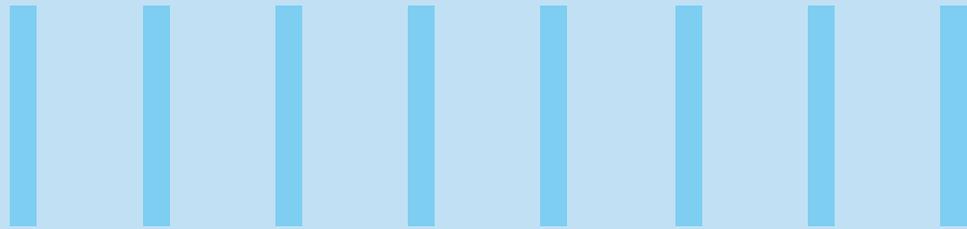




STRATEGIC SOURCING: DESIGNING YOUR RETAINED ORGANIZATION

Considerations and Best Practices
January 2017



Increasingly business and IT leaders are leveraging strategic sourcing solutions to reduce costs and access new technologies and best practices. The retained organization lies at the heart of moving from an in-sourced or staff-augmentation model to a Managed Services sourcing model. This shift requires significant changes not only to the way business and IT processes are delivered, but also to how the retained organization is structured and managed for success (Figure 1).

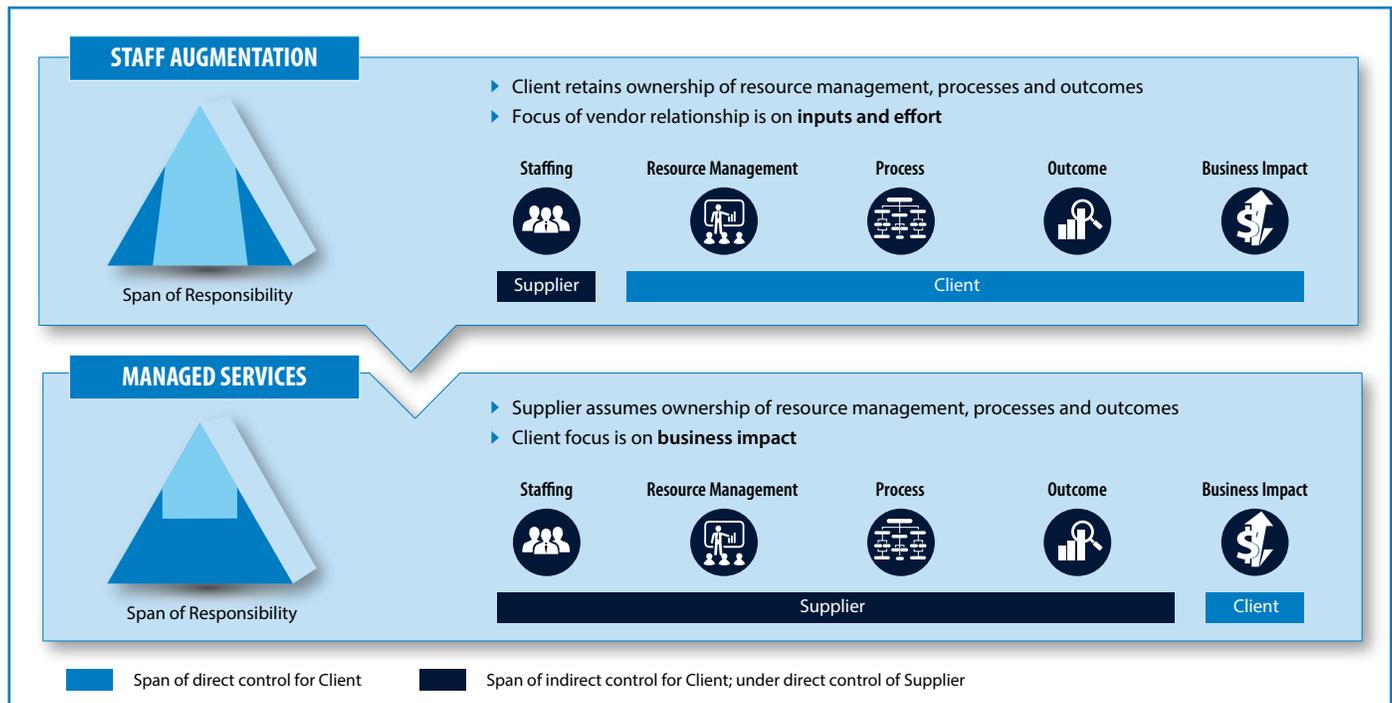


Figure 1: Shifting Control and Business Focus

The purpose of this paper is to highlight key considerations in designing and implementing an optimal retained organization for a single-vendor (sourcing partner) solution. Although each organization is unique, there are best practices for defining, sizing, staffing and enabling a retained organization.

Too often, organizational design efforts focus solely on the organization's structure (reporting relationships, power and decision making authority) in an effort to finalize staffing decisions. The hope is to reduce churn and bring focus to the organization during a period of significant instability. While this initial objective is usually met, other hidden impacts to productivity and effectiveness can emerge (e.g. failing to clarify the group's strategy and vision can lead to organizational confusion with teams pulling in different directions; failing to clarify the retained organization's core competencies can lead to an ill-defined structure that loses ownership of critical functional components) by not aligning to these key considerations:

- What is the strategic role and purpose of the impacted organization?
- What will the retained organization structurally look like and how will it operate, relative to the business organization, supplier and other partners?
- How large should the retained organization be?
- What roles and responsibilities will be required in the new service delivery model?
- What skills and competencies will be needed to successfully perform the new roles?

Design Process

We have found that clients who follow a thorough process to ensure alignment of these considerations experience less disruption during transition and ultimately realize the benefits of global sourcing programs more quickly.

The retained organization design process can be addressed in three phases (Figure 2). The overall goal of the process is to ensure that the organization has the right people, with the right skills, in the right roles to deliver the program's expected business results.



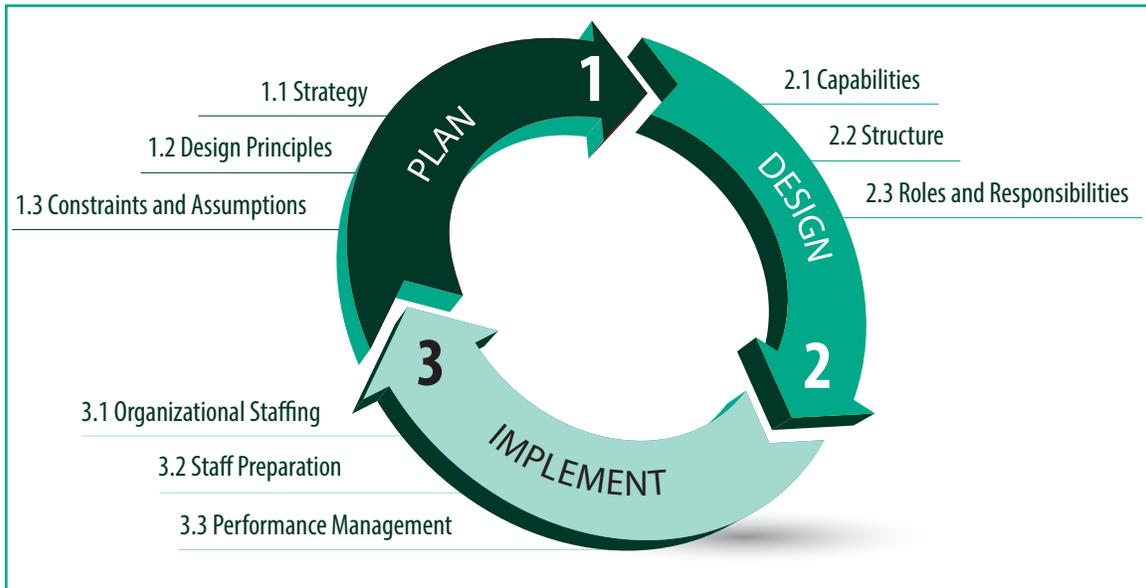
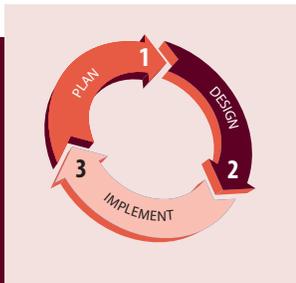


Figure 2: Retained Organization Design Overview



PHASE 1 – PLAN

The first phase of retained organization design focuses on assessing strategic direction and establishing design criteria that will be used to anchor and test decisions made throughout the design process. In this phase, the leadership team articulates a clear picture of the future state and its objectives and defines how the retained organization will operate to achieve those objectives. The output of this phase also defines boundaries to guide the design process.

1.1 Strategy

Whether an organization is sourcing for the first time or re-competing an existing contract, it first needs to consider its sourcing strategy and how it aligns to its business needs. Issues often arise when clients skip this step and jump straight to the tactical details of a transaction. Having a clearly defined strategy allows the organization to understand its future direction and role and enables informed decision making for the retained organization. For example, identifying which specialized or core functions/skills to retain and which commoditized or non-core functions/skills to source is a fundamental design decision that must be consistent with the overall strategy.

The following key questions will assist clients to explore the desired outcomes for the new retained organization:

- How do we define our service proposition to our customers? How do our customers define it (i.e. how do they perceive us)? How should that change?
- What kind of customer focus do we currently have? What should we have?
- Do we deliver a differentiated customer experience? If not, what is our vision for doing so?
- Is our primary goal cost / process efficiency or do we view IT / business process redesign more broadly as a source of competitive differentiation (e.g. by leveraging new technologies, delivering market solutions faster, etc.)?

1.2 Design Principles

Design principles define how the organization will operate in order to fulfill its strategy. These principles shape the development of organizational design alternatives, resolve disputes about various design options and inform decision making about other organizational elements in the design process. In other words, principles describe what the retained organization will accomplish. They are not platitudes or industry truisms, but specific statements focused on the organization's core issues and business drivers. Some of the key questions to consider when developing principles include:

- What key challenges are we facing? What are the highest priority issues that we must get right?
- What activities must we start doing that we do not presently do? What must we stop doing?

- What key results are we trying to achieve and when? What problems are we trying to fix? What performance objectives are we trying to meet? What does success look like?
- What aspects of the organization must be retained? What can be transferred or shared? To what extent?
- What relationships (internal and external) are critical for success and how will we ensure that?
- What HR policies (e.g. rewards and incentives) should we consider to support our strategic objectives?

1.3. Constraints and Assumptions

When setting direction, it is useful for leaders to clarify the limits or scope of the design process. These are the boundaries that establish what is to be addressed in the design process and what is not. For example, there may be policies that specify a desired or minimum span of control for management positions. Structural changes may also be constrained by existing legislation in various geographies in which the organization operates (e.g. some countries have legal frameworks that protect employee rights, thus impacting the retained organization). Other Human Resource policies, practices and information flows also need to be

considered including “no go” areas; that is, specific parts of the organization that should not be disrupted - at least not initially - due to mission criticality or other legitimate business reasons.

Leaders will also want to ensure that any boundaries or limits of the design process are based on valid assumptions and should be explicitly stated. For example, questioning a pre-determined span of control constraint may be perfectly valid considering that the new model requires fewer staff and/or because impacted work units will require fewer people based on a higher skill mix. Giving the design team clear boundaries and valid assumptions ensures maximum productivity throughout the design process.



PHASE 2 – DESIGN

It is instructive to note here that the activity most often associated with retained organization design – the structure itself - is the midpoint of the overall process. This gives an indication that: (1) Effective organizational design is based on first understanding the strategic objectives of the sourcing model and the operational requirements needed to execute it, and (2) The new operating model goes well beyond an org chart to include other foundational elements that enable the structure to come to life.

2.1 Capabilities

An inventory of capabilities catalogs the service delivery activities that must be addressed by the client / supplier partnership (Chart 1). This inventory requires consideration of work flow and interfaces within and outside the organization. Frequently, design teams will encounter work processes with interdependencies across client and supplier teams. This is also an opportunity to rationalize work based upon impact and value.

The next step is assigning accountability for each capability, e.g. retain in house, transfer to the sourcing partner, or share between the two entities. Shared responsibilities require additional discussion to ensure that the expectations of both parties are well understood and agreed upon; for example, defining when one party’s responsibility ends and the other’s begins. Partnering with the sourcing partner on this critical exercise avoids duplication of effort and misunderstandings and allows the teams to begin collaborating on future state roles and responsibilities.

IT Lifecycle Stage / Function	Retain In-house	Joint Responsibility	Transfer to Sourcing Partner
Business Relationship Management	✓		
IT Strategy and Planning	✓		
IT Architecture and Design	✓		
Application Planning and Design	✓		
Business Process Planning and Design		✓	
Middleware Interface Use Case Design		✓	
User Test Case Design		✓	
GUI Interface Design and Test		✓	
Unit and Regression Test		✓	
Systems and Integration Test			✓
Application Performance Analysis			✓
Application Coding			✓
Application Testing			✓
Application Maintenance			✓
Production Support			✓

Chart 1: Inventory of In-Scope IT Capabilities

2.2. Structure

This exercise helps determine the size and shape of the retained organization. The “To Be” structure reflects the logical groupings of retained capabilities and their associated workgroups (e.g. by product, market, process, skill set, etc.). From a sizing perspective, retained teams that are too large risk duplicating efforts with the sourcing partner and/or unnecessarily micromanaging the partner. Under-staffed retained teams, on the other hand, cannot effectively fulfill their mission of vendor management, timely decision making, strategic planning and customer engagement. Both conditions undermine the business case. While there is no golden rule to determine optimal size, Infosys recommends, as a best practice, sizing the retained organization between 10% and 20% of the overall FTE scope of the global sourcing program. This range might be considered an aspirational goal for “Generation 1” outsourcers and well within

the comfort zone of “Generation 2 or 3” outsourcers.

To further optimize the size of the retained organization several key factors should be considered (**Chart 2**).

2.3 Roles and Responsibilities

Retained functions and business processes need to be translated into retained roles and responsibilities. Retained roles do not operate in isolation but fit into “end-to-end” workflows that fully integrate and leverage the sourcing partner and its respective roles. This presents an opportunity to make design choices that refine the retained organization in terms of structure and decision rights.

Clients have adopted a variety of choices related to the structure of their retained organizations. Some organize around functions or processes, others choose to align around internal or external customers and markets. They often seek to balance the control and efficiency of hierarchy with

the speed of decentralized decision making.

When making choices regarding the structure of the retained organization, clients are advised to use the design principles created earlier as a guide and mechanism to test the underlying assumptions of the proposed structure. Design leaders will often review alternative structures and assess whether the alternatives fit within the established design principles, allowing them to develop and exploit the organizational capabilities needed for success.

Once an organizational structure has been determined, it is recommended to test how the organizational design will enable key business processes. Clients will often develop RACI models for key business or IT processes to perform these tests. RACI models provide a map of a key process with a view of the tasks, roles and decisions involved. Use cases (functional scenarios) are also used to validate the new organizational model. This step allows for testing of assumptions and

Retained Organization Factor	Factor Definition
 Geographic Scope	<ul style="list-style-type: none"> If client’s on-site resources reside in multiple geographies, more than one position may be needed for a given role
 Staff Transfer Inclusion	<ul style="list-style-type: none"> If key client personnel are transferred to the vendor, fewer retained resources may be needed since client experience and expertise will shift to the supplier’s on-site team
 Multi-Vendor Governance Structure	<ul style="list-style-type: none"> More vendors require the client to assume more control, effort and/or resources to manage multiple sets of SLAs and OLAs (common to 3SIAM environments)
 Client Sourcing Maturity Level	<ul style="list-style-type: none"> Clients experienced in strategic sourcing may be able to leverage an existing structure to support the new program during steady-state
 Client Risk Tolerance	<ul style="list-style-type: none"> Risk averse organizations will apply more internal controls to avoid potential business, stakeholder and other operational risks
 Type of Outsourced IP	<ul style="list-style-type: none"> IP sensitive information may require more retained staff to manage, whereas non-sensitive information can be easily managed by the sourcing partner and/or 3rd-party contractor
 Scope of Sourcing Solutions	<ul style="list-style-type: none"> The scope of the sourcing solution (ADM, IO, BPO and combinations thereof) affects the need for management controls
 Complexity of Business Requirements	<ul style="list-style-type: none"> The number and type of applications, infrastructure technologies and/or supporting processes, in addition to the client’s organizational complexity, will influence the size and composition of the retained team
 Client Comfort Level with Strategic Sourcing	<ul style="list-style-type: none"> Clients with little or no sourcing experience or who lack confidence in vendor delivery will apply additional mechanisms to manage the vendor relationship

Chart 2: Retained Organization Factors

can later be published to deliver clarity around design intent, decision making and accountabilities. Without clear accountability and decision making, several negative effects can result including:

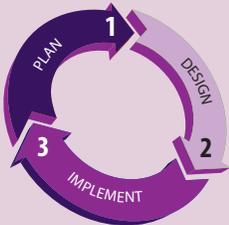
- Duplication of activities in different parts of the retained organization or between the retained organization and sourcing partner
- Outcomes are not accomplished or are not aligned to business requirements

(organizational confusion between effort vs. results)

- Performance measures are misaligned (staff work on the wrong things)
- Position profiles are unclear

Retained roles and responsibilities should also map to ⁵position profiles and ⁶competency frameworks to enable ongoing career development and performance management. Although this

is a fundamental tenet of Organizational Effectiveness, too often clients defer this analysis or stop once the structure has been defined. Making structural changes but neglecting to clarify new roles and responsibilities and expected behaviors risks misalignment. Developing and sustaining long-term organizational effectiveness becomes more difficult when only the structure exits.



PHASE 3 – IMPLEMENT

Moving to a Managed Services model involves a fundamental shift in responsibility from focusing on tactical efforts to focusing on higher value, strategic efforts (Figure 3). Practically speaking, this means allowing the sourcing partner to manage the detailed IT operational activities for which it has been contracted, while the retained team spends more time interfacing with internal clients to manage demand / requirements and set IT strategy and direction.

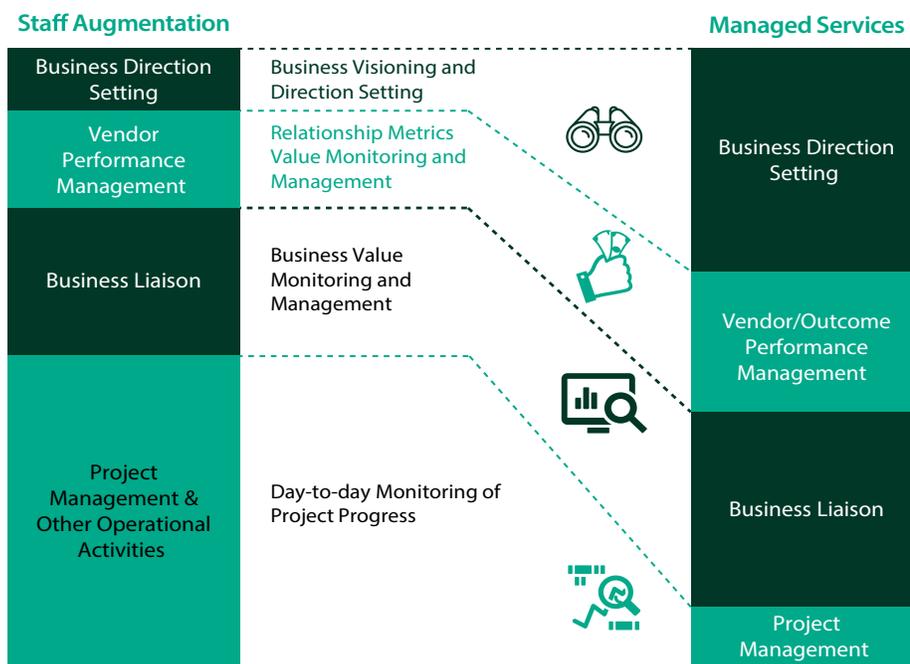


Figure 3: Shift in Responsibilities

As organizations move along the sourcing maturity model, time invested in tactical activities or process execution decreases, while time invested in activities related to setting strategic direction, managing customer relationships and service delivery performance increases (Figure 3). Since the retained organization plays the critical role of oversight, the transition from tactical to strategic responsibilities should be in place before formal cut over. Otherwise, the organization risks reduced operational efficiency, increased cost and attrition of key staff and misalignment with internal or external customers.

3.1 Organizational Staffing

There is an intrinsic shift in the organizational capabilities and skillsets required to manage the day-to-day operations of outsourced functions when organizations move from managing resources to managing outcomes (Figure 4).



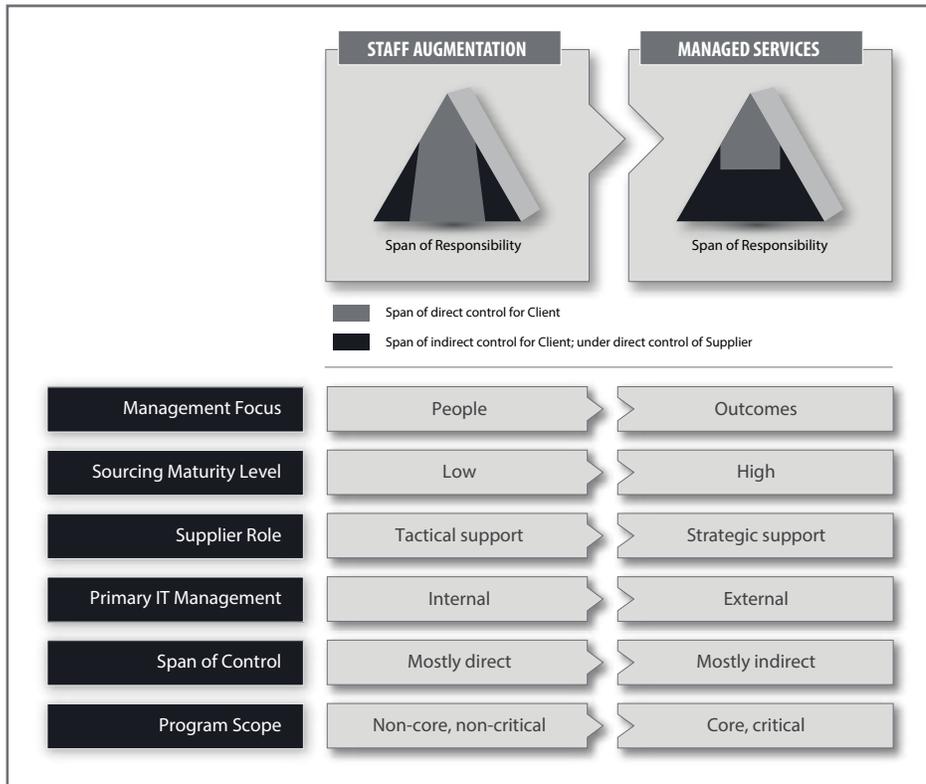


Figure 4: Sourcing Organizational Maturity Characteristics

fair and objective process that is transparent and less susceptible to legal challenge.

3.2 Staff Preparation

The assessment and selection results can also surface individual and organizational skill gaps. These gaps should be used to identify training requirements. Unfortunately, some clients fail to design structured training programs around the retained organization's new roles (i.e. required skills, competencies and behaviors). This can undermine the organization's ability to successfully operate in the Managed Services model because staff will naturally revert to what they know best which is operating in the old model. This can manifest itself in several negative ways, such as executing duplicative or shadow roles, micromanaging the sourcing partner, failing to engage and develop internal client relationships, set strategic direction, etc.

Take, for example, a Senior Software QA Manager who had been responsible for managing a large team of test engineers for several years, and who is now being asked to perform in a very different environment. Shifting away from a *service delivery, direct team management* role toward one focused on *vendor management, strategic planning and business integration* may be considered radical and destabilizing, if not properly managed, and does not happen automatically. Preparing the retained team to make this shift is a critical change management challenge; clients should strive to clarify how the new organization will "look and feel" and how career paths and performance expectations will change.

3.3 Performance Management

Measuring success for the retained organization is a complex task. A basic set of success measures common to most organizations include:

- Meeting financial targets for the sourcing program (including the costs for the retained organization)
- Service delivery excellence
- Enablement and ownership of the enterprise service delivery platform, vision and direction

The skillset required to effectively manage external partners and outcomes is distinct from those needed to manage IT operations internally. Regardless of role, some of the critical skills and competencies typically needed when shifting to a Managed Services operating model include:

- Strategic thinking
- Business relationship management
- Managing across globally distributed teams
- Achieving / managing results indirectly through others
- Organizational skills – project planning, scheduling, budgeting, etc.
- Cross-cultural sensitivity
- Effective inter-personal and communication skills when operating in a diverse workforce environment

Selecting the right people for the right role is a critical success factor for the new organization. A common pitfall is overlooking the need to conduct a formal assessment based on the assumption that high performers in the old model will be high performers in the new model. In fact,

retained staff need to make significant changes to accommodate the fundamental difference of managing an internal service delivery model vs. an externally sourced model. Generally speaking, the new model places greater emphasis on business management skills and less on technical management skills; as a result, some highly valued legacy skills will no longer be relevant in the new operating model. Clients need to understand this so both employees and managers can make informed staffing decisions.

For example, some staff - particularly high performers - may opt out of roles they do not consider challenging or interesting, or that simply lack a defined career path. For this reason, a best practice is to use a robust staff assessment and selection process. The process should ensure existing staff are evaluated against defined skills and competency levels. The criteria for these levels should include relevant business, technology and managerial skills, as well as a screen for the ability to operate in an indirect management environment that involve multiple cultures and communication styles. This approach will ensure that the organization has the right staff in the right roles. It will also ensure a

These three dimensions must stay in a classic state of equilibrium. A lack of focus in one dimension can cause the other two to become imbalanced, ultimately leading to a de-stabilized strategic sourcing program.

Meeting Financial Targets

Retained organization designers may be tempted to meet financial targets by creating a very lean retained organization. It is important to observe that sourcing a very high number of incumbent staff (i.e. > 90%) and retaining a very small number of staff to manage the core capabilities described earlier must be a deliberate decision that reflects both the organization's overall IT / Business strategy as well as its tolerance for operational risk. Understanding the tradeoffs between financial and operational performance / risk are key when determining the size and composition of the retained organization.

Sometimes, financial targets may not be purely cost driven, with success measured in business value. It is important to note here that the retained organization should not be carved-in-stone, nor should it be expected to operate optimally on day 1 (effective date of the contract). It needs to flex in capability and effort depending upon the stage and characteristic of the strategic sourcing program, as well as the evolving needs of the organization.

Managing performance of the retained organization typically involves a new or revised rewards and incentives structure as well. These programs can be focused at the organization, function, process and/or individual level. They reflect the strategic objectives of the sourcing program and reinforce new behaviors and roles for retained staff. Although this is situationally dependent and unique to each client, our experience in Managed Services transitions is that these programs play an important role in motivating and reinforcing change adoption.

Service Delivery Excellence

This critical dimension measures external satisfaction levels among users, consumers and business stakeholders of the strategic sourcing program as well as internal employee satisfaction levels among retained staff. SLA compliance, while important for establishing contractual performance standards, does not reflect the quality of service delivery in and of itself or the health of the partnership. The degree to which stakeholders perceive that the partnership is delivering intended benefits is a better indication of long-term success. Such benefits typically include:

- **Scalability:**
The ability to economically meet demand growth

- **Speed to market:**
The ability to accelerate business strategy implementation
- **Service quality:**
Improved service capability, consistency and expertise
- **Innovation:**
Access to new technologies and business process transformation

Enabling the Retained Organization and Sourcing Partner to Work Together

How well the retained organization and sourcing partner work together is also a critical success factor. Credible sourcing partners should be prepared to provide workshops and training sessions that prepare, enable and accelerate teamwork with the retained organization staff and key business partners. Relevant topics include:

- **Defining an effective retained organization: structure and composition**
- **Applying effective global sourcing communication best practices**
- **Assessing potential for attrition and developing mitigation strategies**
- **Conducting cultural alignment, Managed Services and high performance teaming sessions**





Conclusion

Successful organizations continue to look to Managed Services sourcing strategies to realize their business objectives. The retained organization is critical to achieving these objectives and serves as the foundation for success in leveraging this model. Ultimately, winning organizations take a strategic and thoughtful approach to designing, staffing and managing their retained organizations and working jointly with their sourcing partners to meet these objectives. Indeed, the retained organization is much more than issuing new business cards or connecting boxes with lines on a new org chart; well-designed retained organizations reflect a clear understanding of the interrelationship among the various design elements discussed previously, such as capabilities, roles, culture, etc. Simply put, the best designed organization cannot succeed without having the right people with the right skills in right roles to effectively manage transition issues in the near-term and deliver sustained business benefits in the long-term.

References

1. Other sourcing models such as multi-vendor share many of the same considerations, but there are important distinctions that are the subject of a separate white paper.
2. In an IT organization, decisions regarding IT strategy, enterprise architecture, demand management / project prioritization, etc. are typically retained, with the supplier providing advisory support.
3. Service Integration and Management (SIAM) refers to a multi-sourcing model.
4. Application Development and Maintenance (ADM), Infrastructure Outsourcing (IO), Business Process Outsourcing (BPO).
5. Position profiles and job descriptions capture the purpose and accountability of each work unit, clarifying who does what.
6. Competency frameworks define the knowledge, skills and abilities required to effectively perform each role.

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Related Viewpoints

- "Global Sourcing: Understanding the People and Organizational Capabilities Needed for a Successful Transformational Journey," 2008.
- "Organizational Change Management and Global Sourcing – A Winning Combination," 2005.

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