the same time, the intense changes and discontinuity of IT solutions have created a heavy cost, measured not only in profit, but also in opportunity cost and reduced innovative capacity. The burden to develop and maintain this costly and volatile infrastructure is a steep barrier making it harder to respond to the increasing pressure to do more with less.

Smartsourcing helps you to refocus your business on its core mission and competencies, objectives which may have been long obscured by the fog of technology, but which have always been the core that separates the leaders from the laggards in any industry.

You may have built new enterprise systems, optimized your supply chain, and invested in Six Sigma and ISO operational excellence, but chances are most of your competitors did, too. So any potential advantage from these strategies has been fleeting. Short-term differentiation along the periphery of your business does not create long-term preeminence at its core.

You are now at a turning point. It is time to reinvest in those areas that make your organization not just better but those core competencies that make you great.

Smartsourcing provides the framework and the focus you need to achieve this preeminence. ■

Contact the author, T. Koulopoulos at tk@delphigroup.com

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