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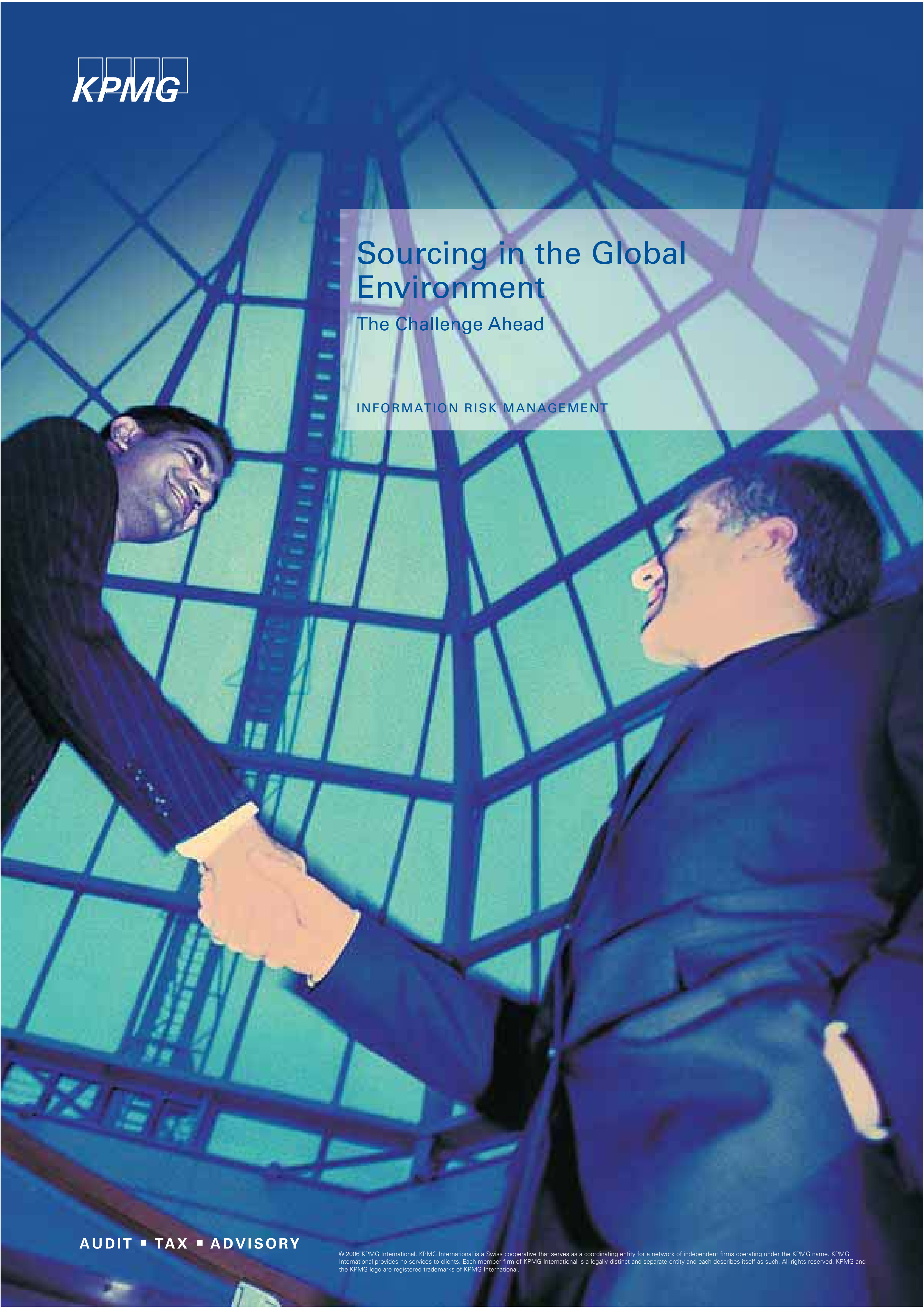


# Sourcing in the Global Environment

## The Challenge Ahead

INFORMATION RISK MANAGEMENT

AUDIT ▪ TAX ▪ ADVISORY

## Contents

# Executive Summary

Many businesses employing an information technology (IT) outsourcing strategy are struggling with how to monitor and measure the risks, value, and performance of sourcing. Executives admit knowing they should take a holistic view of IT outsourcing risks, but typically look first to cut costs and second at managing the inherent risks.

The following are some key highlights of this report:

- According to some estimates one quarter of outsourcing deals fail to meet expectations, and one fifth of all outsourcing relationships fail in any given two-year period. The National Outsourcing Association, based in the United Kingdom, reports that half of all outsourcing relationships fail within five years.
- The reasons for failure are varied, but chief among them is inadequate or inappropriate sourcing strategy or implementation. Service providers also cause failure when they do not understand their clients' businesses or their own. Businesses are often their own worst enemy in outsourcing, lacking understanding of the complexity of their business or inadequately communicating to the service provider.
- Effective use of a step-by-step method through the outsourcing life cycle can identify benefits, lower risks, and build valuable skills to help manage a business's sourcing strategy.
- The sourcing life cycle comprises six stages: *strategy*, *planning*, *selection/design*, *transition*, *delivery*, and *evolution*.
- An organization's sourcing governance functions may be most effective when split into contractual and operational groups. The governance functions can be shared by a centralized authority (such as a project management office, or PMO) and the business units or functional areas, such as IT or supply chain.
- Risks associated with outsourcing can be viewed in the context of six distinct categories: *strategic*, *operational*, *financial*, *regulatory*, *technological*, and *reputational*. And, although enterprises vary, there are some outsourcing risks common to all.
- Key considerations that may help increase the chances of sourcing success include the development of an enterprisewide strategy; the documentation of sourcing's short- and long-term drivers; the development and implementation of a formal and consistent methodology across various enterprise initiatives; the designation and execution of a good governance model; the development of an organizational change management plan; the development of a risk management framework; the development of a program that evaluates, measures, and monitors vendor performance; and the creation of a sourcing center of excellence.

# Introduction

**Egidio Zarrella**
Global Partner in Charge
Information Risk Management

By now, every senior executive or board member has heard the mantra that sourcing is employed most effectively as a strategic tool, not as a tactic or as a one-time event. Yet it is no stretch to say that businesses already sourcing services continue to struggle with this imperative. Like any tool that is handled improperly, sourcing can actually make matters worse when mishandled.

An analysis of several recent surveys commissioned by KPMG, coupled with information gathered by KPMG's partners and professionals, makes it clear that many organizations are struggling with how to create, deploy, and use processes that measure the performance, value, and risk of sourcing, especially IT outsourcing.

Interestingly, executives say they know they should be taking a holistic and current view of outsourcing risks, but they also say they feel compelled by competitive reasons to look first to cut costs and second to manage risks associated with outsourcing.

There can be no question that creating and using well-defined sourcing risk management practices is not simple. Sourcing is a complex and interconnected set of activities that requires unstinting focus across an enterprise. That is why it is critical for sourcing, at its core, to be viewed as a collaboration of parties that is based on knowledge of the purpose for the sourcing activities.

Since sourcing extends an organization beyond its traditional boundaries, there is a premium placed on its governance. When sourcing works well in an organization it is often because the people in it are part of a culture that measures success and failure. That duty falls not only on an organization's senior management and board but also on its sourcing partners. Sourcing also works well when it is not viewed as a series of static contracts. Instead, sourcing must be created and deployed with the knowledge that its pieces are flexible enough to allow for changes in technology and the business environment.

As a significant investment, sourcing has direct impact on an organization's bottom line, and it affects the organization's culture, risk profile, and day-to-day operations. At the same time, it is vital that organizations give careful consideration to complex risks such as reliability, serviceability, availability, contractual obligations, and security.

The presence of these risks should inevitably lead an organization to ask whether sourcing is worth the effort. Establishing a sourcing relationship will be a significant and continual investment of time and resources for an organization. If it fails, who will be accountable for the ensuing cost, loss of business, and loss of reputation?

However, if it is successful, an organization can achieve substantial economies of scale, savings, access to expertise, and diverse offerings as well as time to pursue strategic business objectives—an outcome that justifies the effort.

# Sourcing Life Cycle


*Source: KPMG LLP in the U.S. (2006)*

As a complex business-improvement mechanism, IT outsourcing requires focused attention on its interrelated and complex activities. A framework, such as the one depicted here, can be used to group and assess the critical activities in the life cycle of IT outsourcing. The life cycle helps manage the sourcing process from its inception, right through to its eventual dissolution or evolution.

Organizations either employing or considering IT outsourcing should examine each of these six stages and consider the questions listed below. This will help confirm that sourcing is being considered for the appropriate reasons and help ensure that the appropriate emphasis is placed on this critical initiative by the organization.

### *Strategy*

- What is the key driver to sourcing—cost reduction, focus on core activity, risk mitigation?
- What is the current position of the business—cost base, people, location, regulatory, and tax position?
- Are the risk factors too onerous—government policies, data protection, labor laws, licensing policies, transfer pricing?
- Are there any other options to sourcing—business reengineering, partner collaboration?
- Are the future costs of sourcing significantly less than the "as is" costs?
- Is analysis based on marginal or allocated cost base?

### *Planning*

- What is the current structure of the business—reporting lines, central costs allocation?
- What are the processes, technology, and accounting procedures used by the business?
- Who are the sponsors of the sourcing project?
- What are the performance metrics for control and for the service-level agreements?
- What is the best structure to be adopted for sourcing—sale of the business, joint venture?
- How is the deal likely to be financed?

### *Selection/Design*

- What is the financial strength, credibility, and reputation of the provider?
- Have all the requirements of sourcing been identified to enable correct pricing?
- Is the IT plan sufficient and does it include adequate disaster recovery planning?
- What is the estimated length and cost of transition and the likely scale of disruption to the business?
- What information/data on the current business is necessary for control and for the service-level agreement?

### *Transition*

- How is the change-management program developing?
- How is the separation plan progressing and are costs within designated parameters?

### *Delivery*

- How has the migration progressed?
- Are service levels being met?
- What are the governance processes?
- How is the relationship being managed?
- Are tax and regulatory issues being identified and tackled appropriately?

### *Evolution*

- Are the benefits of sourcing transparent (e.g., are planned cost reductions being achieved)?
- Are the operational controls sufficient to mitigate business risks?
- Is there potential for improving any processes?
- Is there need to restructure the deal (e.g., through joint ventures)?

## Drivers

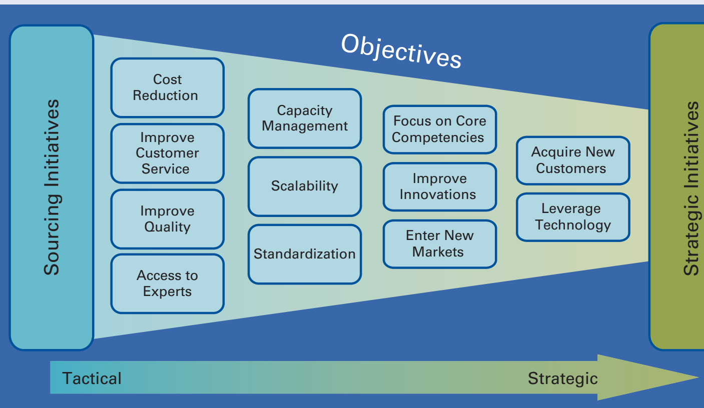
Today's globally competitive business environment is forcing organizations to take a harder look at their business functions in order to compete effectively. Global sourcing is being used to propel strategic and tactical change and to deliver tangible value through transformation.

The forces that drive the need to source those business functions to vendors spread around the globe are myriad:

- Cost reduction through economies of scale
- Improvement in customer service
- Improvement in process quality and efficiency
- Access to expertise that does not exist within the company
- Capacity management
- Flexibility to scale up or down
- Process standardization
- Focus on core competencies by moving administrative functions from operations
- Improvement in the ability to innovate
- Entry into new markets
- Acquisition of new customers
- Leverage technology, using standard infrastructure

Each driver should be tied to an organization's overall business goals, such as meeting customer needs and improving shareholder value.

Although executives in companies that source functions say they intend to use sourcing as a strategic tool, our experience and numerous recent industry surveys and studies show that cost reduction remains the main driver. Still, as sourcing initiatives mature they gradually take on a more strategic role.




*Source: KPMG LLP in the U.S. (2006)*

### Common Sourced Functions

As organizations are seeing sourcing as a strategic opportunity for business improvement, they are sourcing not only individual functions but also integrated processes.

We believe organizations can take sourcing from a tactical to a strategic initiative when they bundle these processes and reengineer them.

**Finance**
Accounts Payable
Accounts Receivable
Fixed-Asset Accounting
Travel and Expense
Customer Collections
General Accounting
Closing Process
Cash Application
Billing/Invoicing
Management Reporting
Treasury

**Human Resources**
Benefits Administration
Training
Payroll
Recruitment

**Sales/Customer Service**
Order Processing
Telesales
Account Inquiries
Claims Handling/Processing
Service Support

**Information Technology**
Network Support
Data Center Operations
Desktop Support
ERP/Project Office Management
Communications Operations

**Other**
Internal Audit
Tax Compliance
Purchasing
Logistics
Construction Services
Real Estate Services

Organizations are increasingly asking whether the processes and functions they undertake in-house could be more effectively provided by service organizations.

# Definitions

Despite being ubiquitous, sourcing isn't easy to define, and terms frequently are misunderstood and misused. Following is a glossary that may help provide clarity for the activities that fall under the term "sourcing."

| | |
|---|---|
| ***Outsourcing*** | A long-term, results-oriented relationship with an external service provider for activities traditionally performed within the company. |
| ***Offshoring*** | Allocation of IT-enabled processes to be managed by an internal/external service provider at a remote location (i.e., at centers in countries outside the originating location). |
| ***Near-shoring*** | Offshore activities within a nearby territory, and accessible by short travel or telephone in the same or neighboring time zone. |
| ***Business Process Outsourcing (BPO)*** | The delegation of one or more business processes to an external service provider who, in turn, owns, administers, and manages the selected process/processes, based upon defined and measurable performance metrics. |
| ***IT Outsourcing*** | The delegation of the information technology function (or components of it) to an external service provider who, in turn, administers and manages the selected process/processes, based upon defined and measurable performance metrics. |
| ***Offsourcing*** | The restructuring of a supply chain where one company relies on its suppliers for functions that were previously performed in-house. The offshored functional unit is able to generate greater values as a part of the supplier's business than in the customer's business. What makes "offsourcing" so powerful is that the supply chain is tightened by the improved functioning of the offsourced employees in the new environment. |
| ***IT-Enabled Services*** | Business processes and services that can be performed or provided from a location different from that of their users/beneficiaries through delivery over telecom or data networks and the Internet. |
| ***Business Process Reengineering*** | Planned changes in the manner of conducting a business function, such as information collection and reporting, manufacturing, finance, compliance, or administration. |
| ***In-sourcing, Back-sourcing*** | The delegation of one or more IT-intensive business functions/processes to an in-house/internal provider who, in turn, owns, administers, and manages the selected functions/processes based upon defined and measurable performance metrics. |

*Source: KPMG LLP in the U.S. (2006)*

# High-Level Risks

The statistics are compelling. By some industry estimates about one quarter of outsourcing deals fail to meet expectations, and one fifth of all outsourcing relationships fail in any given two-year period. The National Outsourcing Association reports that half of all outsourcing relationships fail within five years.

Service providers are often blamed for causing outsourcing failures. While they sometimes are the cause (often through not understanding their clients' businesses or their own), more often than not the business is its own worst enemy.

The reasons for failure are varied, but chief among them is inadequate or inappropriate planning, especially when creating a sourcing strategy or planning for the actual implementation. Failures often result when organizations lack understanding of the complexity of their business, or they are not communicating adequately to the service provider.

**Failure Trends**

- More than one in four outsourcings fail to meet expectations (*Information Week*)
- 20–25 percent of all outsourcing relationships fail in any given two-year period
- 50 percent fail within five years (National Outsourcing Association)

**Drivers**

- Poor planning, design, and selection:
  - Inadequate sourcing strategy and implementation
  - Clients lack understanding of own business complexity
  - Service providers who do not understand the business (either client's or own)
  - Contract does not reflect the reality of the redesigned processes
- Poor contract management and governance:
  - Costs were too high and uncontrolled
  - Service was not up to standard
  - Complex relationships between recipient and provider
  - Retained organization does not drive out recipient-side savings (e.g., head count reductions)
  - Inadequate performance measurements
- Inflexible deal structuring:
  - Pricing
  - Service levels

**Impact on Business**

- Increased business risks
- High costs and/or wasted resources
- Business disruption
- Barriers to future sourcing initiatives

*Source: KPMG LLP in the U.S. (2006)*

Risks associated with outsourcing can be viewed in the context of six distinct categories: strategic, operational, financial, regulatory, technological, and reputational. And, though they may vary from enterprise to enterprise, there are some common risks associated with outsourcing.

## Strategic Risks

Strategic risks are those risks associated with the scenarios, plans, directives, and decisions that dynamically define and integrate the internal and external resources and services required to fulfill the enterprise's business objective.

***Examples:***

- Lack of "visible" executive sponsorship
- Outsourcing strategy does not align with overall business strategy and priorities
- Strategy does not consider long-term goals for outsourcing other processes

- Strategic objectives are not clearly defined or effectively communicated to outsourcing partner
- Failure to identify and involve key stakeholders, both internal and external, in the strategic planning process
- Failure to identify and resolve human resources (HR) issues
- Cost and headcount reduction are the primary strategic objectives as opposed to a longer-term vision that extends beyond economic drivers
- Business processes transferred intact with an expectation that the outsourcing partner will be able to maintain or improve performance levels at a lower cost
- Risks to future flexibility and business options not identified or mitigated
- Failure to identify components of the organization that need to be retained; taking the wrong processes offshore, especially broken processes with multiple hand-offs
- Lack of local market knowledge impacting areas such as location selection, local regulatory compliance, local government monopolies, and delivery quality
- Inadequate scale of offshore operation and lack of attention to local business continuity planning
- Lack of attention to business continuity planning of the supplier
- Failure to perform a consumer impact analysis of offshoring
- Failure to consider team chemistry, management style, and cultural differences, including reverence for hierarchy (or lack thereof), individual vs. team orientation, and tolerance for risk

- Unstable political situation in some countries
- Failure to exercise greater levels of due diligence in the evaluation and selection of an offshore vendor's delivery capabilities

### Operational Risks

Operational risks are risks attributable to operational problems with service or product delivery or inability of an entity to recover fully and timely from unforeseen events.

***Examples:***

- Operational risks not identified and/or mitigated
- Operational risk management complicated by geographical differences
- Operations performance metrics not clearly defined or tracked
- Inability to "operationalize" strategy
- Inadequate attention to recruiting, training, learning curve, and retention at delivery site
- Project charters not clearly defined or prioritized
- Scope and service levels not regularly reviewed
- Skill and knowledge transfer may be difficult and costly to recover
- Operational capacity requirements not clearly defined or understood
- Informal processes may not be documented or their impact to operations is not clearly understood
- Unrealistic reliance on contracts and service-level agreements to ensure success
- Proper oversight of outsourced processes not maintained, inadequate resources allocated to relationship management
- Dependability of and dependence on service providers questionable
- Difficulty retaining management talent during steady state
- Inability to tie in business strategy of the organization to sourcing strategy (e.g., the business strategy may impact in the near future the process that is currently being outsourced)
- High level of workforce attrition in low-cost countries
- Local information structure may not allow for comprehensive employee background checks
- Infrastructure stability issues in a number of upcoming outsourcing destinations

## Financial Risks

Financial risks are risks attributable to interest rate and foreign exchange rate movements or the entity's inability to meet payment obligations as and when they fall due.

***Examples:***

- Financial risks and consequences of an operational failure not identified or mitigated
- Economic benefits and cost levers are not properly defined
- Short-term cost reduction does not justify long-term costs
- Cost reductions not achieved due to inability to reduce workforce and related resources
- Business disruption insurance may not cover offshore outsourcing relationships
- Exchange rate fluctuation can impact cross-border contracts
- Many suppliers outside of India and Western Europe are start-ups without a mature client base
- Inadequate attention paid to tax-related issues so tax incentives available at offshore locations are not achieved
- Failure to baseline processes accurately, hence not able to negotiate better terms with the vendor

## Regulatory Risks

Regulatory risks are risks caused by violation of laws, rules, regulations, prescribed practices, and ethical standards.

| *Jurisdiction* | *Framework* | *Relevance* |
|---|---|---|
| Australia | Corporations Act 2001 (including CLERP 9 amendments) | Aims to strengthen the financial reporting framework |
| Canada | The Multilateral Instrument 52-111 | Promotes an "internal control culture" for improving the quality of financial reporting in Canada |
| European Union | The Financial Services Action Plan (FSAP) 1999 | Designed to create a single market in financial services throughout the EU and consistency in how that market is regulated |
| Netherlands | Corporate Governance Code of Conduct 2004 | Seeks to improve transparency in shareholder and management relations, as well as the structure and accountability of management in the Netherlands |
| United Kingdom | The Companies Act of 2004 | Aims to improve the reliability of financial reporting and the independence of auditors and auditor regulation in the United Kingdom |
| United States | Sarbanes-Oxley Act of 2002 | Management assessment of the design and operating effectiveness of the internal control over financial reporting (Sarbanes-Oxley section 404) |

*Source: KPMG LLP in the U.S. (2006)*

***Examples:***

- Increased regulatory risk
- Predatory lending
- USA PATRIOT Act compliance
- Basel II
- Sarbanes-Oxley Act of 2002
- Regulatory scrutiny over international outsourcing
- Compliance with local tax and labor laws at offshore location

## Technological Risks

These risks relating to the failure of the outsourced entity's IT environment to effectively process and deliver products.

***Examples:***

- Migration and transition strategy not clearly defined
- Future advancements in technology not considered
- End-user, operations, and infrastructure support requirements not clearly defined or understood
- Technology obsolescence not considered in contractual agreements
- Failure to ex  do not adapt well to international recovery requirements
- Security and privacy requirements difficult to define, implement, manage, and maintain
- Protection of intellectual capital
- Failure to plan for and execute a global IT delivery model
- Current vendor support contracts may not cover offshore locations

## Reputational Risks

This is the risk of negative publicity regarding business practices associated with the outsourced operation.

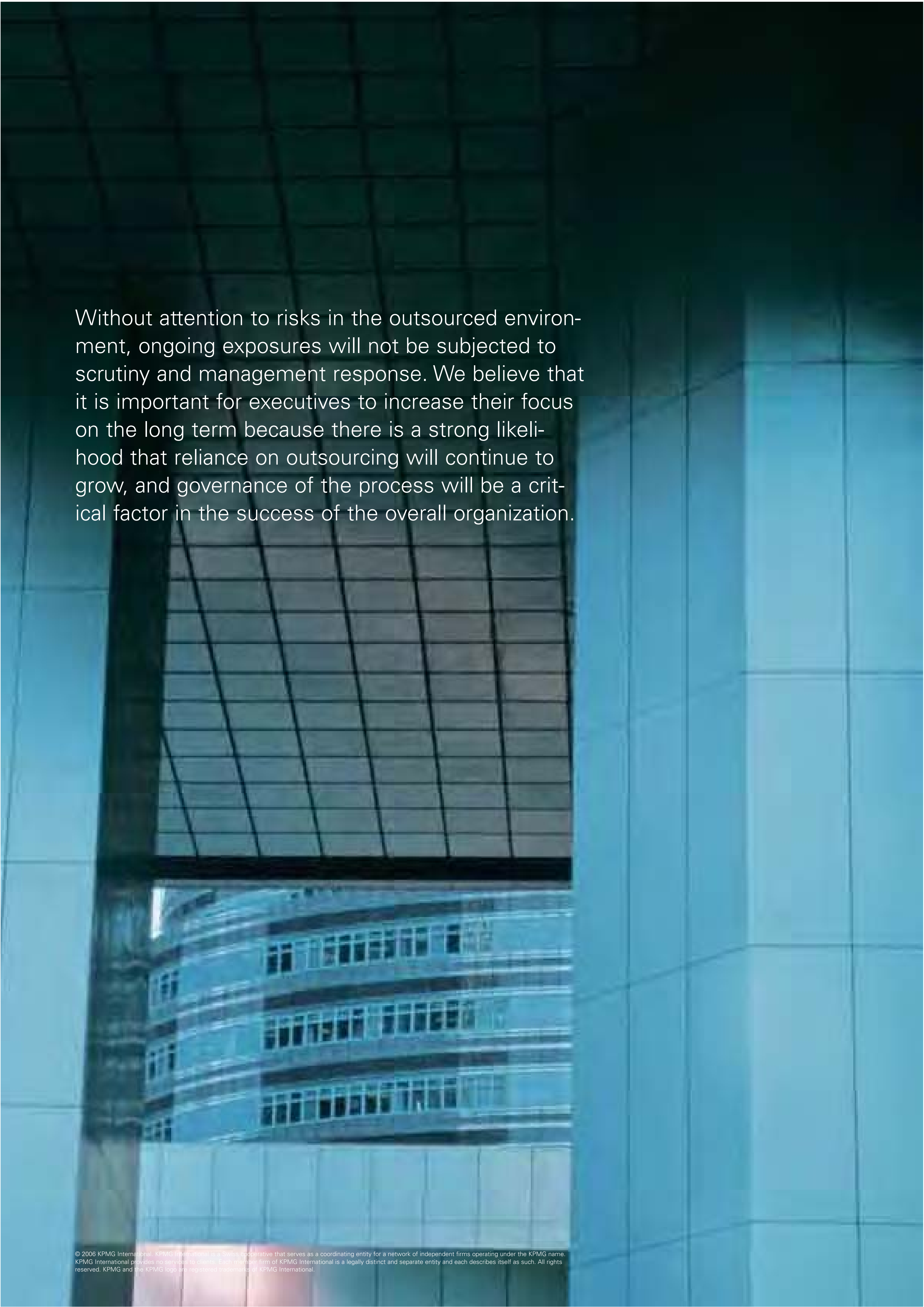
***Examples:***

- Transition issues impacting customer service
- Recent backlash against moving jobs offshore
- Language and dialect issues negatively affecting end-user perception
- Child labor laws not enforced in many countries that are centers for outsourcing
- Lack of proper labor laws in supplier countries that may lead to exploitation of people employed
- Risk of getting "out of touch" with the customer (could happen if there are no channels made available to the customer to reach the company if an issue is not properly resolved by the service provider)

# Survey Results

In the course of an 18-month period, KPMG's global network of member firms commissioned several surveys of C-level executives in global businesses involved in outsourcing activities. The results, we believe, are compelling. A number of distinct themes emerged following an analysis of the data.

- Few organizations developed an up-front enterprisewide strategy for sourcing.
- Although executives generally said they believe they understand the benefits and risks of global souring strategies, many organizations are not adequately tracking either of them. One reason for this lack of tracking may be that many organizations do not have formal means to monitor and manage benefit and risks.
- Many did not have an enterprise view of their sourcing activities. Instead they had a business-unit view.
- In some instances where businesses said they had a defined business case for sourcing, they did track back to see if the business case actually came to fruition.
- Organizations reported having difficulty measuring the performance of their service provider, requiring new assessments and specifications in contract terms, and having to reduce the complexity of service-level agreements (SLAs).
- The selection process for service providers is changing. More subjective, nonfinancial metrics are being used to evaluate the potential service providers.
- Ten percent of financial services organizations in 10 European countries that said the most important benefit of outsourcing is cost savings admitted they are unable to measure it. In addition, nearly 15 percent who said they could measure outsourcing's cost savings use qualitative methods to do so. These results indicate that some organizations may be using a "finger-in-the air" method to measure benefits of a critical business initiative that has significant operational, regulatory, and financial consequences. This subjective process may indicate an absence of underlying systems and processes that provide a view across an organization.
- More than 25 percent of respondents stated their organizations are unable to measure operational and financial risk. Technological and regulatory risks are not measured by nearly 35 percent of companies, and nearly 40 percent of companies could not measure strategic and reputational risk. It is striking that while almost half are not able to measure reputational risk, about 65 percent stated that this particular risk is the second-most important in their rankings.
- About a third of respondents have incorporated the management of their outsourcing supply chain into an existing procurement function. Such a decision could be viewed as being short-sighted, primarily because an outsourcing decision is a strategic call and should not be sited in a part of the business structure that deals with the purchase of products.
- Equally concerning is that a significant portion of participants (more than 30 percent) do not audit or review the management controls over the key risks presented by outsourcing.



Without attention to risks in the outsourced environment, ongoing exposures will not be subjected to scrutiny and management response. We believe that it is important for executives to increase their focus on the long term because there is a strong likelihood that reliance on outsourcing will continue to grow, and governance of the process will be a critical factor in the success of the overall organization.

# Key Considerations

Organizations often ask for help in understanding some key considerations that might be made in to order increase their chances of success and to reduce the risks when sourcing. The considerations listed below could help executives make more informed decisions when examining their sourcing activities.

**Develop an enterprisewide strategy**. Avoid viewing sourcing as a discrete procurement transaction. To gain maximum benefits, view sourcing as a business-improvement opportunity from the enterprisewide perspective instead of a collection of unrelated activities at the business-unit level.

**Document the short- and long-term drivers for the sourcing initiative**.

**Develop and use a formal and consistent methodology across various enterprise initiatives**. The example below graphically depicts ideas for steps associated with stages of the sourcing life cycle.

### Strategy

- Outsourcing vision
- Outsourcing strategy
- Preliminary business case
- "Assess and plan" project plan

### Planning

- Current-state analysis and baseline cost model:
  - Process
  - Organization
  - Technology
  - Assets
- Conceptual business architecture:
  - Governance
  - Retained organization
  - Deal structure
- Risk assessment:
  - Operational risk
  - Regulatory risk
  - Intellectual risk
  - Information risk
- Tax structure:
  - Tax strategy
  - Legal entity structure
- "Scope and plan" project
- Refined business case

### Selection/ Design

- Target operating model:
  - Scope of services
  - Deal structure
  - Service-level requirements
  - Business and regulatory requirements
- Vendor selection:
  - Prequalification
  - RFP
  - Evaluation
  - Selection
- Vendor negotiation:
  - Negotiation strategy
  - Position papers
  - Service-level agreements
- Due diligence
- Detailed "transition" project plan
- Refined business case

### Transition

- Retained organization:
  - Process design
  - Vendor process interface design
  - Organization design
  - Policies and procedures
  - Diagnostic assessment
- Pilot:
  - Design
  - Evaluation
- Transition:
  - Performance measurement frameworks
  - Risk management
  - Communications
  - Execution support
  - Evaluation
- Refined business case

### Delivery

- Governance structure assessment
- Service-levels assessment
- Customer satisfaction survey
- Contract compliance report
- Regulatory compliance report
- Controls assessment
- Refined business case

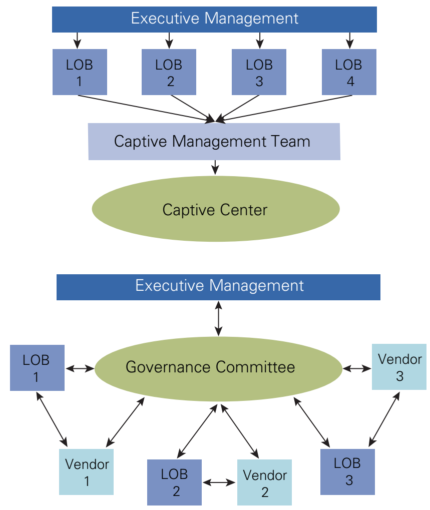
### Evolution

- Outsourcing model strategic alignment review
- Cost-cutting opportunity review
- Mid-term deal restructuring assessment
- End-of-term deal renewal/exit evaluation
- Pre/post-merger assessment

*Source: KPMG LLP in the U.S. (2006)*

**Design and execute a good governance model**. The actual governance model is dependent on the dominant service delivery architecture for the organization. The models depicted on the right are provided as examples only. In our experience, companies with successful outsourcing relationships with multiple vendors tend to have a central governance committee providing oversight. Tasks such as contract management and ongoing vendor interaction are performed by business units. In companies with captive centers, operational areas within the captive center interact with the corresponding process owners of the sourced business unit via management personnel at the captive unit. The captive unit in turn interacts with the sourcing governance organization.

**Governance Models**




*Source: KPMG LLP in the U.S. (2006)*

**Develop a human resources and change management plan**. One of the largest elements to manage as part of a sourcing initiative is the associated change. This is critical in minimizing the impact of the sourcing effort on the organization. Unfortunately, change management is not simply an activity to be performed—it a process that the organization experiences.

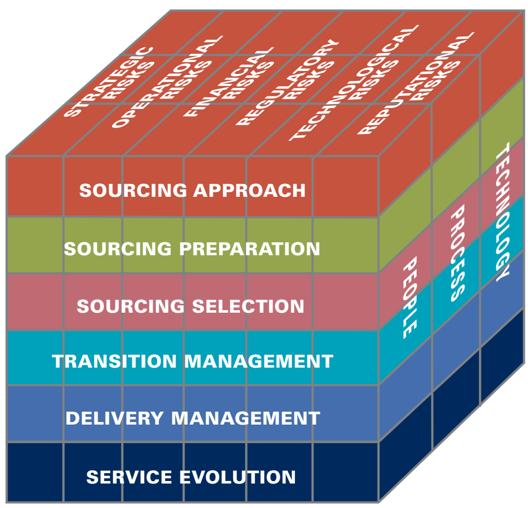
In an outsourcing scenario, people are critical to the delivery of the vision. They are the voice of the organization to your customer; and they have the knowledge, skills, and behaviors to deliver the results you require. Failure to enable change in the human aspects of an outsourcing scenario will result in delayed results, at an excessive cost. Some specific considerations around change management include:

- Create a change management organization
- Develop a specific change plans
- Develop a comprehensive communication infrastructure
- Develop a specific change plan along a leading practice framework
- Focus on high-risk areas first (as indicated by the risk management framework)
- Reduce specific change barriers by building understanding, ability, and willingness in stakeholders

**Develop a risk management framework**. While leading practice outsourcing guidance exists and numerous studies and surveys on outsourcing have been completed, there is little focus on the identification of risk and the evaluation of controls at all stages of the outsourcing life cycle.

Consistent use of a comprehensive and pragmatic risk and control framework for all important outsourcing initiatives is a good practice approach for organizations to gain maximum value from the sourcing initiative.

As indicated by the "risk cube" it is important to focus on the identification of risk and the evaluation of leading practice controls at all stages of the sourcing life cycle. It is important to draw on this framework to gain comfort that the multitude of outsourcing risks are suitably considered and adequately mitigated at all stages of the outsourcing life cycle.




*Source: KPMG LLP in the U.K. (2003)*

We believe organizations should anticipate the relevant business drivers and incorporate proactive and preemptive measures to deal with the risk issues that will inevitably be raised as a consequence throughout the agreement.

*On the right side of the table below are ideas for steps to mitigate possible risks associated with sourcing.*

| | |
|---|---|
| *Wrong process/activity selection* | Define target operating models; assess all in-scope processes for risk complexity, customer touch points, deliverable benefits. |
| *Intellectual property/confidentiality* | Discrete conduct and classification of non-physical assets, such as patents, copyrights, and other exclusive rights. |
| *Experience drain* | Clearly understand and articulate core competencies and areas of competitive advantage (in both front-line and support functions). Ensure that internal staff are involved in these types of projects to build internal experience. |
| *Regulatory compliance exposures and document retention* | Plan to achieve regulatory compliance and supplement internal experience with industry specialists. |
| *Transfer pricing and internal pricing exposures* | Plan for efficient tax management by supplementing internal experience with industry specialists. |
| *Tax compliance and audit issues* | Confirm that tax requirements are properly identified, reports are timely filed, and documentation is appropriate and available. |
| *Hidden transaction and transfer costs* | Perform studies to identify gaps between tax regulations and operations. |
| *Value chain inefficiencies* | Perform business case analysis to plan for efficient value chain management. |
| *Cost savings as overriding decision factor* | Focus on the value drivers as well as the achievable cost benefits. Identify short-to long-term objectives. |
| *Lack of enterprisewide service management and governance framework* | Build performance, service management, and governance frameworks. |
| *Process reengineering and rationalization detached from and preceding actual offshoring* | Stabilize processes—reengineer once migration is complete. |
| *Misjudgment of technology enablers and inhibitors* | Identify and assess technology enablers and inhibitors early in the program life cycle.<br>Confirm alignment of technology and process architectures. |
| *Lack of performance under the contract* | Identify key controls and agreement on key performance indicators.<br>Clearly agreed on service-level agreements with uniform reporting.<br>Institute governance framework with escalation structure. |
| *Experience through implication* | Be wary of implied and limited experience—supplement internal teams with skilled advisors. Trust the judgement of advisers with industry-recognized experience. |

**Develop a formal vendor performance evaluation, measurement, and monitoring program**. Such programs inevitably vary among organizations. Organizations contemplating sourcing may consider a four-part process in vendor section: clarify the objectives and goals of the sourcing program; confirm the vendor-selection process; develop the request for proposal (RFP) document; operationalize the RFP process and vendor selection. Example steps within this process may include:

***1. Clarify the objectives and goals of the sourcing program***

- Document objectives, goals, and governance of the sourcing program
  - What are we expecting to achieve from the sourcing program in the short-term, medium-term, long-term?
  - Governance of sourcing program
  - Establish time frames driving the sourcing program

***2. Confirm the vendor-selection process***

- Develop and confirm the vendor-selection process
  - Document approach to vendor selection
  - Consider timelines for response
  - Define and document involvement of key participants in the process
- Develop framework of the vendor-selection principle
  - Develop request for information (RFI)
  - Define "straw man" profile of the vendor and short-list criteria
  - Market test these principles

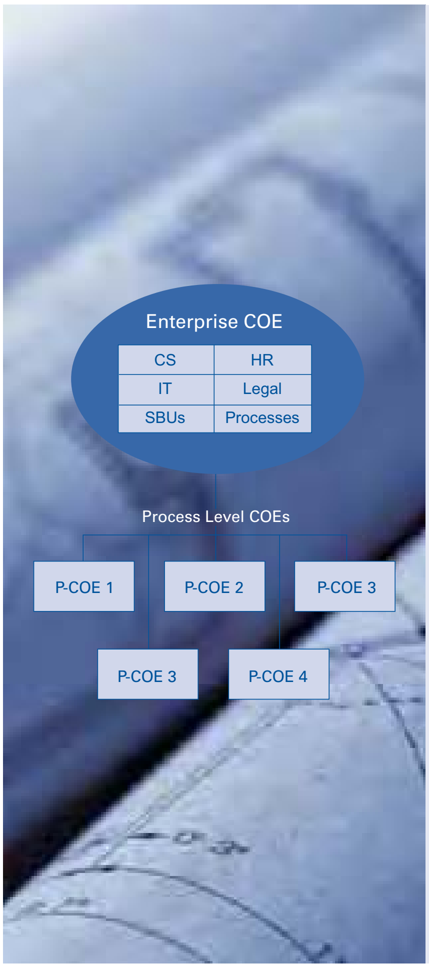
***3. Develop the RFP document***

- Apply RFI findings
  - Confirm and modify sourcing solution goals and objectives
  - Confirm short list of vendors
- Develop RFP structure and key components
  - Define information to be provided to the respondents
  - Document vendor information requested
- Compile the RFP
  - Define scope of services
  - Define operating model and governance structure
  - Establish deal principles and structures
  - Identify alternative pricing models
  - Include high-level evaluation process
- Confirm logistics of the RFP process
  - Consider legal and compliance processes
  - Agree on key personnel

***4. Operationalize the RFP process and vendor selection***

- Publish RFP
  - Send RFP to vendor
- Facilitate vendor response
  - Develop data capture requirements and populate data
  - Identify key respondent interface points
  - Establish exception decision-making process
- Evaluation process
  - Document the evaluation and selection processes
  - Validate evaluation process with key management
  - Perform due diligence activities
- Short list
  - Reduce to two vendors
- Contracting and negotiation
  - Evaluate terms and conditions
  - Assess impact of proposed contract
    - Service ramp-up
    - Service-level agreements
    - Contemplate exit scenarios

**Develop a center of excellence**. A center of excellence is a key element in new sourcing deals, moving beyond traditional procurement support. Its key responsibilities include formulation and deployment of methodologies and frameworks to assist with assessing sourcing opportunities and defining a sourcing approach. It must assist in creating a contractual framework and the required elements and clauses. It should have people in it who have negotiation experience as well as people who can develop and deploy risk assessment tools and mitigation strategies. It must have personnel who provide SLA guidance and tools, who understand regulatory requirements, and who can provide transition and change-management advice.




## Center of Excellence: Introduction

- Develop an Enterprise-level Center of Excellence (E-COE) to oversee and coordinate company-wide process improvement, automation, consolidation, and sourcing activities, supporting Company ABC's overall sourcing strategy.
- To support the E-COE, establish Process-level Centers of Excellence (P-COE) for all process areas.

### E-COE Key Characteristics

- Strategic
- Proactive in monitoring global sourcing landscape
- Enterprisewide, standardized effort
- Coordination of large-scale process improvement initiatives via automation, process changes, and sourcing
- Representation and participation from healthcare strategic business units as well as HR, IT, legal, procurement, and enterprise operations
- Consistent measurement of efficiency gains throughout the organization

### P-COE Key Characteristics

- Tactical
- Reacting to SBU demands around sourcing
- Each P-COE is responsible for a process group: the existing front-end, customer-service and back-office organizations evolve into P-COEs; P-COEs are established for other processes
- Methodologies and tools built by the E-COE are used to implement strategic initiatives
- Implementation of various process efficiency alternatives, such as process improvement, automation, and sourcing
- Coordinating measurement of process quality and other metrics for processes not sourced or sourced directly by SBUs

*Source: KPMG LLP in the U.S. (2006)*

## KPMG Contacts

Egidio Zarrella
Global IRM Lead
KPMG in Australia
+61 (2) 9335 7590
ezarrella@kpmg.com.au

Pradeep Udhas
Global Lead, Sourcing Advisory
KPMG in India
+91 22 3989 6000
pudhas@kpmg.com

Armin Weyell
EMA Lead, Sourcing Advisory
KPMG in Germany
+49 69 9587 2745
aweyell@kpmg.com

Brett Hall
ASPAC Lead,Sourcing Advisory
KPMG in Australia
+61 3 9288 6204
bhall@kpmg.com.au

Kalpana Ramakrishnan
Americas Lead, Sourcing Advisory
KPMG in the United States
+1 714 850 4355
kramakrishnan@kpmg.com

## Risk Advisory Services Contacts in China and Hong Kong SAR

### Beijing

Danny Le
Partner
+86 (10) 8518 9720
danny.le@kpmg.com.cn

### Shanghai

Ning Wright
Partner
+86 (21) 6288 3055
ning.wright@kpmg.com.cn

### Guangzhou and Shenzhen

Gary Yuen
Senior Manager
+86 (20) 2237 2257
gary.yuen@kpmg.com.cn

### Hong Kong

Tom Wilson
Director
+852 2143 8648
thomas.wilson@kpmg.com.hk

KPMG contributors to this publication include Egidio Zarrella, Pradeep Udhas, Kalpana Ramakrishnan, Brett Hall, Armin Weyell, Kumar Parakala, Alex Blues, Rebecca Daniels, Timothy Dougherty, Srinivas Krishna, Peter Merrick, Jonathan Ohm, Jacqueline Riley, Jehil Thakkar, Anish Zaveri, Viral Thakker, and Alex Delechambre.

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