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Strategic Analysis Report
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Sourcing Strategies: Relationship Models and Case Studies

Pushed by tactical problems, pulled by strategic trends, overwhelmed by sourcing complexity, enterprises struggle with their sourcing strategies. This Strategic Analysis Report *provides the complete framework focused on the alternative relationship models available to implement a sourcing strategy, as well as some sample strategies.*

Management Summary

While the current economic downturn and climate of uncertainty push enterprises toward outsourcing IT services for the tried-and-true need to cut costs and increase IT efficiencies, what is really going on behind sourcing decisions is far more complex than that. Sourcing is moving toward becoming a strategic tool for enterprises to evolve into the connected economy. Two trends are pushing sourcing to be strongly connected to the business strategy:

- The need for improved business processes
- The necessity for strong IT management

Pushed by market competition, enterprises must become more focused, streamlined and IT-intensive. However, the collection of today's tactical sourcing decisions will soon become unable to cope with the strategic requirements that enterprises have. Proceeding with a tactical approach to outsourcing will increase the number of unsuccessful sourcing deals that will damage — not streamline or improve — the business.

Gartner's *Strategic Analysis Report*, *"How to Build a Sourcing Strategy,"* R-18-1099, 23 September 2002, details Gartner's view of — and practical suggestions on how to develop — a sourcing strategy for IT and business processes (BPs). It also includes a framework to assess an enterprise's sourcing strategies and sourcing strategy capabilities.

As part of this methodology framework, this *Strategic Analysis Report* presents the result of years of research and analysis on sourcing relationship models, utilized in different ways and for different objectives all around the world. For each of those relationship models, this report provides positive and negative aspects, samples of real organizations using these models for IT and BPs, as well as Gartner's Strategic Planning Assumptions for the use of such relationship models.

In addition, to allow business and IT managers to truly understand and see what a sourcing strategy looks like, real strategy samples are presented at the end of this report as well.

Because sourcing decisions are usually huge and impact the business organization for a long time, a negative aspect of sourcing is that each organization makes relatively few significant sourcing decisions.

That means that executives and managers are often facing the first — or one of the first — attempt to leverage sourcing as a strategic weapon, and that makes the likelihood of mistakes significantly higher than in other practices.

As the overall samples provided in this report clearly demonstrate, an important market trend exists in sourcing strategies: "more outsourcing" and "more leverage of competition."

Nevertheless, the different sourcing strategies are clearly demonstrating that a sourcing strategy is always based on an individual case:

- The starting point is different.
- The vertical industry and, therefore, the vertical market business requirements and issues are different.
- The country, business culture and legal, financial and taxation requirements are different, building to a different solution or different path-to-solution.
- As a sourcing strategy progresses (a matter of years, not months), the business changes, the competition increases, the internal know how evolves and the technology advances.

All of this makes a sourcing strategy not a fixed story, nor a make-or-buy decision, nor an evolution toward a defined steady state.

A sourcing strategy is a continuous journey into the best balance between internal and external activities, services and know how. It is a continuous alignment between business strategy, business processes and IT services on behalf of the organization's strategic achievements. It is the researching of a path that always keeps a balance between the decisions an enterprise must make, the results that must achieved and the future options open to be taken when necessary. It is an instrument for flexibility; not a rigid decision or a static outsourcing contract based on a service provider's brand.

A sourcing strategy is a process, not a one-off decision.

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FIGURES

1.0 Introduction

As part of their externalization strategies, worldwide and European organizations are using, and will continue to use, not only outsourcing but also different intermediate models. This report describes these alternatives that are part of the Gartner framework for building a sourcing strategy for IT and BP.

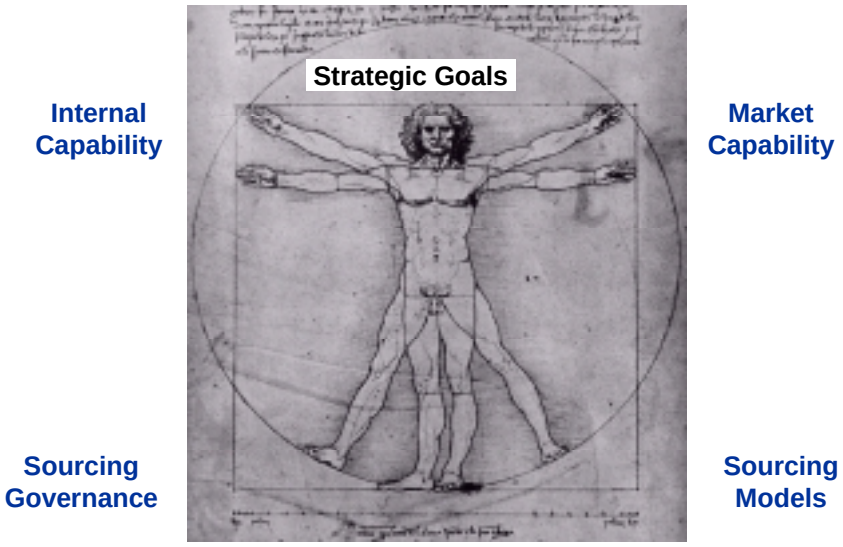
Gartner's definition of strategic sourcing: Strategic sourcing is the dynamic delivery of internal and external, business-oriented or IT-oriented resources and services to ensure that business objectives are met. Strategic sourcing includes four major phases:

- Sourcing strategy
- Providers evaluation and selection
- Contract negotiation
- Sourcing management

Although in the past 20 years most of the focus has been in phases two and three (selection and negotiation), currently leading organizations are focusing mostly on the first and fourth phases: continuously aligning and managing sourcing toward the changing business needs.

Gartner's definition of a sourcing strategy: The set of scenarios, plans, directives and decisions that dynamically defines and integrates the internal and external resources and services required to continuously fulfill an enterprise's business objectives. A sourcing strategy is built by exploring the five main dimensions of the strategic sourcing world:

- Business goals
- Internal capability
- External market capability
- Sourcing models
- Sourcing governance (see Figure 1)



Source: Gartner Research

Figure 1. The Five Dimensions of a Sourcing Strategy

Vitruvius' man from Leonardo da Vinci: Vitruvius, in his "De Architectura," described a person as part of the anthropomorphic measurement system of that age, to be inscribed in both a circle and a square. Leonardo da Vinci represented this, in around 1490, as part of his studies on geometry, architecture and anthropometrics. Some authors have interpreted it as the person at the center of the scientific comprehension of the world. Gartner has chosen this image because it represents a complex scenario (i.e., the circle and the square), with human capacity at the real core of its comprehension and management.

This *Strategic Analysis Report* focuses entirely of the fourth dimension of strategic sourcing, looking for the best market engagement model and addressing a framework (i.e., the sourcing strategy space) and the included sourcing relationship models.

1.1 Gartner Research on Sourcing Strategies

Gartner's research on sourcing strategies is carried out as follows:

- Drilling down into the different externalization models in terms of objectives, business mechanisms, strengths and weaknesses, and stability
- Analyzing and representing real cases of sourcing strategies to learn about them
- Developing a methodology for assessing and building a sourcing strategy
- Advising client organizations on how to plan their sourcing strategy

2.0 The Sourcing Strategy Space

The sourcing strategy space is a very important sourcing framework that covers the fourth dimension of sourcing by including all the different relationship models as well as by providing a basis for the visual representation of a sourcing strategy.

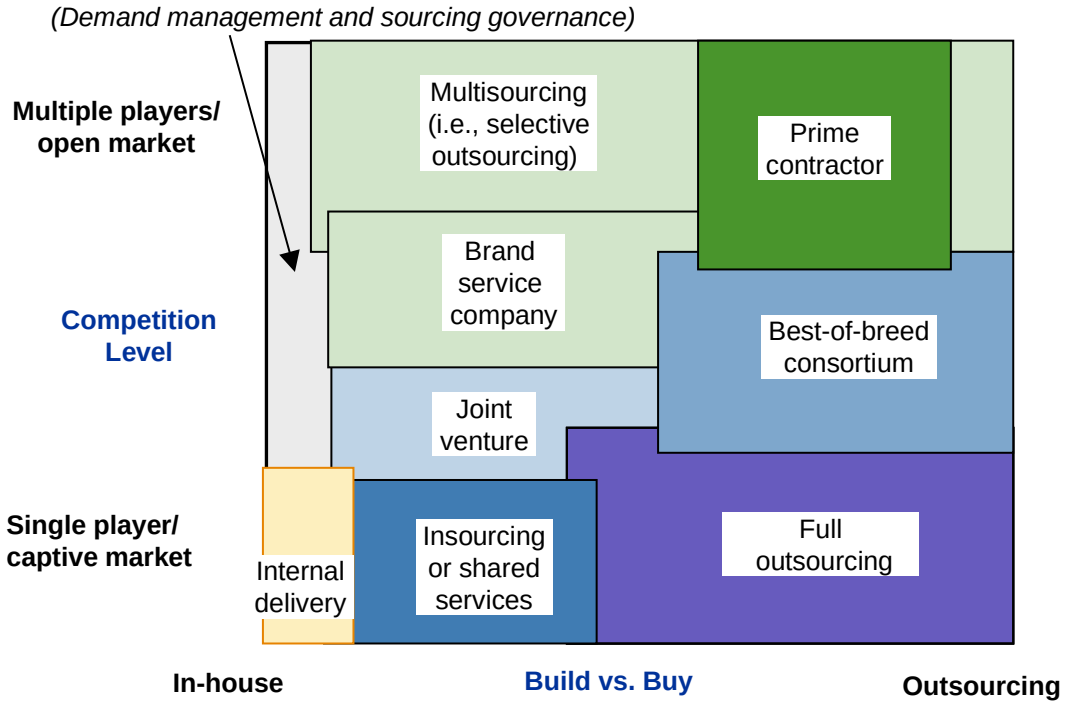
As part of their externalization strategies, worldwide and European organizations are using — and will continue to use — not only outsourcing but also different intermediate models. Some of the intermediate models provide tactical steps that are part of a whole strategy, while others may become a stable solution to an enterprise's needs.

In the past, most enterprises' concept of outsourcing has been centered on full outsourcing. In reality, the model that enterprises most often adopt today for IT services is the selective outsourcing (i.e., multisourcing) approach. Other models have often been used by enterprises, especially in Europe, due to the relatively low maturity of the outsourcing market and the limits imposed by strict labor regulation and powerful unions. Those different models are now becoming useful to build sourcing strategies in a turbulently changing marketplace for IT and BP services. The relationship models for a client-organization and a service provider are useful for representing the strengths and challenges of a service relationship, almost regardless of the actual content of the service to be delivered. However, when referring to the models' main characteristics, it is important to clarify the differences in the context of IT outsourcing or business process outsourcing (BPO).

Gartner has plotted the different sourcing relationship models in the sourcing strategies space against two important organizational characteristics.

- *Build vs. buy axis:* represents the enterprise's will to leverage (buy) or not (build) on capabilities that are not strictly internal to the organization to satisfy its IT or BP needs.

- *Competition-level axis:* represents the enterprise's will to work with a single IT or BP provider (i.e., minimizing management overhead but with a risk of becoming a captive market) or to fully leverage competition (i.e., managing different providers and accepting the overheads and complexity of a multiprovider or multicontract situation) (see Figure 2)



Source: Gartner Research

Figure 2. The Sourcing Strategies Space and the Sourcing Models

It is very important to understand that the sourcing strategy space and the relationship models can be applied to IT sourcing and BP sourcing decisions. Therefore, it is always important to define the scope that a strategy is about: IT infrastructure, IT applications, IT as a whole, certain BPs or business areas, e.g., payment systems, human resource (HR) payroll, finance and accounting (F&A) or all HR functions.

Eight main sourcing models describe the alternative relationship models between a client organization and the service market for a given process area. Enterprises should note that the "Demand Management and Sourcing Governance" box in Figure 2 is not a sourcing model in itself. It represents a key need for any organization moving outside the internal delivery model into the different sourcing models. The presence of this element also emphasizes that the structure of "Demand Management and Sourcing Governance" must be aligned with the kind of sourcing model in effect (e.g., a multisourcing approach requires more governance than an insourcing model).

2.1 The Building Block: A Sourcing Relationship

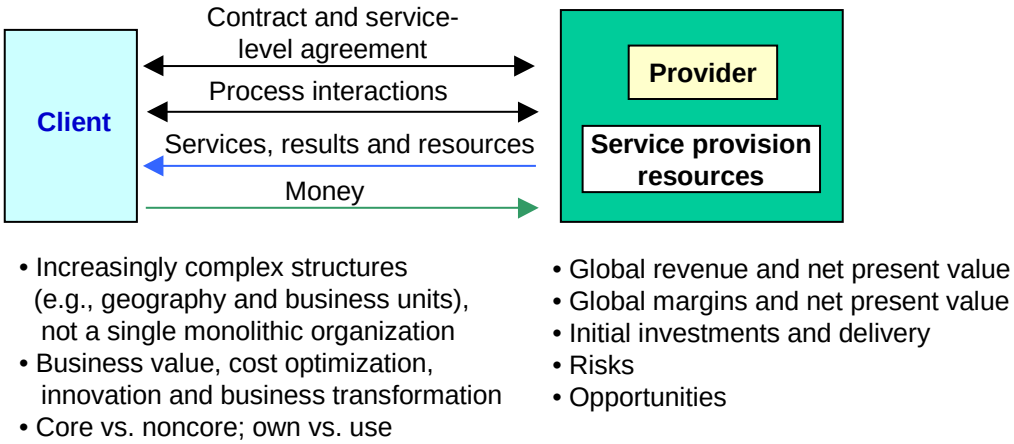
All the sourcing relationship models are based on — and benchmarked against — the relationship model of a basic client-provider sourcing relationship (see Figure 3).

The client enterprise receives services from the external provider enterprise through a contract relationship, which includes a contract plus a service-level agreement (SLA) or project specifications.

The organization that provides the client with the service is somewhat "virtual," because it cannot be separated from the overall vendor body since it is normally built around different parts of the vendor

organization, and the client has no control over it. The rules that the client and vendor must follow are those defined in the contractual relationship (i.e., contract plus SLA), and the two enterprises have many "process interactions" that should follow predefined rules (i.e., contract, SLA, vendor's processes and procedures shared with the client and vice-versa, including program and project management).

Process interactions are still one of the weakest parts of the sourcing relationship. In most cases, huge service relationships are entered into without a clear understanding nor a detailed definition of those multiyear processes.



Source: Gartner Research

Figure 3. Contract-Based Sourcing Relationship

Some important changes have been transforming the client (i.e., the recipient) of the service, thereby changing the service delivery in the late 1990s and into the beginning of the new millennium. Increasingly, what has been called "the client" is not a single monolithic organization but an aggregate of different business units (BUs), differentiated by business focus, geography and sometimes even business culture. Additionally, enterprises are becoming highly demanding in terms of receiving real value for money, true and provable cost reductions, organization and technical innovation and support for business transformation. These tough requirements mature as long as client organizations increase their focus on core business, value and leadership and switch their approach toward *using* IT services or noncore business processes, instead of necessarily *owning* them. As part of this evolution, an increasing number of complex enterprises are leveraging various relationship models that were not used in more monolithic organizations.

From the vendor point of view, these deals are, instead, measured overall by the following financial factors:

- Global revenue and yearly distribution or net present value (NPV)
- Direct costs to provide the service and NPV
- Global margins and NPV
- Initial investments, payments and costs (i.e., for the resources transition, to start the service and to implement migrations and transitions)
- Risks (i.e., penalties, client business stability, liabilities, scope evaluation errors or uncertainty)

- Opportunities for additional business with this client or in the client's vertical market or geographic region, to open a new offer line or to get a critical mass of business

The relative importance of these factors varies by provider and geography, and changes over time. Normally, margins and revenue are the most important, followed by investment dimension, risks and opportunities.

Successful outsourcing deals are well balanced and take into account client as well as vendor needs. The theory of win-win deals would require that value for the client is exchanged for profit for the provider. However, the reality is often far from it. Purchasing IT services means acquiring processes, knowledge and interactions and not objects. Therefore, understanding the logic and mechanism of the relationship is more important than in other business transactions for both client and vendor. Understanding the vendor point of view enhances the client's negotiation capacity and improves the final deal value, and vice-versa.

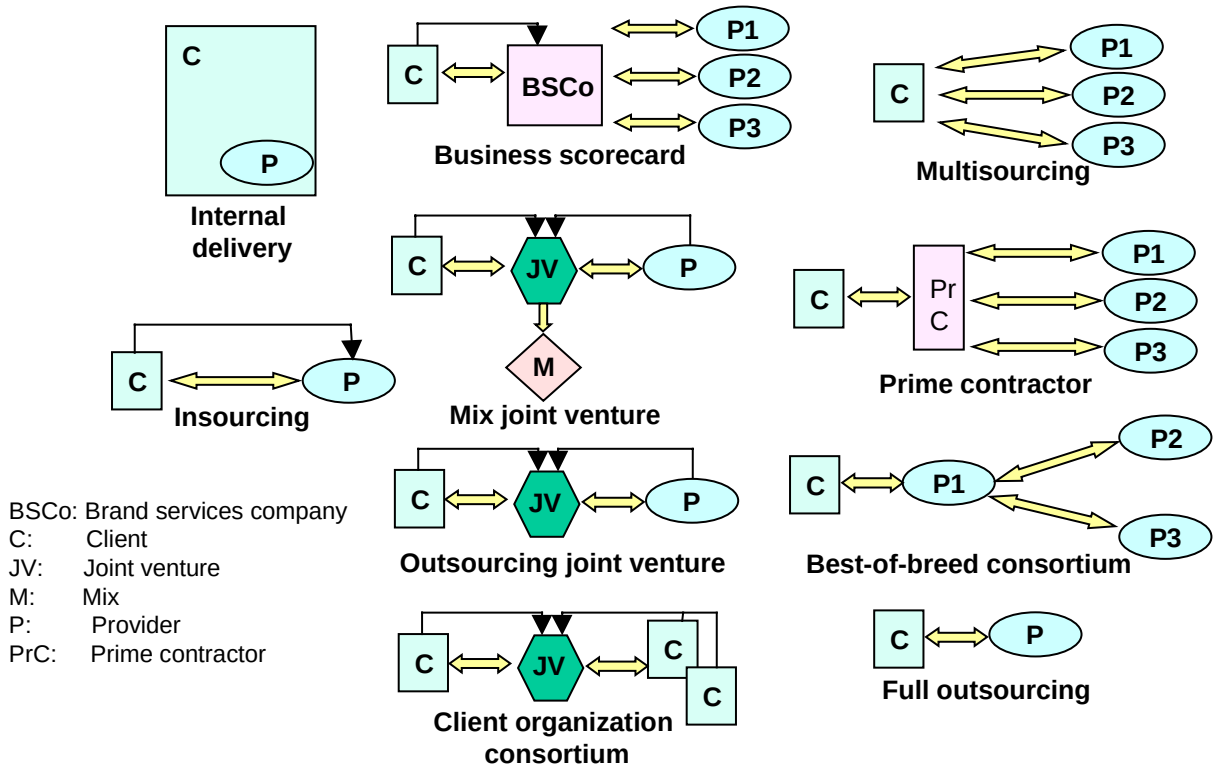
When analyzing sourcing models and strategies, it is always useful to compare the client and provider point of view as well as comparing potential alternative models' outcome (i.e., scenario planning and evaluation) looking for the best combination of positive implication and lower risks.

2.2 The Sourcing Relationship Models

The eight sourcing models are relationship models; therefore, they can be used for different business or IT processes. Enterprises must specific what BPs or set of BP areas the alternatives are supposed to address. These relationship models and the related sourcing strategy can be applied, for example, to the IT infrastructure or IT overall; a horizontal process (e.g., HR, BPO and F&A); or vertical, specialized processes and services (e.g., a bank's card management or insurance firm's loan management).

Every model presents a different relationship balance between service recipient (the client) and service providers, which can be external service providers (ESPs) or internal providers (e.g., with insourcing). Every model has different strengths and weaknesses, and each case may present better opportunities or more threats, different stability time frame, different access to economies of scale or economies of knowledge.

A strategy requires a whole vision of the overall balance between internal and external capabilities toward a certain business objective and a certain scope (i.e., the process or service area that is the sourcing strategy scope). This is where sourcing models apply. Current — or future — capacity (i.e., available internally, in the market or through a partnership) can be engaged and exploited through different sourcing approaches and models. Again, this seems to be just the case of a *make-or-buy* decision. However, in some cases, a *partner* solution may also be envisaged, ranging from partnering agreements, building joint ventures (JVs) or business partnerships for a complete business result, as well as buying capabilities through merger and acquisition. It other cases — although it is less frequent — a *complete* solution (e.g., building a new market player for a certain service area to compete in the service market instead of buying from it) will also be part of a sourcing strategy. Based on different levels of leverage of multiple partners, these decisions can be realized through different sourcing models (see Figure 4). These models can be suitable only for a certain level of organizational maturity or used at different stages of implementation of a sourcing strategy. Time is always important, since some of these models are unstable and must be evolved as a part of the overall sourcing strategy.



Source: Gartner Research

Figure 4. Sourcing Models: Any Others?

The most relevant sourcing models that are in use in many, different organizations in Europe and around the world include:

- *Internal delivery:* This is the current status of most enterprises' IT or BP operations as well as the delivery model that every manager knows. The internal organization provides services to the enterprise, and implements new services and architectures through internal projects. Everything is managed through the direct relationship between an organization and its associates. It is the most elastic model, because the unit manager may change the rules and the processes as much and as often as it is needed. Nevertheless, it is also the most limited sourcing model with regard to scale (i.e., dimension of operations) and knowledge (i.e., experience, innovation and available additional resources).

- *Multisourcing:* Also known as selective outsourcing, it is a separate outsourcing contract that is established for selected IT functions or BPs using a best-of-breed tactical approach and competitive deals. This is the most used approach for IT sourcing.

- *Insourcing:* Insourcing is the process of separating the IS or process organization from the enterprise as a BU, usually measured by its own profit and loss. The insourced organization provides the enterprise with services on a business-rules basis (e.g., semiformal contracts, SLAs and definition of tariffs for services). IT insourcing has been used quite often by large European enterprises that also have the scope to sell IT services to the market. In the case of business process, the insourcing model is also known as "shared services."

- *JV:* To exit from the internal IT or insourcing model limitations (e.g., economies of scale or knowledge), the enterprise builds a separate service company and shares it with a market provider.

Normally, the ESP gets the majority of the JV shares (typically 50 percent to 80 percent) and manages the JV operations.

- *Full outsourcing:* This is the most classic outsourcing model. It is based on a single contract with a single ESP for all the in-scope services. The main characteristics of the full outsourcing model include:
  - Single provider and single contract approach
  - Covers a large part of the enterprise's IT or process needs
  - Often includes a top-management strategic partnership with the provider
  - Often is a long-duration contract (five to 10 years)
- *Best-of-breed consortia:* This model appeared in the market as an evolution of the full outsourcing model for very large deals of major multinational companies or for government deals. It happens when the client requirements exceed the capabilities of a single, large provider. Based on a customer request, or on an ESP's decision, a consortium is built, and one of the providers takes the role of main contractor.
- *Brand services company (BSCo):* Similar to the insourcing model, a company is built to provide services to a large organization or a group of business-oriented companies. Services provided — which may include non-IT services and BPs — are carefully compared against the market, and the services company leverages ESPs, selectively outsourcing part of their services. The services company can be allowed — or is even intended — to serve the external market.
- *Prime contractor:* An organization providing the ability to manage and integrate multiple providers (e.g., products, projects and services) to derive a single or global solution or service for the client.

All of these models are represented in Figure 4, where some of the most important types of JVs are represented.

The first element that becomes clear by looking at Figure 4 is that sourcing is not a make-or-buy option. The richness of different models makes it a far more complex and business-oriented decision.

Additionally, it is important to note that nothing in these models is theoretical. All these models have been used and are utilized by organizations around the world for IT services and BP (i.e., each model represents some real case for both categories of service). The unique model that still does have some theory in it is the prime contractor. As a result of market immaturity, this model is not as broadly accepted, although this role will develop in the course of the next few years.

The final issue in the sourcing strategies realm is that there is no single perfect relationship model and no single choice for everyone and forever. Rather, any model has strengths and weaknesses, including a stability time frame. Therefore, there is no single or perfect strategy for everyone. Enterprises should understand the different models and decide on an appropriate sourcing strategy to accomplish their objectives, based on their unique characteristics in terms of organization, behaviors and constraints (see Section 4). Any sourcing step and the related deals should fit not only current tactical needs but also should be part of the overall strategy.

3.0 The Relationship Models

For each of the models defined, the following sections of this report will detail:

- The relationship schema and the relevant definition

- The main positive and negative aspects of the models as well as the typical case of use
- The Strategic Planning Assumptions defining the development in the use of these models according to Gartner forecasts
- Samples of use of IT sourcing and BP sourcing (It is important to note that the samples report the utilization of a specific model at a certain point in time. This does not necessarily imply that the client or the provider are still in such a relationship.)

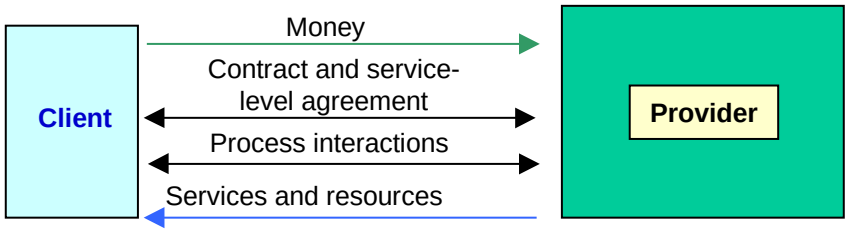
For some more complex or important models (e.g., multisourcing or JVs), other material is included with other relevant aspects or drill-down analysis.

3.1 Full Outsourcing

Strategic Planning Assumption: Through 2007, 70 percent of the potential traditional full IT outsourcing deals with be replaced by a mix of shared risk/reward approaches, JVs, consortia, prime-contractor models, utility services and BPO deals (0.7 probability).

Full outsourcing definition: Full outsourcing is the most classic outsourcing model. It is based on a single contract with a single ESP for all the in-scope services (see Figure 5). The main characteristics of the full outsourcing model include:

- Single provider and single contract approach
- Covers a large part of the enterprise's IT or process needs
- Often includes a top-management strategic partnership with the provider
- Often is a long-duration contract (five to 10 years)



Source: Gartner Research

Figure 5. The Full Outsourcing Model

In the 1980s and 1990s, full outsourcing was used extensively for IT outsourcing. However, this model's adoption has decreased in a maturing market in which competition has increased and enterprises are less willing to give away IT control. Full IT outsourcing megadeals are decreasing, while more-advanced relationships, based on shared risk/reward models, JVs, consortia, prime contractors, utility or on-demand deals and BPO are emerging. For BPO, full outsourcing will be one of the preferred sourcing models in cases of significant asset transfer and complex processes. In a low-maturity marketplace, this also is driven by providers specializing on a defined set of processes and a better potential for covering through the terms and conditions (T&Cs), SLAs, scope and quality of the service delivered.

Full outsourcing's main characteristics include:

- Single contract; single ESP

- *Pro:* Low cost of procurement and reduced management overhead; service provider familiarity with client needs
- *Con:* Captive or even exclusive relationship; service provider investments often set the pace for dissatisfaction; no competition; no innovation (i.e., for free)
- Full IT outsourcing and static megadeals decrease while BPO, shared-risk/reward and other models increase.

Samples of full outsourcing include:

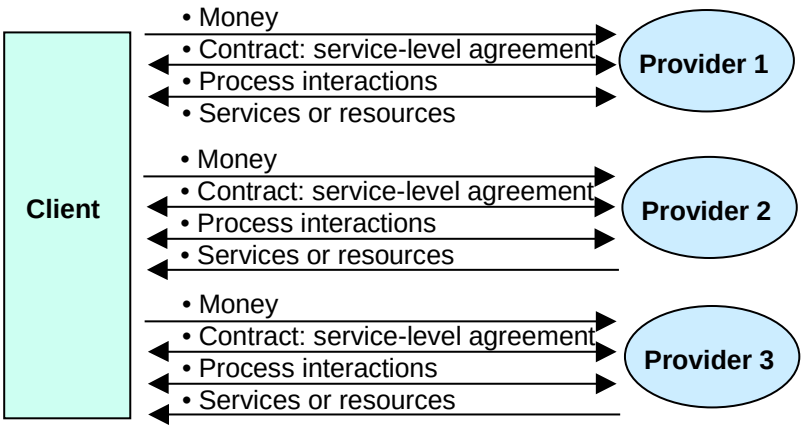
- *IT examples:* Commonwealth Bank of Australia and EDS; Xerox and EDS; Inland Revenue Department and EDS; Italian Ministry of Public Instruction and EDS; Italian Ministry of Healthcare and Finsiel; and Deutsche Bank and EDS.
- *BP examples:* Hungary Matav and EDS; BP Amoco and PricewaterhouseCoopers (PwC) for F&A; General Motors Europe and Andersen for HR processes; BEA Systems and Xchanging for HR processes.

Action item: While leveraging the lower cost of procurement and management of a full outsourcing model, enterprises cannot abdicate their sourcing governance duties. In the long term, an exclusive and unmanaged full outsourcing relationship can be more expensive than the market average by 50 percent, while not providing satisfactory services or innovation to the enterprise.

3.2 Multisourcing or Selective Outsourcing

Strategic Planning Assumptions: Through 2007, in Europe, although multisourcing will remain the dominant sourcing strategy, less than 50 percent of enterprises will have a formal sourcing strategy and appropriate governance in place (0.8 probability).

Multisourcing definition: Multisourcing or selective outsourcing is a separate outsourcing contract established for selected IT functions or BPs, using a best-of-breed tactical approach and competitive deals (see Figure 6). This is the approach used most often for IT sourcing.



Source: Gartner Research

Figure 6. Multisourcing or Selective Outsourcing

Selective outsourcing is based on highly leveraging market competition capabilities. Although selective outsourcing is easy and natural to implement tactically (i.e., it is the selection of the best provider for a given need), it is the most difficult sourcing model to manage. Enterprises must be system and service

integrators because of the overlap or uncovered areas at the edge of different providers. In addition, enterprises are the primary risk owners, especially regarding problems that span multiple providers or when disputes and finger-pointing among providers occurs. Too many different service providers are sometimes the result of a very tactical, unplanned approach to IT. As far as any new need arise, a new provider is selected to take care of it. In this sense, multisourcing is an approach frequently used for IT, although often "by default."

The main characteristics of this type of sourcing include:

- Selected services by different contracts with best-of-breed ESPs
- *Pro:* Leverage providers' best capabilities in a strongly competitive environment. Innovation is available directly from the market. Agility, flexibility and scalability are available when managed properly.
- Con: Easy to implement; difficult to master. Requires the highest sourcing management capabilities. Most-used model for IT, often by default.

Samples: Because selective outsourcing is the preferred model, an example list would be extremely long, especially for IT services. Many organizations use one or more providers for IT infrastructures (e.g., for data centers, networks and desktops) while keeping in-house applications and projects. Others keep in-house the ongoing operations (e.g., infrastructures and application management) while extensively leveraging other, more application-oriented or project-oriented providers.

For BPO, multisourcing is less widely employed. It is used when the BP offering is specific to a single process or function (e.g., Equitant and Hewlett-Packard for order-to-cash processes) or when other processes are kept in-house (e.g., for HR or different geographies).

The list of challenges that arise when managing multiple service providers is quite long and includes the need for the client to be the “service integrator” between different — usually competing — providers. Then it is necessary to build some element of cooperation between the different providers, although problem rejection and finger pointing are the more usual reactions.

Potentially, this model can provide the best of everything; but it is very sophisticated to manage and requires the appropriate governance structure (e.g., the sourcing office) and management practices. If done correctly, it is the best model for competitive and dynamic enterprises.

Action item: While leveraging the superior potential (i.e., cost, service quality and innovation) associated with multisourcing, enterprises must invest sensibly in their sourcing governance capability. Multisourcing should not be attempted without a strong management capability in place. Elsewhere, it should be replaced by other, less-complex sourcing models.

To get additional advice on how to build cooperation and develop adequate governance for multisourcing, please refer to the following research documents:

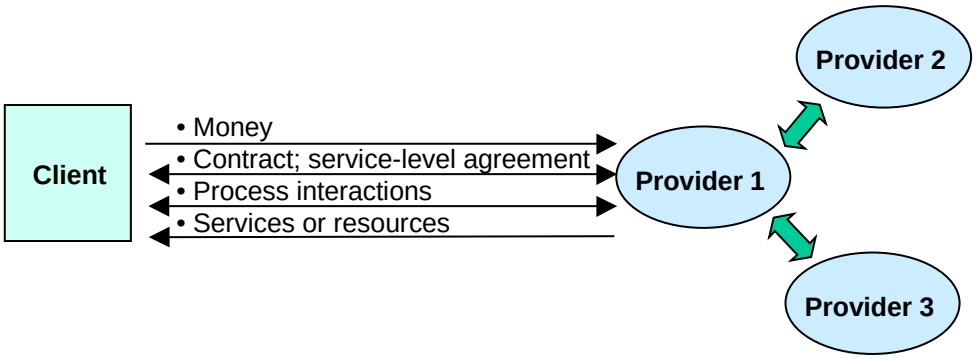
- "Managing Your Multisourced Environment," LE-16-5071, 10 May 2002 and referenced documents
- "Aggregate Multiple Delivery Sources," AV-16-5109, 10 May 2002 and referenced documents
- "The Promising Journey Toward the Sourcing Office," COM-16-1738, 9 May 2002
- "New Rules, New Roles for Effective Services Management," COM-15-8333, 5 April 2002
- "Aligning Services with Business Objectives by Sourcing," COM-15-8326, 5 April 2002

- "How to Build Cooperation in a Multi-ESP World," TG-11-0693, 4 September 2000
- "Outsourcing? Think in Terms of Processes or Suffer," SPA-08-2203, 11 October 1999

3.3 Best-of-Breed Consortium

Strategic Planning Assumption: Through 2007, the best-of-breed consortium will be one of the most-popular models for large government deals, with increasing requests over time for private financing and better contractual and process specifications for the prime contractors (0.7 probability).

Best-of-breed consortium definition: A consortium of best-of-breed providers is built for a single-case deal to fulfill the often huge needs of a large enterprise. One of those providers takes over the main contractor role and manages the others ESPs and the overall project and service integration (see Figure 7). The alliance between those providers is mostly tactical. In a new deal, those providers are usually participating in different groups.



Source: Gartner Research

Figure 7. Best-of-Breed Consortium Model

The best-of-breed consortium is an intermediate model between full outsourcing and multisourcing. Government or commercial organizations that are looking for extensive capabilities obtained from multiple providers often employ it. It also has appeal due to the low level of client management required by a main contractor. During large government deals, competing providers deploy their commercial partnership networks to look for the best association that can provide the highest chance of success. Sometimes, the partners of a consortium are part of a different consortium for the next deal. This does not establish a common ability to deliver end-to-end services from a "tactical," single-case and static consortium.

The main characteristics of this model include:

- Consortium of providers, with one taking the main contractor role
- *Pro:* Leverage the providers' capabilities at a low management complexity (i.e., intermediate between full and selective outsourcing)
- *Con:* May inherit the best or worse aspects of full outsourcing and multisourcing, depending on demand or relationship management and the main contractor capability
- The static composition of providers may cause cartel behavior.

Samples of best-of-breed outsourcing include:

- *IT examples:*

- The Pinnacle Alliance — JP Morgan, Computer Sciences Corp., (CSC), Accenture, Bell Atlantic Network Integration and AT&T Solutions;
- The Outsourcing Desktop Initiative (NASA) — Boeing Information Services, Computer Sciences Corp., Dyncorp Techserv, FDC Technologies, OAO and Getronics Government Solutions;
- U.S. General Services Administration — EER Systems, FDC and IBM; and the U.S. Internal Revenue Service-CSC PRIME Alliance

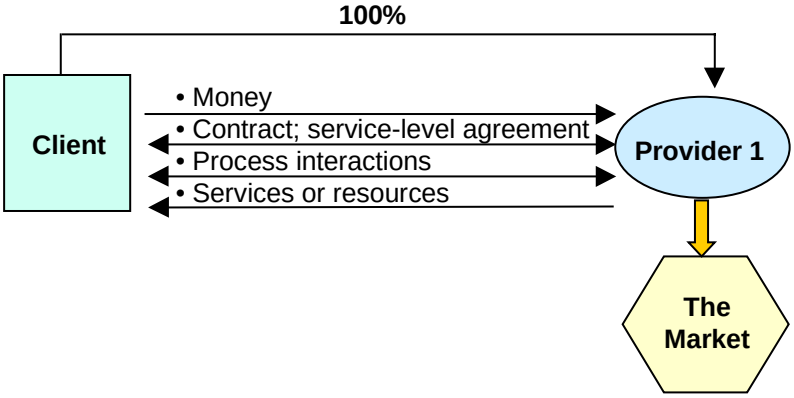
- *BP examples:* HydroOne (Canada) — Vertex and Cap Gemini Ernst & Young

Action item: This intermediate model may inherit the best or worst aspects of full outsourcing and multisourcing. During the selection process, enterprises must heavily weigh the proof of co-operation among providers, as well as the main contractor's ability to manage the others. During negotiation, focus on T&Cs, SLAs and BPs related to the main contractor's end-to-end responsibility.

3.4 Insourcing or Shared Services

Strategic Planning Assumption: Through 2007, 70 percent of IT insourcing and 40 percent of BP shared services will evolve along different sourcing models, becoming JVs (i.e., 20 percent) or BSCo (i.e., 30 percent), or will be fully outsourced or sold to vendors (i.e., 50 percent) (0.7 probability).

Insourcing definition: Insourcing is the process of separating the IS or process organization from the enterprise as a BU, usually measured by its own profit and loss. The insourced organization provides the enterprise with services on a business-rules basis (e.g., semiformal contracts, SLAs and definition of tariffs for services). IT insourcing has been used quite often by large European enterprises that also have the scope to sell IT services to the market (see Figure 8). In the case of BP, the insourcing model is also known as "shared services."



Source: Gartner Research

Figure 8. The Insourcing Model

The primary use of the insourcing model occurred in Europe during the late 1980s and early 1990s. Most IT insourcers tried to become service providers, although few succeeded (e.g., Origin from Philips; Debis from Daimler Benz; and others in niche markets, e.g., BossLab from BSI). Now, most large, global enterprises have implemented or are building shared service organizations for selected process areas, usually F&A, HR management and other multilocation, multiprocess organizations. In addition, North America organizations that usually refrained from this model are currently building a model in between the insourcing model and the BSCo model, i.e., the *internal service company (ISCo) model (*refer to "Running IS Like a Business: Introducing the ISCo Model," R-18-4277 16 January 2003).

The main characteristics of insourcing include:

- Creation of a separate BU, spin-off, shared services or insourcing service company
- *Pro:* Consolidation, integration and standardization benefits, direct control of the service provider, plus market activity potential
- *Con:* Captive, often budget-based; make services on request as direct provider; control vs. innovation; potentially unstable
- Popular after mergers and acquisitions (M&As), for re-centralization and cost optimization, often a first tactical step of a sourcing strategy

Samples of insourcing include:

- *IT examples:* Shell (Shell Services International, now Shell IT International); ENI (Enidata); Fiat (ITS and GSA); Hydro (Hydro Business Partners); AXA (Axa Tech)
- *BP examples:* Compaq Computer, Bell South, Novartis, Polaroid, BHP, Telstra and most banks.

Action item: The IT organization spin-off is usually only the first step toward a more-complex sourcing strategy because of its instability, which is caused by the combined drivers of client organization innovation requirements and market provider competitiveness on service quality and price. Shared services can be the final state of a sourcing strategy or only an intermediate step toward BPO, depending on those two drivers, in addition to the core or noncore attributes of those processes.

3.4.1 The Future of Established Insourcing Companies

Strategic Planning Assumption: Of the established insourcing companies in Europe, 70 percent will evolve into different sourcing models through 2007, becoming JVs (i.e., 20 percent), BSCos (i.e., 30 percent) or being fully outsourced or sold to vendors (i.e., 50 percent) (0.7 probability).

The classic insourcing move (also known as IT service business) happens when an IS organization is split off from the enterprise as a BU or a separate company, then usually measured by its own profit and loss. The insourced IS organization then provides the enterprise with IT services on a business-rules basis. Two main objectives are almost always addressed: recentralize services for the parent organization, and sell services in the market.

Insourcing has been the most common intermediate externalization model in Europe for the past 20 years. However, the model has become progressively less stable due to overall market pressure; but for European organizations, it is still a common first step toward externalization and sometimes a step toward outsourcing. Most of the advantages of insourcing are related to consolidation, recentralization and leveraging economies of scale, especially during M&As. The client-provider relationship model of insourcing resembles full outsourcing in some ways, but it has some significant differences including:

- Relationship: often the client is the captive, single or main market
- Contract and SLA: quite often these are not properly formalized and managed; the insourcer has not really changed its approach, so the relationship tends to remain budget-based rather than business-based
- Process and resource management: insourcer staff tends to consider itself as being on the parent company's payroll; in this respect insourcing is easier to manage on a day-to-day basis than outsourcing, and processes are often not disrupted during the transition

- Transition: transition problems are minimal because staff is just transferred to a group's new controlled company
- Services provided: mostly services delivered already; insourcers often lack innovation and new capabilities
- Service approach: mostly "build and operate"; the task of innovation capability often brings to an ESP engagement the need to deliver new, business-oriented projects, further decreasing the "insourcer value" for the business
- Value: during M&A, consolidation and recentralization phases, the leverage of economies of scale can produce significant value for the client. This is a short-term gain that does not offset the many long-term issues related to an insourcer's value and stability.
- Insourcing is nearly always accompanied by a second objective: the insourcer wants to be a market provider, selling services outside the parent company. In practice, less than 5 percent of insourcers become successful ESPs. Most do only 10 percent to 15 percent of their business with external organizations, often in the same market as the parent (i.e., a related market). Building commercial operations in the IT world starting from an internal IS department is hard; the effort needed is often greatly underestimated.

What makes this relationship unstable? The first, very common, risk of an insourcing move is that nothing will really change. In this case, the "IS organization segregated into a company" will often be more expensive than the internal IS organization, will be less connected with the business and will probably suffer from BU political attacks, progressively losing business to ESPs that deal directly with the business.

An internal IS organization operates on a budgeted, direct-cost-only, basis. A separate company has expenses that were often outside its budget when it was part of the client organization (i.e., administration, HR, management and services). It must invest in additional management, sales and marketing forces, plus new technical skills. Any participation in a deal is a significant investment, often without success in the first nine to 18 months. Any subsequent commercial success will then pay back six to 18 months after that. Thus, there are growing indirect costs (overheads) and internal investments that the client organization will be obliged to subsidize.

The second, common, risk is that the insourcer will concentrate only on changes related to M&As, consolidation and IS restructuring. That may grant the insourcer some successes (e.g., cost reduction) in the short to medium term, but it will leave longer-term issues unresolved. Few changes will be made to the relationship between client and insourcer, making future dissatisfaction and a lack of a commercial "soul" in the insourcer likely. Insourcers do not leverage external competition on behalf of their client; thus, the third risk is to lose its entire captive market to ESPs, which can buy the insourcer. Finally, in the growing outsourcing market, an internal service company is just in the middle between a source (the client organization) and the natural destination of money (the ESPs).

How should an insourcing venture evolve? Further development of the insourcer can be initiated by either the client organization or the insourcer; therefore, insourcing can evolve in various ways, including:

- The client shares it with a market ESP, realizing an outsourcing JV.
- The client sells it to a market ESP (i.e., in exchange for a long-term outsourcing contract with this ESP).
- The client brings it back in-house.

- The insourcer spins off a successful commercial venture, leaving with the client only the structure delivering service to it.
- The insourcer starts to address the "make-or-buy" dilemma and enlarges its business with the client (i.e., non-IT services and processes), becoming a BCSo model.
- The insourcer is very successful and becomes a market ESP.

The classic insourcing model is unstable in the current globalized and competitive market. Client organizations already using an insourcing model must plan for changes now. Both the client organization and the insourcer must evaluate the next steps of their sourcing strategy and evolve accordingly. Client organizations now evaluating this model must put it in the context of a wider sourcing strategy.

3.4.2 Turning Internal Departments Into New Businesses: Will It Work?

During the late 1980s and the early 1990s, many client organizations (non-IT businesses) attempted to transform a problem into an opportunity by creating a separate unit providing IT services back to the client organization and attempting to sell those services to the open market as well. During the 1990s, this was also the case in the BPO arena, mostly by partnering with consultants and outsourcers. This trend has always been significant in Europe, where creative sourcing strategies have been the norm because of market fragmentation, language, cultural and legal issues, and the relative immaturity of the service market.

Gartner expects a new wave of these business approaches to occur in Europe in the next few years. Some of the reasons for this include:

- In an uncertain business climate, the service market (for IT and processes) remains on high relative growth with quite interesting margins, making it an attractive business target.
- The economic downturn and increasing competition are putting cost pressure on enterprises. Industry consolidation continues to create opportunities for outsourcing as back-office functions become redundant. Outsourcing is also a popular way to optimize internal IT or process operations — large organizations may try to leverage these economies of scale and capabilities even more.
- Enterprises around the world are attempting to focus their investments on core business processes, while outsourcing noncore processes; large enterprises or best-in-class niche service organizations may be willing to take advantage of market opportunities.
- Enterprises need their internal IS organizations to evolve from the "internal IT farm" into a new, market-oriented "IT broker and integrator" role. This requires a new, dynamic relationship with the open market, and it may also lead to the spin-off of market-oriented entities for selected services.
- The increasing role of IT as an enabler of business services will produce interesting opportunities for process-oriented, IT-intensive services where client organizations may extract value from their expertise and scale.

Although the vast majority of these attempts have failed to build real market entities in the past, client organizations will persevere because there certainly are opportunities in the service market; and the potential advantages can be extremely enticing during bad economic times. However, the service market is changing, and new service providers must plan for the future market.

Outsourcing has changed, and it continues to change with the evolution of the IT service market. Some still call it outsourcing, but it is no longer the "game as we knew it."

The most important opportunities in the market are for offerings in the "access" market, i.e., mainly infrastructure services and application service providers (ASPs), and in the "creation" market, i.e., mostly around exchanges, multiclient connected services and business service providers (BSPs) (i.e., for access and creation markets definitions, please refer to "The 2001-2010 Reshaping of the IT Service Market," M-12-7186, 2 April 2001). These service offerings are mass-customized and delivered as shared solutions. Not only is the delivery affected, but the entire service offering and life cycle are different. The deal is no longer oriented to just outsource an established service to reduce costs, and the provider risk tends to be far higher than before. Being a successful provider is increasingly difficult because the whole market is restructuring, with different success rules in different areas. Even well developed IT service providers are struggling to address all the new challenges of a changing marketplace in a turbulent era. Client organizations must understand that becoming a successful provider is more difficult than ever, especially for new offerings where significant up-front investments need to be paid off by the immediate generation of high-volume or high-margin business.

Apart from countries with an undeveloped service market, there is very little potential for success in the traditional IT outsourcing offerings (i.e., management and optimization markets); but some success stories may occur in the traditional BPO market or in limited niches with vertical specialization. It is important to note that the most interesting opportunities (i.e., access and creation markets) require a very focused and entrepreneurial approach that is generally absent in internal delivery organizations. In Europe, this challenge is particularly acute because of the current country-level market fragmentation and the trend toward a more unified and open European market. Although the typical case will be a country-level approach, new businesses should evaluate their current geographical coverage, compare that with their prospects' future needs and plan for the best approach (i.e., national, multinational or European) through a direct or indirect, partnership-led approach.

To underline Gartner's warnings, some of the typical initial mistakes that must be avoided to keep the chances of success alive include:

- *From value proposition to offering:* Due to the inherent time-to-market for real commercial operations, the value proposition must address the future market (e.g., 2003 to 2005). Generic, self-confident evaluation will not lead to success — a professional market analysis is required. A market niche must be clearly identified and assessed according to a map of current and future competitors' strengths and weaknesses. The value proposition must then be boiled down into offerings (i.e., a service that can be easily presented to a prospect and sold through a contract). A new commercial entity should not have numerous offer lines (e.g., consultancy and system integration, development and outsourcing) as this indicates a lack of focus, and it is very difficult to be truly competitive with a broad service portfolio.

- *Real capability assessment:* Often the client evaluation of its internal arm (IT or process) is poor. If it is not good enough for the client, why should it be good enough for the market? A careful and objective evaluation of strengths and challenges, to act as a benchmark against market providers and best-in-class vendors, must support any decision. Analyze how those capabilities support the value proposition, the offering and the position in the market. Typical capabilities that need to be filled or even created are business-oriented management, marketing and sales, chief financial officer (CFO) (e.g., investments, cash flow, costing and pricing management), product planning, account executives and engagement teams. These capabilities typically do not develop in a monopolistic, budget-driven internal organization.

- *Select the right sourcing model and partner:* Different sourcing models (e.g., insourcing, JV or BSCo) can be used to create this new entity. Build different scenarios, and evaluate the risks and implications of each one. Select the most appropriate in terms of scope and company culture. With fully owned

organizations (insourcing or BSCo), the next step is the business plan, including the single offer analysis, an early prospects list and a finance model. Because failure is still a possibility, an exit plan should also be established at this early phase. After the decision to proceed or not has been made, the final step is hiring the right people and starting the new unit.

In joint ventures, these final steps will be carried out with a partner that must be selected by a competitive approach. At least three credible competitors must compete for the partnership through a process similar to that of an outsourcing deal. A critical part of the deal is the business plan for the venture and the related contractual terms and conditions. Organizations must always focus on the "killer question" for any partnership or joint venture: "Does this partner really need me to achieve the common objective?"

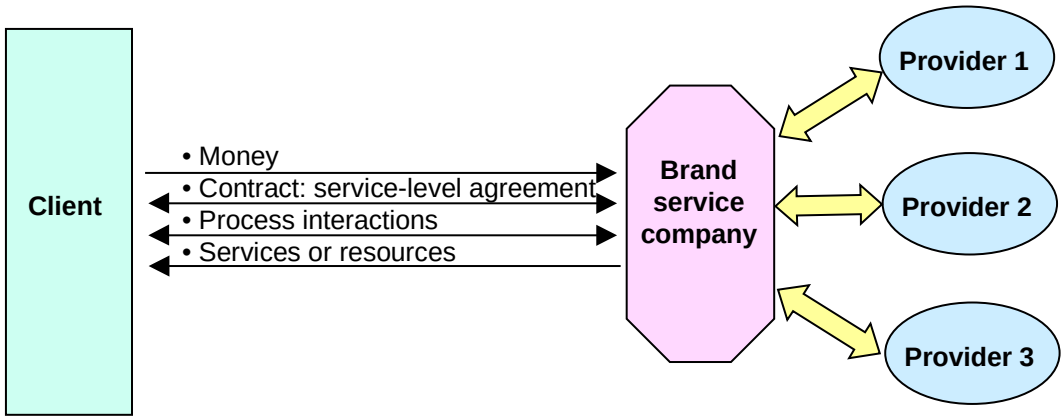
New markets and offerings (i.e., especially process outsourcing, exchanges, ASPs, BSPs or service utilities) are most likely to require partnerships, as are new entrants in an established market. One reason providers may need a partnership is to acquire client competencies (typically, the vertical ones) and scale, as well as transferring part of the risk onto someone else. The client is also looking for this, and careful risk management must be in place to balance the deal.

Business organizations may be willing to transform a problem into a business opportunity by building a commercial service provider for IT services, e.g., IT outsourcing, or business process services (BPO or BSP). This move is becoming more difficult than ever, and it is a substantially different business from providing internal services. Therefore, failure is the rule and success is the exception. A good value proposition for the future service market, the right offering, capabilities, model and eventually a good partner are required; and all these steps must be carried out at a high professional level. The success rate is so low that it does not allow for wrong or suboptimal decisions. Since failure is still a possibility, the exit plan must also be evaluated early in the process.

3.5 Brand Service Company

Strategic Planning Assumption: Through 2007, in Europe, more than 30 percent of BSCos will increase their use of ESPs, improve their vertical business focus and start commercial operations in relevant vertical markets (0.8 probability).

BSCo definition: Similar to the insourcing model, a company is built to provide services to a large organization or a group of business-oriented companies. Services provided — which may include non-IT services and business processes — are compared carefully against the market, and the services company leverages ESPs, selectively outsourcing part of their services (see Figure 9).



Source: Gartner Research

Figure 9. Brand Service Company Model

The services company can be allowed — or is even intended — to serve the external market.

The main characteristics of the BSCo model include:

- Similar to insourcing with extensive leverage of ESPs and often extending the service scope from IT to BP
- *Pro:* Like insourcing, plus a strong leverage on market capabilities and innovation; M&A and recentralization, plus innovation for IT and business processes; external market opportunities for core vertical capabilities
- *Con:* Decreasing value and role if it cannot manage business expectations and innovation; a strong, flexible and already successful model

Samples of the BSCo model include:

- *IT examples:* Italian Ministry of Treasure and Consip; Bank Groups that grew through a series of M&A
- *BP examples:* Fiat Business Solutions; Vertex (from United Utilities); and IT Net (Cadbury and Schweppes); bank groups that grew through series of M&A

Action item: A BSCo must evolve continuously according to new objectives of the client organization or toward the market to avoid complacency and decline.

3.5.1 The BSCo: Is It Insourcing or a New Model?

In the early 1990s, Italian companies and groups started building or evaluating a new services sourcing model: the BSCo. Is this the renaissance of the old insourcing model, or is it a new model altogether?

This is a new model: a single large organization or a group of similar or linked organizations (the "*brand* group") builds a separate company (the BSCo) with the aim of providing the organization — or organizations — with services (i.e., "brand" denotes the brand name of the group). This model resembles the old insourcing approach in that the key question is: "What really changes?"

However, this new model is different from the previous insourcing model, because:

- Insourcing has often been used to consolidate and reduce costs during stable market periods. Now it is happening in a quickly changing marketplace, often during M&A operations involving large groups.
- Comparison with market and best-in-class providers is now mandatory for the services company, in terms of service quality, costs and benchmarking.
- Use of selective outsourcing by the services company is a clear possibility. It may already exist, resulting from merged companies that have already outsourced certain activities.
- Previously, insourcing was restricted to IT; now other processes are often provided: horizontal (e.g., HR, procurement or real estate management) or business-specific (e.g., check or loan processing for a bank, training on specific processes, documents and archives management).
- The BSCo has a group of clients within the brand group; the services company must build a service pricing strategy and manage margins and investments.
- The BSCo often has the freedom to sell its services in the market; in some cases this is mandatory.

Examples of this model can be found in the Italian finance industry and public administration, and other organizations are evaluating it. The model has also been used in other European countries and elsewhere.

Outsourcing is growing not only in the IT sector but elsewhere, especially the business area, via BPO and other business relationships among companies in the same or a different value chain. Notwithstanding the differences between the externalization of different kinds of service, the BSCo is a model in line with current business thinking to outsource or spin off noncore activities.

In the BSCo model, the brand group, BSCo and open services market are related. The client (the brand group) is a business-focused organization that uses its services company to get the services needed to run the business. Contracts, services and providers here are not necessarily restricted to IT.

The main questions that define the services company scope and mission are included in the following framework:

- *Strategy and services:* What are the BSCo's strategic objectives? Does it provide IT services only or also non-IT services and processes? What are — in the brand group's perspective — the most important assets of the BSCo?
- *Relationship with the internal clients:* What are the engagement rules between the brand group and the BSCo? Will the use of the services company be mandatory or discretionary? What kind of contract and pricing, costing and budgeting rules will be set up?
- *Relationship with ESPs:* Is the BSCo a direct service provider, or does it externalize again? What are the engagement rules between the BSCo and ESPs? Why externalize again? Will it externalize only when providers can do the service better and less expensively? How are such comparisons measured?
- *Profits and investments:* Is the BSCo a profit or a nonprofit company? How are investments managed? Should the company provide services to the open market?
- *Assets and resources:* How are staff and asset transitions managed? How is the staff managed? Who is paying for the service asset new investments?
- *External market:* Does the BSCo sell and provide services to the market? What kinds of services are offered? To which type of market: open, related or captive?

This framework can help organizations to focus on the key issues of the model. It can be applied to various kinds of services companies, with different objectives, management structure and styles, staff behavior, services and cost-effectiveness, and with different relationships with the market in terms of both buying and selling services. This relationship schema and framework form the basis for future Gartner research on the BSCo model.

The BSCo is a complex model, very much in line with the trend of business organizations externalizing noncore activities. The model allows for a range of possible outcomes, from the old insourcing model to new kinds of service companies.

However, organizations should focus on the key issues and evaluate their approach to this model carefully, because the BSCo has two roles: as a client and as a provider.

- *Client aspects:* The BSCo is the client organization of selective outsourcing contracts and represents its internal group in most IT aspects (e.g., architecture, standards and delivery management).

- *Provider aspects:* The BSCo is the outsourcer of its client group. Additionally, it may become a market service provider, selling services to other clients.

Due to this complexity of choices (i.e., well represented by the question framework above), a BSCo can operate in different ways:

Main contractor: This type of BSCo indirectly provides overall IT services to the group's clients on a mandatory basis. Most projects and operations are outsourced, mainly by using a selective outsourcing approach, with routine benchmarking on ESPs. The BSCo retains and focuses on IT governance, architectures, IT marketing, evaluating client needs, solution planning, user training, measuring satisfaction and managing the program or project and ESP or service. Its financial margins are addressed mainly to staff, skills and know-how investments. It buys services mainly from ESPs using its very strong planning, negotiation and management skills. No services are sold to enterprises outside the group (i.e., apart from projects and services to the brand group supply chain or common services to be provided in its vertical market). This type of BSCo may spin off a "main contractor" ESP when there is more call for this role in the maturing market.

Service engine: The BSCo provides IT as well as non-IT services and processes to the business group. The focus is mainly on servicing the group cost-effectively. An established route is to benchmark internal and external services and make market comparisons. Selective outsourcing is leveraged when ESPs offer better value or are more effective, while other services and processes are provided directly. Resources for projects and services are purchased in the marketplace. The staff is mostly established employees, and often the company does not seek profit or look for additional business outside its organization (i.e., although this can also be driven by taxation issues). Commercial activities may eventually lead to a spin-off of best-of-breed service areas.

Commercial venture: The main scope of the BSCo is to build or to become a new external business. The successful ones will first concentrate on becoming a main contractor for all the services they do not consider to be core to their business. Those services are outsourced, and the BSCo retains most of the relevant advantages. They then will concentrate on directly delivering the core services they aim to provide to the market. For these core services, the scope is clearly to become a niche market leader. The internal market is leveraged to the maximum extent, as a captive market, to support the external strategy. The relationship with ESPs is very complex (i.e., providers, competitors or partners), and there is a high possibility of tactical partnerships or JVs with selected ESPs. A future complete spin-off of the commercial side is probable.

Another important aspect to support external business operations is the financial relationship (i.e., budget-based vs. balance sheet-based). One aspect that a new BSCo tends to inherit from its previous life (i.e., as an internal IS group) is to have an annual predefined and guaranteed budget. When founded on an aggressive strategy to become an ESP, the starting company needs a "period of grace," often between 12 and 36 months. After that time, the BSCo must be able to deal with internal clients using tariffs and outsourcing contracts — and not an annual fixed amount. It must be able to sustain the market pressure and deal with risk, penalties, profits and investments (i.e., building investments and trade-off capability).

Since a BSCo can operate in different ways, enterprises aiming to start this model from their internal IS group must define carefully what they would like to achieve by answering the reported questions and looking at the sub-models described. A careful strategy must focus on building a "main contractor" approach to become very efficient in managing ESPs and better serve the internal client needs. Other focus areas — internal and external — will vary depending on the enterprise's strategic objectives.

3.6 Joint Ventures

There are few terms as confusing as "joint venture" in the IT services market today; therefore, it is important for enterprises to understand what JVs mean in this context to engage in the model successfully and identify the main reasons so many fail.

What they are: The term joint venture is often used interchangeably with the terms "alliance" or "partnership." Although market value can be created through alliances and partnerships, they are separate models. Gartner defines a JV as "the creation, by two or more partners, of a new business entity."

The single, most-compelling reason to form a JV is for the partners to leverage their relevant capabilities together to create a service that has market value and that the partners would not be able to create individually. The value is often based on one partner's vertical or industry expertise and another partner's technical capabilities.

What they are not: An alliance or partnership may be as insignificant as a combined marketing message or as substantial as two vendors — often a product vendor in conjunction with a service vendor — conducting joint research and development for product development and significant product certification activities.

Partnerships and alliances differ from JVs in one material aspect: they do not involve the creation of a separate accountable BU that is expected to result in a discrete revenue stream. Legal considerations often affect which type of relationship is created.

Why they fail: There are myriad reasons why so many JVs fail — and many more fail rather than succeed. The reasons include:

- Misaligned objectives of the partners
- Lack of business focus
- Conflicting management interests
- Lack of exit planning

By understanding these common pitfalls, enterprises that are considering buying the services of a JV will be able to assess the likely success or failure of their service providers.

How to make them work: Several critical success factors must be present for a JV to flourish and deliver the intended value to the partners involved. They include mutual opportunity, strategic value, cultural fit, trust and due diligence, objectives and decision paths, insight and ability, governance, sales and marketing, and funding. Much like understanding the common pitfalls, enterprises can evaluate the existence of the critical success factors before purchasing services from a JV entity.

3.6.1 Motivations and Metrics

Several motivational factors make JVs attractive to enterprises, including:

- Achieving expanded reach within their industry
- Positioning themselves strategically within their markets
- Leveraging assets

- Exploiting brand equity
- Meeting the regulatory requirements that make a JV arrangement favorable

It is paramount that the metrics align with the motivational forces that lie behind the creation of the JV.

3.6.2 Partners and Scope Define the Type of JV

The Gartner JV classification is based on two main aspects:

- Type of partners: IT businesses (vendors and providers) and non-IT businesses (clients)
- Business objectives that must be further split into:
  - Business objectives toward the open market (i.e., often in the same vertical market as one of the partners)
  - Service delivery toward a client/partner (i.e., typically an outsourcing contract between the JV and one or more partners for IT outsourcing or BPO services)

These elements can combine to create many different models, but the taxonomy highlights the five major kinds of JV (see Figure 10). These are the most common types of JV and are too different to analyze as a single group. Each model must be evaluated separately in terms of motivations, critical success factors, good and bad practices, and success rates. Figure 10 shows general characteristics and samples of each kind of JV based on the Gartner classification.

Partners involved	Business Objectives		Joint venture type
	Open market	Service to partner(s)	
Two or more providers	New services to the open market	None or limited	Provider joint venture
Client(s) and provider(s)	New services to the open market	None or limited	Pure business joint venture
	New services to the open market	Services to the client/partner	Mixed business joint venture
	None or limited	Services to the client/partner	Outsourcing joint venture
Two or more clients	Some services to other similar organizations	Services to all clients/partners	Consortium

Source: Gartner Research

Figure 10. Joint Venture Taxonomy

3.6.3 Providers Joint Ventures

There are examples of provider JVs in the ASP and telecommunication markets. ASPs are a multitiered, multiprovider model and can be created and managed as a JV between the different providers (e.g., infrastructure provider, independent software vendor and system integrator). Examples of this kind of agreement include:

- Avanade: Accenture and Microsoft for Internet-enabled business applications
- Pandesic: Intel and SAP (1997 to 2000) for full Internet services to small and midsize businesses (SMBs)
- Cyber.Solutions: Qwest Communications and KPMG
- Concert Communications: AT&T and British Telecom (BT)
- KPNQwest: Qwest Communications and KPN (ended in 2002)
- Telstra and Pacific Century CyberWorks

3.6.4 JV between Client(s) and Provider(s)

According to the stated taxonomy, the three kinds of such JVs are:

- *Pure business JV:* A user and a vendor decide to bring together their capabilities to build a new market player that will provide innovative business/IT services for the client's vertical market. The JV does not inherit any outsourcing contract from the client/partner. Innovation and new offerings to the market are the key objectives. Examples include FinancialSettlementMatrix.com (created in 2000) and Hubsys (created in 1999).
- *Mixed business JV:* This JV between a user and a provider has two sets of objectives and is used often. On one hand, there is an — often huge — outsourcing contract between the JV and the client/partner, and the client's service assets (IS organization or process organization) are transferred to the JV. On the other hand, the JV is expected to sell these services to the open market. It is one of the most difficult JVs to manage because it mixes an outsourcing side (i.e., often oriented to cut costs and improve service to the client) and a commercial side (i.e., with the opposite objectives). Most of these JVs fail commercially and are left with the large outsourcing contract between the client and the providers that absorb the JV. Examples include IT outsourcing and BPO JVs such as Tasco Europe (Shell and Ernst & Young for finance and administration BPO in 1997 to 2000), Xchanging and BAE Systems (2000), Calanais (SAIC and Scottish Power), and TIG Holdings and PriceWaterhouse (now IBM/PricewaterhouseCoopers) in 1997. The recent deals between Fiat and IBM, and Electronic Data Systems (EDS) and Abbey National can also be classified in this category.
- *Outsourcing JV:* This kind of JV between a client and a provider has one main objective — the outsourcing contract with the client. Open market activities are often seen as a tactical possibility only and are either not pursued actively within the JV or are left to the provider. In such cases, the JV is mostly a tactical instrument of transition. It is used in Europe particularly to overcome cultural or trade union transition issues, when the client feels uncomfortable with a direct outsourcing deal, or when a brand new solution needs to be developed and managed. The total or partial IT (or process division) spin-off and the JV agreement are the first steps toward a contract-based outsourcing relationship that can be attained in two to four years. This kind of JV may have almost the same results and critical success factors as an outsourcing contract, but they are reached in a medium term. Outsourcing JVs cannot provide the same kind of cost saving and service improvement that the outsourcing contract can (refer to *Strategic Analysis Report*, "Sourcing Strategies: The Joint Venture," R-07-1542, 11 January 1999). There is a quite long list of this kind of JV in Europe, including Banca di Roma and EDS, Novartis and IBM, and Eni and EDS. Elsewhere, there have been JVs between Ernst & Young and Farmland Industries (in the United States in 1997), and the Commonwealth Bank of Australia and EDS. An example of a new service is the electronic customer relationship management (e-CRM) JV between Ford and Trilogy Computer Systems.

- *Consortia:* Increasingly, enterprises are combining their capabilities (e.g., economies of scale or knowledge) to provide services to all partners and, possibly, to other similar entities. It is quite a successful model where the partners' needs are very similar. It is a model that suits basic, nondifferentiating needs. The main difficulties with consortia relate to the agreement process on future development of services and the stability of the client set on business terms and requirements. Examples include consortium service providers for SMBs on the same vertical (quite typical for regional or small banks) or vertical e-marketplaces.

When highly innovative services are required (e.g., e-marketplaces and related services), consortia take a different shape. In such cases, it is usual to find vendors or providers also entering the JV (with a minority stake) to ensure support and enforce partnership and knowledge transfer. These consortia are less common than those created between clients and are used for innovative services (e.g., e-marketplaces). A complex example of that is Covisint — DaimlerChrysler, Ford Motor Company, General Motors, Nissan and Renault (PSA Peugeot Citroën is in the process of entering) with Commerce One and Oracle creating the main Internet automotive exchange.

3.6.4.1 Forecasts and Key Facts

Strategic Planning Assumption: Through 2007, more than 75 percent of outsourcing JVs with open-market commercial plans will fail to provide services to the market (0.7 probability).

Strategic Planning Assumption: Through 2007, 50 percent of business aggregators that provide one-to-many ASP/BSP market solutions will be a JV between providers and client organizations in the relevant vertical market and geography (0.7 probability).

The key facts regarding JVs include:

- Provider JVs do not automatically ensure a better success rate than single provider initiatives.
- Most JVs between clients and providers address mixed objectives (market and outsourcing contract), often with very poor results.
- Outsourcing JVs are often transitional instead of relationship instruments.
- Many providers' relationship managers with experience with outsourcing and JVs openly state that an outsourcing contract is far better than a JV.

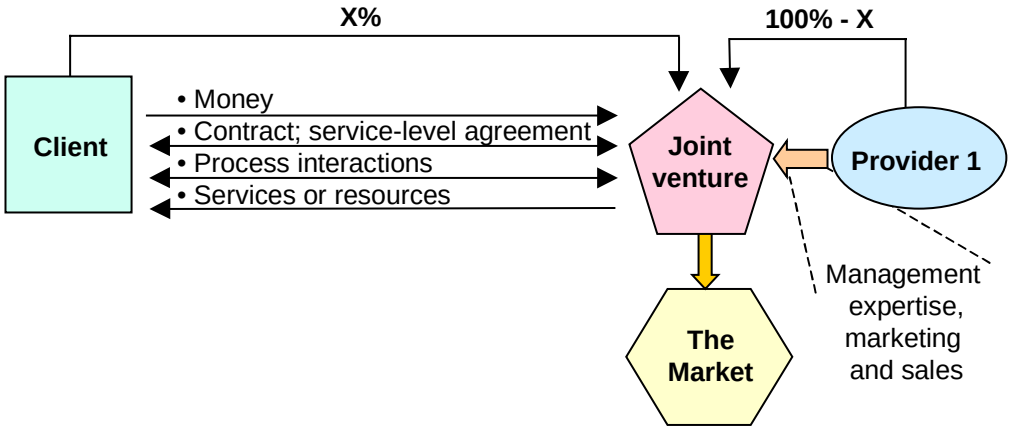
The connected economy's transition toward business/IT fusion will require partnering vehicles far stronger than the ones that have been experimented with in the past. JVs are still accustomed to realizing a measurable partnership, but past experiences clearly underline that this sourcing model does not succeed easily. The partners' objectives must be clear to verify if this sourcing model is the right vehicle and to choose the best JV type. Business management skills are then required to implement and drive this very complex business transaction, because only a minority of such deals will succeed.

3.6.4.2 Outsourcing and Mixed Business JVs

Strategic Planning Assumption: Within two years of inception, 80 percent of mixed-business JVs that lack clear and committed business plans, financial capabilities and the right skills will default to a nonprofit outsourcing JV (0.8 probability).

Strategic Planning Assumption: Within three years, 60 percent of outsourcing JVs will become progressively unstable and revert to an insourcing model (0.3 probability) or will be sold to the partner (0.7 probability).

Outsourcing or mixed business JV definition: To exit from the internal IT or insourcing model limitations (e.g., economies of scale or knowledge), the enterprise builds a separate service company and shares it with a market provider. Normally, the ESP gets the majority of the JV shares (typically 50 percent to 80 percent) and manages the JV operations (see Figure 11).



Source: Gartner Research

Figure 11. Outsourcing and Mixed Business Model

Depending on the true focus on the external market, JVs can be classified as outsourcing JVs (with limited or no focus on the market) or mixed-business JVs (that sells services to the market). *Outsourcing JVs* are mostly accustomed to overcoming cultural or legal resistance toward an outsourcing deal. This is a *transitional,* not a *relationship,* model; and usually it results in a normal outsourcing deal after a few years. *Mixed-business JVs* focus on building a new business in the open market and leveraging the client/partner assets and outsourcing contracts, as well as provider expertise and market capability.

The most important JV advantages are the easy transition and service continuity. In addition, the client retains an influence in — and even the right to buy back — the company. JVs also have the potential to create value through market activity. However, this does not come for free. A careful analysis of JV business mechanisms reveals potential reasons of failure.

Outsourcing JVs focus more on the client/partner outsourcing service, while mixed-business JVs focus on the internal contract and the external market. The main characteristics of an outsourcing and mixed business model include:

- An insourcing, spin-off or shared service is participated in or controlled by a provider or partner.
- *Pro:* Outsourcing advantages in addition to market opportunities and lower transition issues
- *Con:* Contradictory objectives (savings and market exploitation), often within contradictory partners objectives
- Widely used for IT services and BP as well; quite unstable; failure is the norm; success the exception

Samples of outsourcing JVs include:

- *IT examples:* ENI and EDS; Banca di Roma and EDS; Novartis and IBM; and Commonwealth Bank of Australia and EDS
- *BP examples:* Dairy Farms and Ernst & Young; Hungary, MOL and Accenture

Mixed-business JVs include:

- *IT examples:* Fiat and IBM; Scottish Power and SAIC; TIG Holdings and PwC; and Bank of Scotland and Xansa
- *BP examples:* Shell and Ernst & Young; BEA and Xchanging; BT and Accenture; and Abbey National and EDS

Action item: Organizations planning to build outsourcing JVs must carefully evaluate every aspect of the delicate balance that makes a JV succeed. Since failure is the norm, fallback plans must be ready early — even before negotiation begins — as part of the sourcing strategy future options.

3.6.4.3 Strengths and Weaknesses

Enterprises must be aware of JV characteristics when evaluating it as an alternative to an outsourcing contract. When choosing this model, enterprises should leverage the JV strengths, but they must also adopt counter measures to reduce and manage the identified JV weaknesses (see Figure 12).

Strengths	Weaknesses
Easy staff and asset transition	The negotiation seems (but is not) easier since client and vendor both control the joint venture.
High service continuity during the deal and transition phases	Knowledge transfer from vendor to joint venture is limited. Consolidation and economies of scale are limited. Cost reductions are seriously limited.
Partial client control over the joint-venture resources, organization and strategies	The joint venture is managed by the vendor. The joint venture is a captive market. The vendor sells resources, services and knowledge to the joint venture at a high cost.
Possibility of a call-back	Staff issues, vendor knowledge and other clients' destiny in the event of a call-back
Possible profits from the joint venture selling services and solutions in the open market	Difficulties of making profits and investments, profit sharing, the joint venture could become a competitor of the vendor, lower client focus and loss of preferred conditions
	Instability of the joint venture model in the long run

Source: Gartner Research

Figure 12. Joint-Venture Strengths and Weaknesses

Gartner advises enterprises to consider a JV primarily as a tactical approach to externalizing IT services, knowing that this model is often unstable in the medium-to-long term, and plan a sourcing strategy in advance to evolve it into a different model.

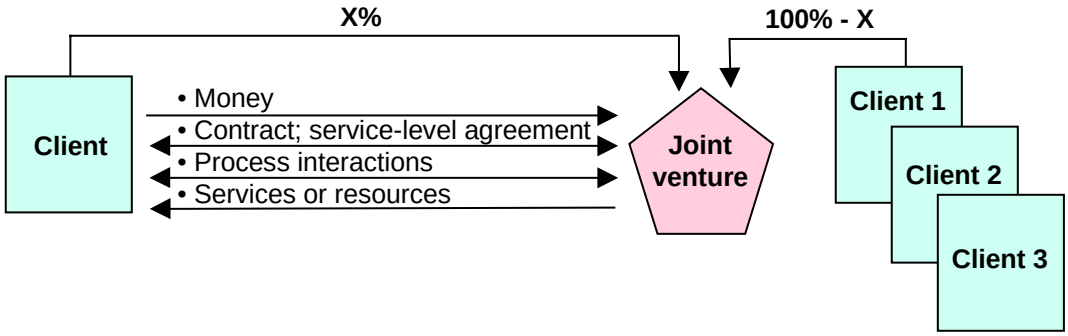
Figure 12 compares the major strengths and weaknesses of a JV when used as a substitute for a contract-based outsourcing relationship. The final consideration is that the JV model, when used in this way, is unstable in the long term and should be adopted in light of a broader strategy.

3.6.5 Client Consortia JVs

Strategic Planning Assumptions: Through 2007, in Europe, the client consortium JV will become a primary sourcing model for developing ASP/BSP and business solution aggregators for SMBs, local governments, and local service companies (0.8 probability). Many consortia will have one or more service providers as partners and co-financiers (0.7 probability).

Client consortia JVs definition: An IT or BP service provider is created by many client organizations that share the same service needs. Through the common service provider, the clients enjoy economies of scale and knowledge that could not be afforded at the single organization scale.

Client consortium JVs mostly are built between client organizations with similar needs (see Figure 13). Previously, market providers participated as subproviders, not partners. In the future, consortium-based JVs will include market providers as partners to deliver better economies of scale and innovation; and this will be the basis for developing new, interesting offerings and players. Client-led consortia are used primarily by midsize organizations in Europe (e.g., small and midsize banks or insurance companies). For these, a consortium approach helps build the economies of scale that one organization would never achieve. However, the need to serve similar — but competing — businesses tends to limit consortia's innovation capability and the single business' capability to differentiate itself in the market. Therefore, partner negotiations to define the investment or development direction for the consortium can be lengthy and provide unsatisfactory results. In addition, the stability of the set of partners is an issue (i.e., if 20 percent of the partners are acquired and leave the consortium, the overall economics are damaged).



Source: Gartner Research

Figure 13. Client Consortia JV Model

The main characteristics of the client consortia JV model include:

- Similar businesses with the same needs build and share a common service company.
- *Pro:* Cost savings from economy of scale; centralization; highly focused services
- *Con:* Client stability is an issue; internal scope negotiations may hinder innovation
- IT and BP services as well; successful model when applicable; includes providers as partners.

Samples of client consortia JV models include:

- *IT examples:* Italian small and midsize banks, Cedacrinord, CSE and SEC; Germany's Sparkassen Service Centres; the Global Straight Through Processing Association; and Norway insurers and Gjensidige

- *BP examples:* DaimlerChrysler, Ford, General Motors, Renault-Nissan, PSA, CommerceOne, Oracle and Covisint; Italian chambers of commerce and Infocamere

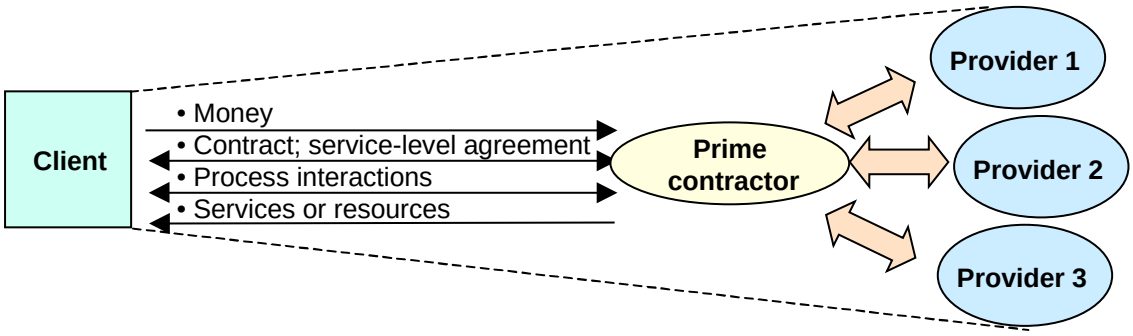
Action item: SMBs should envision and support the creation of client-consortia initiatives in their relevant markets. This model can provide SMBs and other organizations the economies of scale and knowledge they cannot achieve by themselves.

3.7 Prime Contractor

Strategic Planning Assumptions: Through 2005, the IT prime contractor role will progressively establish itself in the marketplace, although neither clients nor vendors will claim this role as their unique specialty service (0.7 probability). Through 2007, in Europe, although multisourcing will be the dominant sourcing strategy, only 30 percent of large enterprises will adopt a prime or general contractor to manage ESP market chaos (0.7 probability).

Prime contractor definition: Single entity (external provider or client-built) assumes end-to-end responsibility for integrating or managing multiple services and providers to derive a single solution or whole service for a client.

Prime or main contractors, management contracting and contract management are different flavors of the same role: the ability to manage and integrate multiple providers (products, projects and services) to derive a single solution or service for a client organization (see Figure 14). These roles and their related costs to the enterprise are well defined and accepted in many mature industries (e.g., civil engineering, energy and manufacturing). The overall IT service industry (i.e., the Immature Giant) has not been sufficiently mature for this. The 2000-to-2010 time frame will be a period of intense and turbulent maturation for the market. Thus, this sourcing model will emerge in terms of market offering (external prime contractor) and internally (i.e., as the evolution of large enterprises' sourcing strategies, especially from JVs, BSCos and best-of-breed consortia).



Source: Gartner Research

Figure 14. Prime Contractor Model

The main characteristics of the prime contractor model include:

- A new model growing with the 2000-to-2010 IT services market evolution and maturation
- IT services and business processes; it is mirrored by IT services supply chain and solution aggregator trends in the market

There are few complete prime contractor arrangements in the market. Some are emerging from long-standing relationship (e.g., Services New Brunswick and CGI Group), and others are from new deals (e.g., BT Cellnet and IBM, Royal Mail and CSC). Some are beginning to emerge for very complex

consortia in U.S. government deals (e.g., for the National Security Administration or the U.S. Navy) or specific sourcing strategies (e.g., JV renegotiations).

Action item: Enterprises that are willing to adopt this model may build it as part of their sourcing strategies or focus on progressively building trust with their preferred service providers and, therefore, extend this relationship into the prime contractor. The biggest challenge is in the contract: the prime contractor's contract is definitively innovative and mostly based on relationship processes and not deliverables.

3.7.1 The IT Prime Contractor: A Role Destined to Grow

IT service needs, the dependency on IT innovation and the complexity of overall solutions are clearly increasing for every business. At the same time, the overall IT service industry (i.e., including the internal IT functions and how businesses understand and leverage IT) is not sufficiently mature.

Standards, methodologies and the relationship between different providers are not good or stable enough to ensure a smooth integration of activities *provided by different sources.* Another reason for this is that the different providers are quite often competitors in the market.

The main activities and responsibilities that could be part of a prime contractor role are currently carried out by different organizations in different contexts. These include:

- Understanding the business objective and the impact on technology and business organizations
- Analyzing the current IT status to undertake an impact analysis of the anticipated evolution
- Stimulating, understanding and defining technically the business IT needs based on strategic directions and practical objectives
- Defining or confirming the choices in terms of architectures, technology platforms, integration standards, development and integration platforms, data security and information access policies, and common methodologies
- Acting as a business consultant for impact analysis of business or requirement changes or new available technologies
- Translating business needs into technical specifications for evaluating (feasibility study), planning (i.e., business case or pre-executive plan) and executing (executive plan)
- Project, and in some cases program, management (e.g., manage the overall plans, including the time scale for precedent studies, deals or tenders, internal reorganizations and change management, transitions and deal startups, and unplanned events)
- Service providers selection, deal or tender fulfillment or supervision up to the project or service startup and delivery (i.e., sometimes substituted by predefined service partnerships or deals carried out directly by the client)
- Service providers — or sub-providers — contracting
- Providers' projects or services monitoring and management
- Service processes management and methods (e.g., project, problem and change management, and escalation)
- Management of contracts, SLAs, invoicing and penalties, and in some cases, arbitration or renegotiations

- Fulfillment of tests, acceptance plans, documentation provision and testing, and quality certification
- User documentation and training, delivery monitoring and management
- Customer satisfaction management

Sometimes, this role is totally under evaluated, and some activities are not carried out at all. Quite often, selective outsourcing strategies are not properly managed during their execution.

In some cases, a business group will approach an ESP hoping that the ESP will solve every problem, even without being managed. For multiple ESPs in different service areas (selective outsourcing), the hope is that they will fit naturally or the internal IS group will take care of this. This expectation often leads to unsatisfactory services and relationships. Strategic sourcing, as a set of management practices to be installed on both the client and provider side, is Gartner's answer to these difficulties.

3.7.2 Who Does Part of This Job Today?

The order below is based on the amount of direct control from the client (i.e., those mentioned first are under more-direct control).

- *Internal IT:* This is the most-common approach. The IS group is the service integrator and the prime contractor of most externalized service or activity. Providers are selected and managed under the control of the business organization and through the IT internal arm. The difficulty for an internal IS group to manage effectively a selective outsourcing strategy is often under evaluated, and the management capacity is often inadequate.
- *BSCo:* A company owned by the client organization and that runs projects and services on behalf of its brand group, with an extensive leverage of external providers. The external providers are selected and managed by the BSCo, which takes over complete responsibility for the service to be delivered.
- *Best-of-breed consortium:* A consortium of best-of-breed providers is built on a single-case deal to fulfill the often huge needs of a large enterprise. One of those providers takes over the prime contractor role and manages the others ESPs and the overall project and service integration.
- *Full outsourcing or single provider:* When a single ESP has the full responsibility to deliver a defined objective or service, its account management team takes on the prime contractor role to fulfill the contract and manage the third parties and the different ESP internal units involved in the delivery.
- *ASPs as main contractor:* An ASP is often the client front-end of a multi-ESP service delivery. Thus, the ASP is also the prime contractor of the different partners or sub-providers. This constitutes one of the main challenges for this model.

3.7.3 Why Has This Role Not Yet Emerged Clearly?

Client side: In a low-maturity IT market, enterprises tried to address the complexity by building their internal IT arm: the IS organization. This organization aimed to do everything internally, mostly involving ESPs on a single activity or project. IS organizations were more focused on internal delivery than on building a comprehensive approach to this role. Thus, the businesses were not ready to recognize and value this hidden and often unsatisfactory IS activity.

Vendor side: The contractual protection based on the fact that "everything not clearly stated in the contract is not included" is still of value to providers. They are organized to provide what has been defined in their offers and contracts; and they are far less interested in accepting overall risks and responsibilities,

unless this role is well recognized and paid for. Some providers — especially consultants — have had program and project management as part of their offerings for a long time, but their clients used this offering more to speed up changes than in a true prime contractor perspective.

3.7.4 Why Will This Role Now Emerge?

Client side: It is increasingly difficult for an IS group to satisfy the growing business needs through internal skills and activities. More and more, the IT portfolio is made up by mixed internal/external activities and services. In a selective outsourcing world, managing the different parts of the services is a very tough task, and managing the end-to-end service quality requires even stronger management. In virtual organizations and complex supply chains, the entire concept of an internal IS organization is becoming less adequate. The prime contractor role will emerge as a support for internal IT capabilities or as a substitute for it.

Vendor side: Most providers has been really trying to do everything (see "Why IT Service Providers Lack Core Business Focus," M-11-6473, 29 November 2000). However, only a few will be able to build global, end-to-end, multipurpose and multivertical enterprises. Most will focus on fewer service areas, where their real strengths are. This process will also be fueled by the emerging split between commodity and value-added services. A broader service coverage will be maintained by partnering, and all this will push the rise of better practices for the prime contractor and the subcontractors.

3.7.5 Who Will Carry Out the Subcontractor Role?

Providers focused on horizontal services (e.g., infrastructure facilities like data center, desktop and LAN management) or on vertical specialties (e.g., a niche application for a specific vertical market) will be used extensively by prime contractors to provide part of more-complex end-to-end solutions. Prime contractors will become a very important channel to the market for those subcontractors. The need to make those relationships stable will help to establish service management processes between the different providers.

3.7.6 Who Will Take Over This Role: Client or Vendor?

The prime contractor role is mostly concerned with skills, experience, processes, program and project management, the ability to manage risks and opportunities, and vision supported by solid practice. It clearly represents a large step ahead in the maturity of the IT service industry. Client organizations are already working to improve this internally as part of their strategic sourcing practices (internal IT or BSCo). Providers will extend their capability in this area (especially consultants, system integration vendors and ASPs), both due to complex delivery failures and direct client request. Through 2005, the IT prime contractor role will progressively establish itself in the marketplace, though neither clients nor vendors will claim this role as their unique specialty service (0.7 probability).

Pressed by the competitive pressure of the connected market, every business is asking: "Who will ensure that IT innovation will really be up and running according to our business strategy?" Some internal IS groups are able to stand up and ensure this, while most are not. Therefore, businesses and IS organizations should focus on their strategic sourcing management capability and improve it as one of their main priorities. Service providers must focus on the skills, methodologies and partnerships needed to provide end-to-end solutions through internal and external resources, since this capability will become a market differentiator.

4.0 Real Sourcing Strategy Examples

In this section, Gartner reports some of the sourcing strategy case studies or real samples resulting from research on sourcing strategies. Each example represents the real answer that organizations in different

vertical markets (e.g., government, banks and telecommunication) have adopted as a solution (good or bad, early or late) to their business challenges.

The total of experiences gathered by Gartner in this area (i.e., as well as in the area of best practices for the following steps of the sourcing life cycle) make up a knowledge base of good and bad practices that basically allow organizations to avoid repeating mistakes that others have already made.

Ultimately, because sourcing decisions are usually huge and impact the business organization for a long time, a negative aspect of sourcing is that each organization makes a relatively small number of significant sourcing decisions. That means that executives and managers are often facing the first — or one of the first — attempt to leverage sourcing as a strategic weapon, and that make the likelihood of mistakes significantly higher than in other practices.

For additional information on sourcing practices and the case-by-case differences, refer to "Case Studies of Leading-Edge Sourcing Practices," LE-18-2298, 17 September 2002, and referenced documents.

4.1 Government IT, Then E-Procurement: 1997 — 2001

In 1997, two Italian ministries were unified in a single "Ministry of the Economy" while many of Italy's challenges (e.g., European monetary union participation and administrative decentralization) were directly related to this ministry's competencies and responsibilities (see Figure 15).

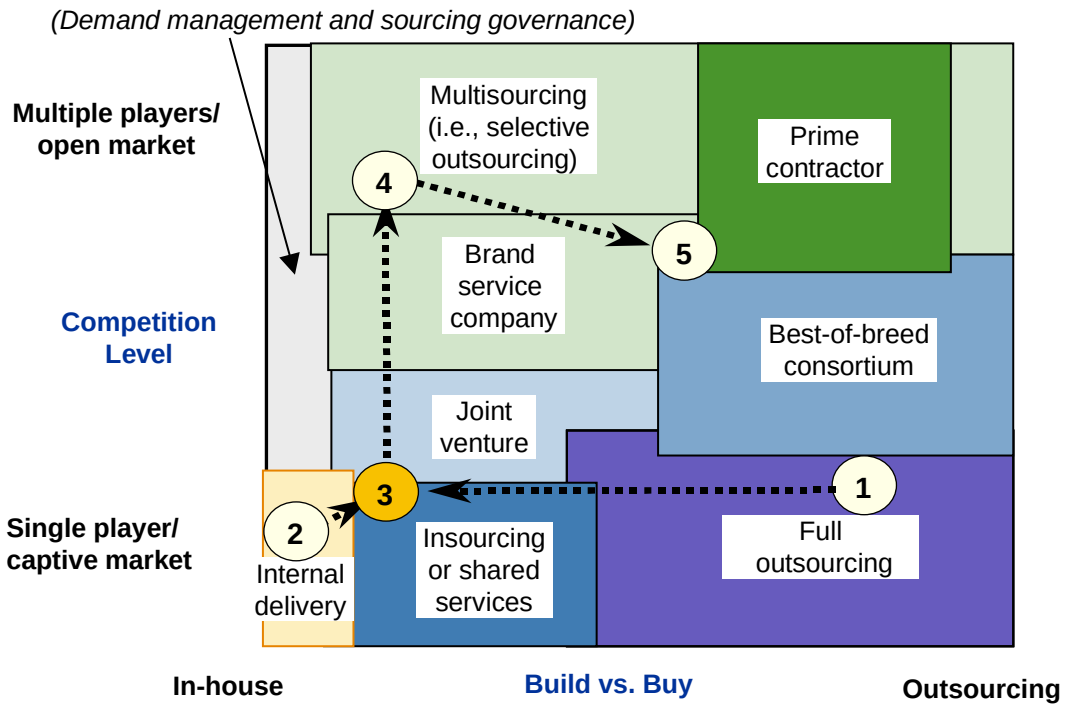
The ministry identified IT as a basic instrument to support its "change phase," while improving the efficiency of its operations and the quality of its results, as well as reducing its overall cost to the community.

Owing to independent IT purchasing decisions made throughout the previous 30 years, the legacy IT status of the ministry comprises many independent custom information systems, one managed in a 30-year old full outsourcing contract **(1)** and others managed in-house with extensive vendor help **(2)**.

In addition to the challenge of rationalizing the legacy information systems on these different platforms, the ministry must deal with the IT application problems that typically face Italian public administration departments, including:

- Italian legislation is highly complex and volatile; therefore, applications are complex and their maintenance is intensive.
- Information systems often are not upgraded in terms of architectures, technologies or new functions.
- Public administration has always had difficulties in recruiting, training and retaining skilled IT people.

To answer those tough challenges, a new role was defined by law. It was a new agency, fully owned by the ministry and with a private company structure, to be the administration's IT service provider (insourcing) **(3)**. The name of this company is Consip.



Source: Gartner Research

Figure 15. Case Study: Italian Government

Consip was asked to provide the ministry with the following:

- A unitary structure for implementation and delivery
- A unique technical interface as the guarantor for technical, functional and architectural integration
- Projects and services requested by the administration, mostly via ESPs or — in some case — directly

Consip's startup management included managers and technical people from major IT services and outsourcing providers in Italy. This composition addresses the inherent skill problems in public administration, and it ensured that Consip started with the competencies needed to undertake its challenges.

During its evolution, Consip avoided becoming a classic insourcer (full service provider), specializing instead on covering the higher value activities and leveraging (though tenders) the external service market, thereby going into the multisourcing market **(4)**.

The final position in the sourcing strategy market for Consip is in the BSCo area (i.e., it still directly manages part of the centralized IT services) very near to the prime contractor model **(5)**.

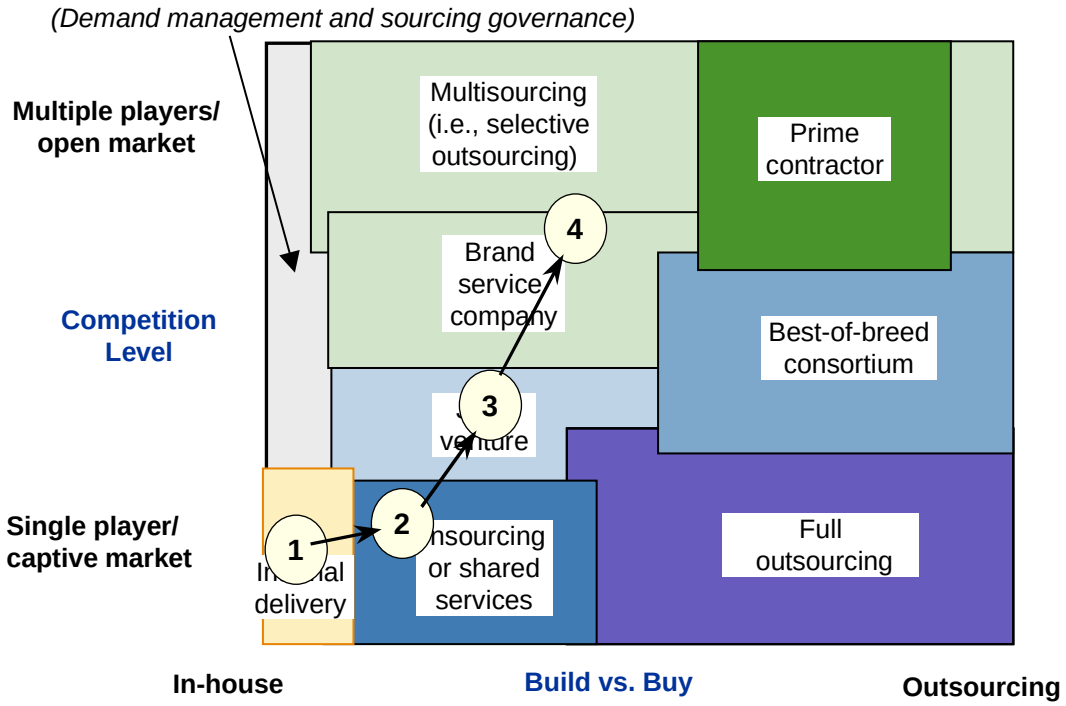
More details on this case have been published in a case study/forecast on Consip (see "Italian Public Administration IT Management: Consip," COM-04-8722, 10 September 1998), which was produced at the very beginning of Consip's life in September 1998.

After completing its initial mission — and keeping the new services updated — Consip was requested to build an e-procurement system for the whole Public Administration in Italy. This initiative has been carried out successfully (see "Italy Brings Electronic Public Procurement Down to Earth," CS-13-5193, 15 May 2001). With this move, Consip has completed the evolution into a BSCo of the prime contractor type,

delivering IT services (to the Ministry) and BP services (i.e., a significant part of the procurement process for the Italian Public Administration organizations).

4.2 Regional Bank, IT and Back-Office Processes: 1992 — 1999

A European regional bank grew all along through the 1990s via a number of M&A (see Figure 16).



Source: Gartner Research

Figure 16. Case Study: Regional Bank

Before starting the growth, IT services were first provided by an internal IS function **(1)**. Then, an attempt to build a JV with local service providers for application delivery for the bank and the local market started and quickly failed.

In 1992, the bank started to grow through the first two M&A, and an insourcing move **(2)** was decided with the transfer of computer assets and the consolidation of three data centers into one insourcing model. This consolidation brought several opportunities, including:

- Cost reduction through competitive bidding for external services
- Introduction of methodologies and improved know-how in service delivery
- Evaluation of the externalization path

In 1994, the bank agreed to share its insourcing as a JV with a Tier-1 service provider **(3)** to gain additional cost reduction and access to extended know-how. During 1997 and 1998, the bank grew dramatically, expanding from 170 branches to 300 in one year.

In the mid-1990s, the new structure of the group of banks and the changes in the financial market required further service consolidation, faster response to changes and quality delivery at lower cost.

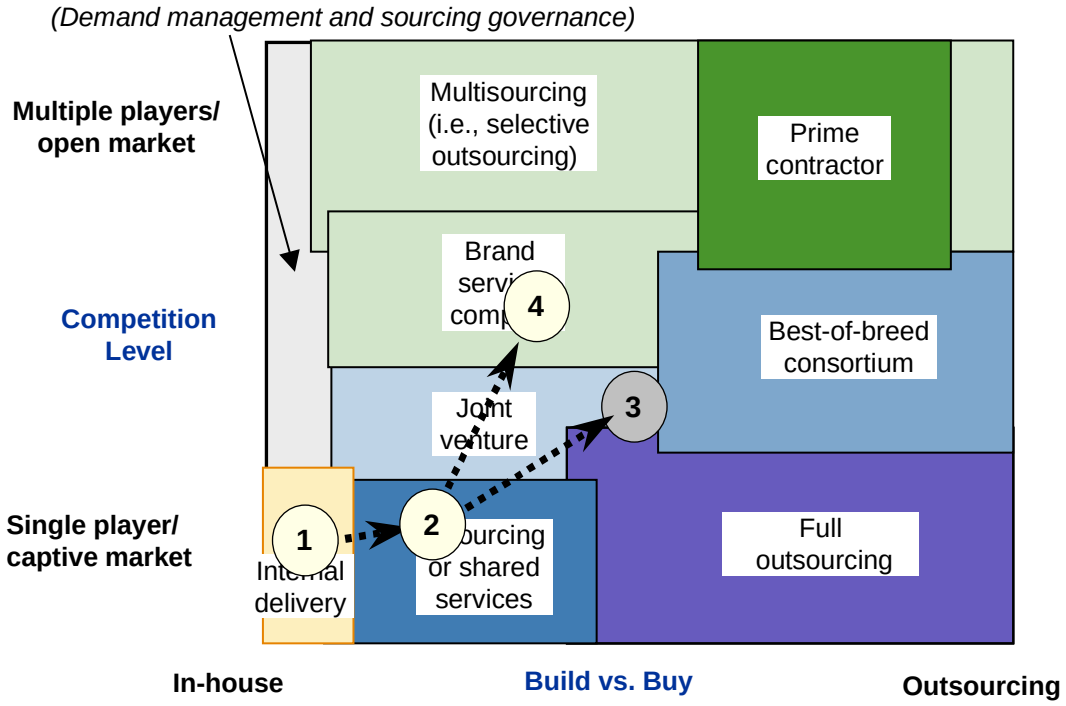
To achieve this, the bank started a BSCo organization for IT services and back-office processes **(4)**. The main lessons from this 10-year sourcing strategy evolution include:

- Building commercial operations in the IT world starting from an internal IS department is not easy.
- Insourcing can provide good results during M&A and consolidations, but it often leaves unresolved issues about the future of the insourced company.
- A JV has appeal, but the weaknesses of this model must be known and managed carefully. Short-term gain is possible, but this model is often unstable in the medium to long term.

For more details on this case, see "Sourcing Strategy: Insourcing to JV to Services Company," CS-06-4531, 8 April 1999.

4.3 Industry and IT Infrastructure: 1993 — 1998

Until the early 1990s, one large Italian manufacturer's IT services were managed directly by the different BUs (see Figure 17) **(1)**.



Source: Gartner Research

Figure 17. Industry and IT Infrastructure

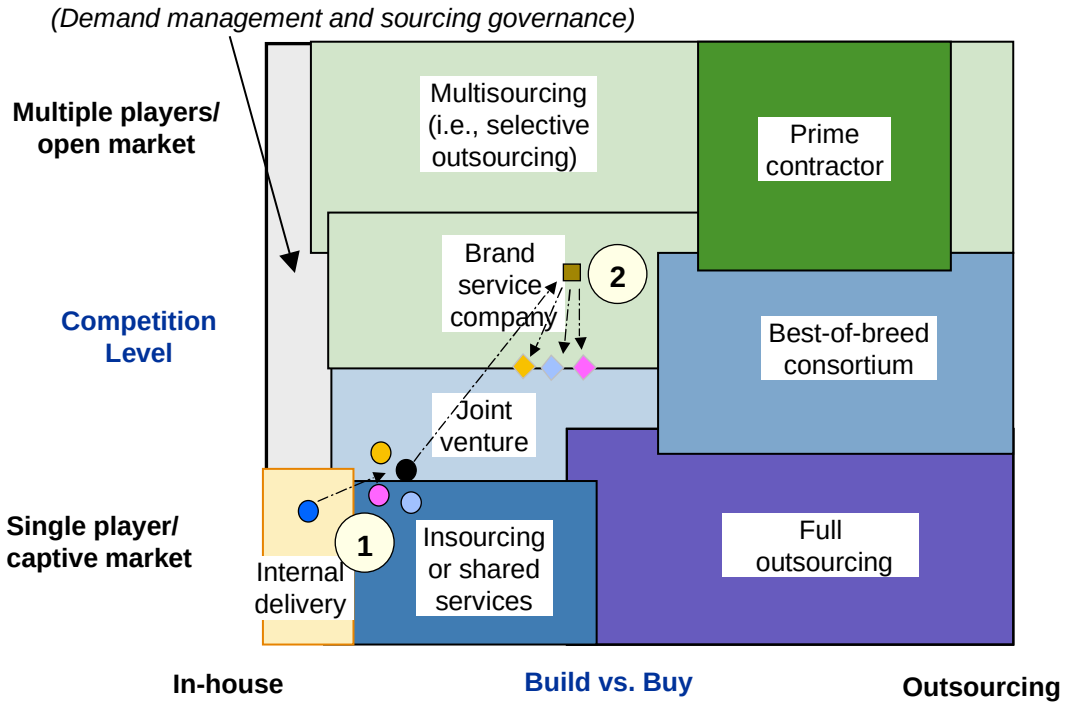
In 1993, a separate company was created to manage IT infrastructures for the entire group, implementing a classic insourcing model **(2)**. The first years of activity focused mainly on physical consolidation to gain economies of scale. In 1996, a tactical initiative began via a providers' JV between four different Italian insourcers (Arancia). This initiative soon failed due to partner changes and because the insourcer's challenge to become a business is far larger than just adding a sales force **(3)**.

From 1994 to 1999, the insourcer experienced significant growth as the consolidation of previous separated IS groups proceeded. The growth involved a 400-percent increase in revenue and a 300-percent increase in staff, transferred from the different BUs to the insourcer. This growth has been a major opportunity and challenge. The main result has been the evolution from a single-client organization to a multiclient, multinational service provider. At the same time, the service portfolio has shifted from host-centric to a distributed, complex environment.

Facing this complexity increase, it realized that the build-and-operate approach was no longer adequate. Ultimately, the mix of needs for investment in better services and customer satisfaction — together with the need to extend the worldwide coverage of distributed infrastructure, while reducing the service cost to the group — was unmanageable. The insourcer started addressing the make-or-buy dilemma and implementing other changes, including the shift from operations to services; a better focus on service levels, measurement and processes; improving the customer relationship; building continuous improvements and proactivity. Selective outsourcing deals have been started to provide services that the insourced organization could not provide internally at a competitive level. This began the transition from the insourcing model to the BSCo model **(4)**.

4.4 Industry, BP and IT: 2000 — 2002

Starting in 2000, the Fiat Group business strategy addressed the growing BPO market, by building a complex structure named Business Solutions, with the aim of expanding the services provided to the open market in Italy and in some selected countries abroad (see Figure 18). Established shared-service companies and some new entities **(1)** have been involved in this move.



Source: Gartner Research

Figure 18. Industry and Processes: 2000 — 2002

The overall strategy is aimed at reducing the dependence of the Fiat Group on the highly cyclic automotive market (i.e., as the current times are clearly demonstrating) by improving the amount of anti-cyclic services business. The Fiat strategic statement has been that by 2005, services would bring in 40 percent of its revenue.

As a result, Business Solutions **(2)** is a holding company (i.e., that only partially follows the concept of a BSCo) that includes different companies, focused on different areas of BPO: F&A and e-procurement, HR services, property engineering and facility management, IT and telecommunication services.

The Business Solutions group includes roughly 8,000 staff with a total annual revenue of roughly 2 billion euros.

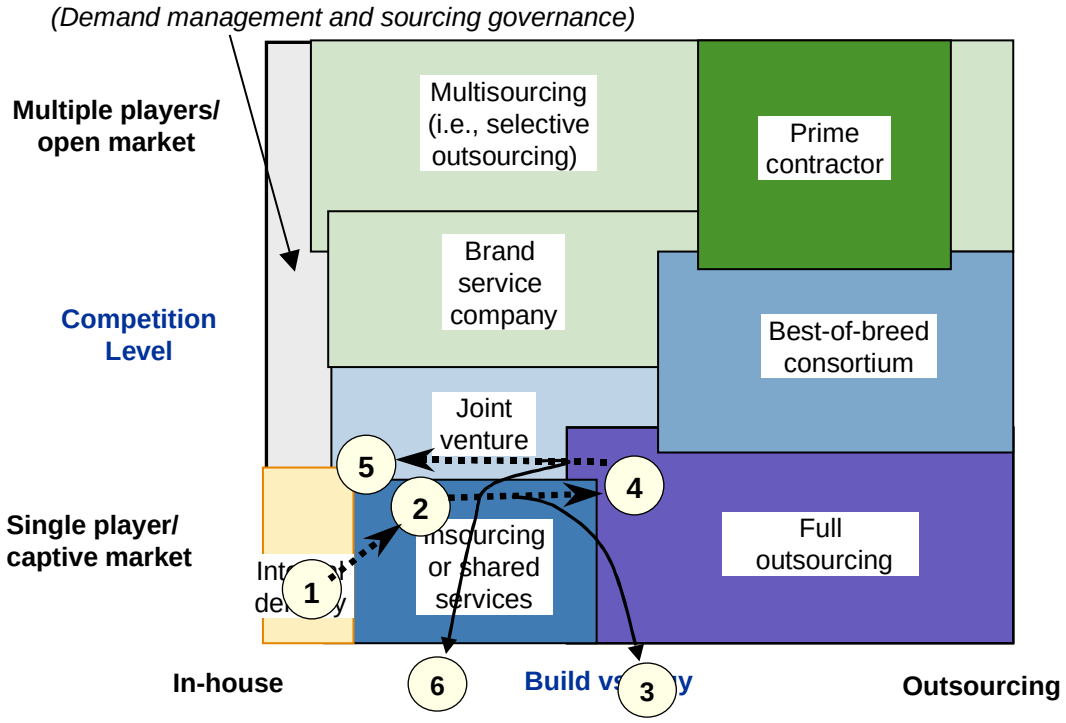
As part of this evolution, selected JVs have been built with focused market players (e.g., Johnson Controls for buildings, KPMG for F&A consulting, Telefonica and Acea for telecommunications, and Cap Gemini Ernst & Young for e-business).

The most important JV (i.e., an outsourcing mixed business JV) has been built with IBM, including two former IT insourcers as well as some IBM business that has been fused into the new entity called Global Value.

Although the current Fiat Auto difficulties are certainly challenging the overall strategy, Fiat is currently in the early moves for southern Europe in the promising BPO market.

4.5 Local Public Administration, Client Consortium for IT and Business Outsourcing: 1993 — 1998

Cerved was created in 1975 by a spin-off of established IS organizations **(1)** to give the chambers of commerce in one Italian region a centralized service for registering companies (see Figure 19).



Source: Gartner Research

Figure 19. Local Public Administration, Client Consortium for IT and Business Outsourcing

By the early 1990s, **(2)** it was owned by — and servicing — almost all the Italian chambers of commerce (i.e., becoming, therefore, a client consortium JV). During its initial growth, Cerved spun off **(3)** a commercial entity (i.e., Engineering, currently one of the largest Italian service providers). The central business of Cerved was to provide IT and BP services to the chambers of commerce; however, almost half its revenue (about 180 billion lire in 1994) came from selling commercial information to the market and sometimes also competing for some IT projects in the market **(4).**

In 1991, the Italian antitrust authority filed a lawsuit against Cerved for abusing its dominant position. The verdict confirmed monopolistic practices; and these were stopped, enabling third parties to become "chamber information dealers" via a standard contract. Finally, in January 1995, the former Cerved was split back into two entities:

- InfoCamere, a consortium 100-percent owned by the Italian chambers of commerce, which focuses on providing IT services to them **(5)**
- Cerved, a commercial company increasingly owned by financial institutions, is an information distributor and service provider to the market **(6)**.

Figure 19 represents the sourcing strategy of the chambers of commerce.

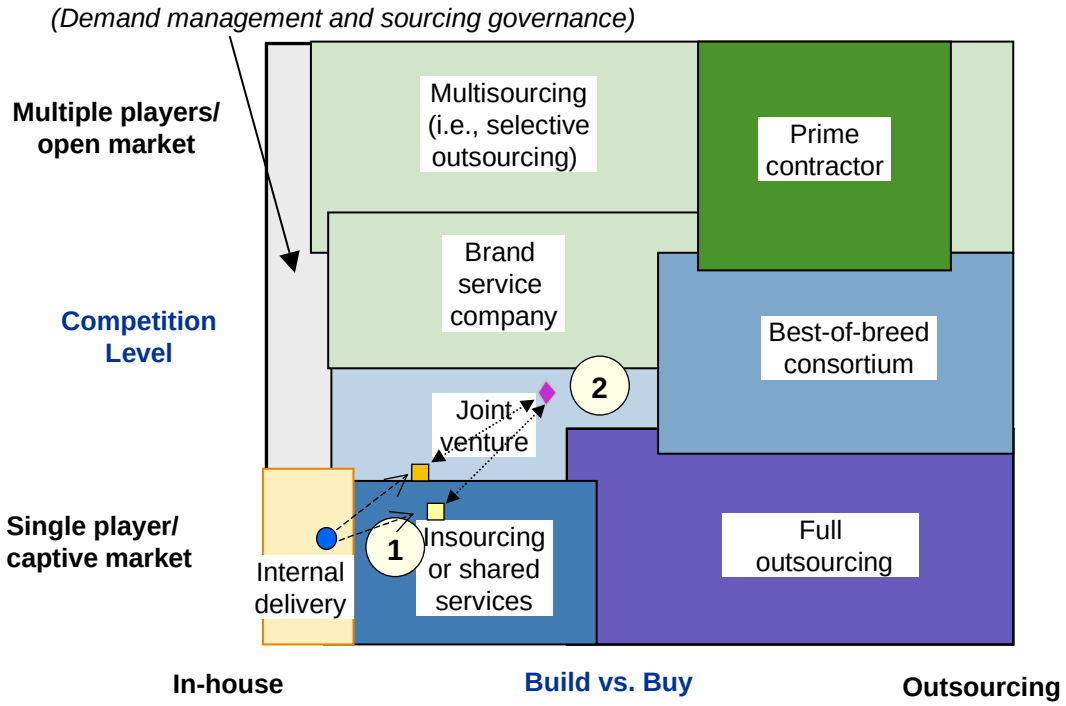
Service companies owned by Public Administration organizations are being challenged in their captive markets and monopolies from several directions:

- Market forces (e.g., ESPs with better services, lower prices and more innovation)
- Activities of regulatory bodies
- The trends toward privatization and decentralization

Public tenders or some separation of commercial activities may become the norm in the near future, and centralized captive organizations could be decentralized. Public Administration service companies need to evaluate the extent such trends will impact them and their economics, and prepare themselves to defend their business in the market. Such companies should work — together with their Public Administration clients — to build a sourcing strategy that may well include a spin-off, client consortia or "co-opetition" (i.e., competition plus cooperation) with the market and ESPs.

4.6 Bank's Failed IT Sourcing Strategy: 1999

In 1999, a European Bank tried to evolve its IT sourcing strategy — i.e., based on two insourcing organizations **(1)** by negotiating a mixed business JV with a Tier-1 service provider **(2)** (see Figure 20).



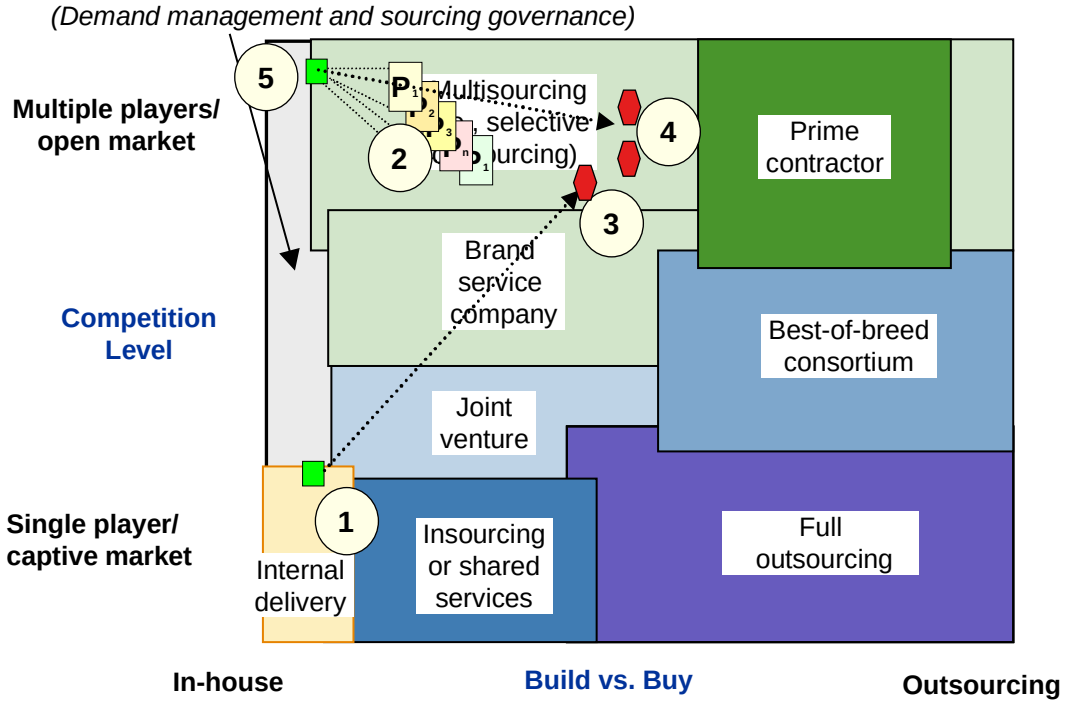
Source: Gartner Research

Figure 20. Bank's Failed IT Sourcing Strategy

The negotiation took more than six months work and finally failed due to the different, contradictory expectations on the two partners. Gartner concludes that a failure in negotiation is a bad result (i.e., a huge effort without any result). However, a failure in negotiation is still far better than a failure during execution.

4.7 Telecommunication Multisourcing Restructuring: 2001 — 2002

New telecommunication providers grew in the European market during deregulation. Some of them experienced very fast growth from nothing to huge businesses (see Figure 21).



Source: Gartner Research

Figure 21. Telecommunication Multisourcing Restructuring

To support this growth successfully in an IT-intensive market like telecommunication, their sourcing strategies has been mostly tactical and opportunistic (i.e., to leverage anyone able to provide solutions in the strict available time frame). That brought new telecommunication vendors into the market to:

- Manage internally most of their continuous operations **(1)**
- Leverage to the maximum extent multisourcing for infrastructure and application development and maintenance **(2)**

Starting in 2000, as their business started to mature and quick growth declined, new telecommunication vendors discovered that this strategy has two strong negative sides:

- Most, if not all, of their IT management bandwidth is drained by simply managing the service providers.
- Even worse, most, if not all, of the know how and competencies about core applications are in the providers' hands and not in the telecommunication company's hands.

Because this situation is potentially dangerous, some of those organizations are re-evaluating their sourcing strategy by:

- Evaluating the risk and opportunities of operational outsourcing for some part of their services **(3)**
- Restructuring their portfolio of service providers, reducing the number, gathering back know how and control, and trying to build "prime contractor" roles at least for defined subsystems or applications **(4)**
- Reviewing and enforcing their sourcing governance **(5)**

5.0 Conclusion

As the overall samples provided in this report demonstrate, a clear market trend exists regarding sourcing strategies. The trend is "more outsourcing" and "more leverage of competition." Nevertheless, the different sourcing strategies are clearly demonstrating that each sourcing strategy is always a single case:

- The starting point is different.
- The vertical industry and, therefore, the vertical market business requirements and issues are different.
- The country, business culture and legal, financial and taxation requirements are different, building to a different solution or different path-to-solution.
- As far as a sourcing strategy progresses (a matter of years, not months), the business changes, competition increases, internal know how evolves and the technology advances.

All that makes a sourcing strategy not a fixed story, nor a make-or-buy decision, nor an evolution toward a defined steady state. A sourcing strategy is a continuous journey into the best balance between internal and external activities and services, and know how. It is a continuous alignment between business strategy, business processes and IT services on behalf of the organization's strategic achievements.

Ultimately, a sourcing strategy is a process, not a decision.

Appendix A: Acronym Key

ASP	Application service provider
BP	Business process
BPO	Business process outsourcing
BSCo	Brand service company
BSP	Business service provider
BT	British Telecom
BU	Business unit
CFO	Chief financial officer
CRM	Customer relationship management
CSC	Computer Sciences Corp.
e-CRM	Electronic customer relationship management
ESP	External service provider
F&A	Finance and accounting
HR	Human resources
ISCo	Internal service company
JV	Joint venture
M&A	Merger and acquisition
NPV	Net present value
SLA	Service-level agreement
SMBs	Small and midsize businesses
T&Cs	Terms and conditions