

The Retained Organization: Managing the Hybrid Sourcing Solution

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A hybrid of outsourcing and insourcing is the most common sourcing strategy for information and communications technology (ICT) in organizations today. It's very rare to see an organization that has outsourced 100% of its ICT needs to third parties; likewise, it's rare to see one that keeps everything inside.

In Cutter's last global survey on IT outsourcing, only 4% of the 73 respondents outsourced all of their ICT spend, while only 8% did not outsource anything — leaving the vast majority (88%) somewhere in between.¹ Moreover, not only are the two extremes of total insourcing or total outsourcing uncommon; it is also uncommon to see any particular ICT functional area totally outsourced. Partial outsourcing exceeds full outsourcing in every service area. On average, partial outsourcing outnumbers full outsourcing by 4-to-1. For example, a partially outsourced help desk might affect only the first level of that service, or perhaps involve retaining the first level and outsourcing the second level.

This effectively creates an interdependent hybrid ICT organization, combining internal and external providers (13 on average), which has to deliver an often complex array of services to the business, ideally in a seamless manner. In fact, the internal IT organization really needs to act as a systems integrator by being a supply chain integrator. Although the performance of activities outsourced is the domain of the providers, accountability for the ultimate service outcome always ends with the organization: because, at the end of the day, the providers are merely its agents.

While many organizations that embark on outsourcing initiatives spend significant resources on defining the scope of the providers' responsibilities for tendering and contractual purposes, the same level of effort is seldom put into defining the responsibilities of the ICT organization that will remain (known as the retained organization). Such an organization represents the people, process, and technology necessary to perform the activities it retains. The organization also manages the ICT and business interfaces within the organization as well as the interfaces between the organization and its providers.

The retained organization strategy is a key part of the early planning in the Building Block 3: Strategize stage of the outsourcing lifecycle, as shown in Figure 1.² The key activities in this building block provide a very clear way forward for outsourcing and how it will be managed successfully throughout the lifecycle. In effect, you plan the entire round-trip journey before you embark.

Accordingly, the retained organization strategy is developed to document the following:

- Retained services, functions, and work processes that will continue to be performed by the organization
- Revised organizational structure, incorporating all interfaces internal and external to the organization
- Roles and responsibilities of the retained organization
- Costs for the retained organization, including investment in new skills

The time to decide what needs to be done, and by whom, is not after the deal has been signed and key people leave the organization. While some organizations are tempted to wait and "make a go of it," delaying organizational decisions is rarely successful and usually results in out-of-control costs, high staff turnover, inadequate supplier monitoring, and poor coordination among the parties.

Many organizations cut too deep when arranging a major outsourcing initiative. At face value, not having duplicate skill sets among the many parties involved

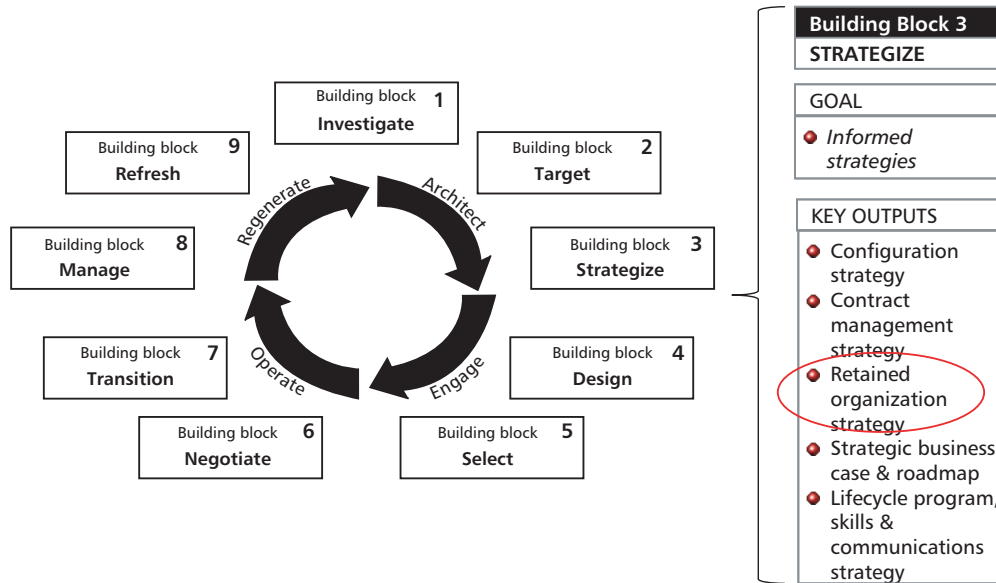


Figure 1 — The outsourcing lifecycle.

appears to be a rational decision, and it is in certain areas. But organizations have found that certain skills are necessary to retain, even if the providers also had them. Such skills include anything that:

- Has a considerable impact on the business (i.e., scheduling downtimes)
- Is a primary enabler of business initiatives (i.e., strategy)
- Requires an intimate knowledge of the organization to obtain best value from that skill for it to be effective (i.e., business analysis)
- Requires ongoing decisions to be made in the organization's best interest (i.e., hardware procurement)

It is critical to acknowledge that the use of outsourcing should never imply less effort in managing IT, only a different emphasis. For example, the top IT manager will need to concentrate more on direction, strategy, and implementation than with routine service delivery and staff management. The internal audit function, which may have limited reviews to comply with company policies in the past, must have a more active role. Auditing (compliance, validation, and value for money) is generally more extensive and frequent because the organization's accountability hasn't changed, but direct

control and physical proximity are now absent, and the introduction of profit as a key motivator behind everything the provider does (e.g., its advice/recommendations, service delivery, and resourcing strategies) must be taken into account. Planning becomes absolutely critical in outsourced environments. It is the familiar "garbage in, garbage out" paradigm; the only difference is that "outsourcing garbage" costs you much more. There is an increased need to appropriately authorize plans, costs, recommendations, and actions, and then sign off on deliverables — if only for the reason that most providers will not begin work without appropriate approvals to make sure they get paid. New requirements, and those that require changes from what was originally agreed to, will need to be negotiated and will have a cost impact.

The breadth of the information requirements of the retained organization actually increases under outsourcing. The organization must have information equal to the providers to be able to effectively and regularly evaluate all aspects of the services and determine whether reasonable value for money is being achieved. The need to appropriately evaluate plans, costs, recommendations, actions, and deliverables becomes greater because the cost required to do it again is so much greater under outsourcing. Furthermore, the retained

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CASE STUDY: IMPACT OF NO RETAINED ORGANIZATION

A state-based insurance company had entered into a “strategic partnership” with an IT organization. The board, believing that the supplier was now its official IT department and would act accordingly, saw no need to retain any IT capability. Furthermore, it believed that since it “wasn’t in the business of IT anymore,” it did not need skills duplicated within the supplier. Accordingly, it outsourced the entirety of its IT people, processes, technology, and strategy to the supplier. After the transition was completed, the soon-to-be-exiting CIO realized that no thinking had taken place regarding managing the supplier, let alone managing the utilization of IT in the company. He commissioned a study to determine what prudent management should be in place and

was startled by the degree of basic management activities required, never mind the more advanced ones. He proposed to the board the resulting strategy for retained organization and contract management, but was overruled. The board put the supplier in charge of its own contract, instead of having its own retained capability. By the end of the contract some years later, IT strategy was nonexistent, the entire IT infrastructure and related practices were obsolete and not supported anywhere in the industry, and IT costs were consistently well above the highest benchmarked market price. The organization had to rebuild its IT organization, beginning with the hiring of a CIO.

organization must stay informed about any events that may affect the providers (including their financial situation, court cases, published audit findings of other clients, and public blacklists, such as those by the World Bank).

Be very afraid if the only thought given to the retained organization is the amount of headcount that can be reduced, if the retained organization strategy is absent, or if it comes as an afterthought. These are all warning signs that your organization has assumed a level of effortlessness that rarely exists in the management of outsourcing and in the hybrid organization it creates.

ENDNOTES

¹Cullen, Sara. “The Configuration Concept: Scope Grouping.” Cutter Consortium Sourcing & Vendor Relationships *Executive Update*, Vol. 7, No. 17, 2006.

²For more on the outsourcing lifecycle, see the author’s four-part *Executive Report* series: Cullen, Sara. “Key Activities of the Outsourcing Lifecycle: Parts I-IV.” Cutter Consortium Sourcing & Vendor Relationships *Executive Report*, Vol. 10, Nos. 1-4, 2009.

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Dr. Cullen is a widely published author. Her publications include *The Contract Scorecard*, *Intelligent IT Outsourcing*, *Outsourcing: Exploding the Myths*, *Contract Management Better Practice Guide*, *Best Practices in ITO*, *Lessons Learnt in Outsourcing*, *Service Provider Management*, *Outsourcing Guidelines*, and *Outsourcing: What Auditors Need to Know*, in addition to research with various universities since 1994, including the London School of Economics, University of Melbourne, Oxford University, and the University of Warwick. She has been featured in such publications as *Australian Financial Review*, *Business Review Weekly*, *Computerworld*, *Directions in Government*, *European Journal of Information Systems*, *Information Economics Journal*, *Journal of Strategic Information Systems*, *Information Technology Report*, *Insurance Directions*, *Oxford Handbook*, *MIS*, and *MISQ Executive*. Her expertise is globally recognized, and she performs peer reviews of outsourcing research for *Harvard Business Review*, *California Management Review*, and *European Conference on Information Systems*. Dr. Cullen has lectured at many universities, including the University of Seoul, the University of Melbourne, the University of Monash, the University of Swinburne, Queensland University of Technology, and the Royal Melbourne University of Technology. Dr. Cullen earned a BS in accounting from St. Cloud State University (US); she was awarded a master’s of management (technology) from Melbourne Business School, and earned her PhD from the University of Melbourne. She is also a Chartered Accountant in the US. She can be reached at scullen@cutter.com.