



The Sourcing Canvas: A Strategic Approach to Sourcing Decisions

By Ralph Loftin, Richard Lynch and Jack Calhoun



Contents

Abstract	3
Role of Business Capabilities in Sourcing.....	4
Decision Logic for Developing a Sourcing Canvas – An IT Case Study	7
Step 1: Build the Capability Model	7
Step 2: Assess Capability Value Contribution	7
Step 3: Build the Business Case and Determine Sourcing Objective	8
Step 4: Determine the Type of Knowledge Required by Target Capability	9
Step 5: Plot on the Sourcing Canvas.....	9
Step 6: Review Sourcing Advice.....	10
Step 7: Assess Enterprise Portfolio of Sourcing Opportunities.....	11
Conclusions.....	12



Abstract

For many years executives believed that costs could be reduced by outsourcing certain functions to specialty firms. Businesses that had seen savings and simplifications by outsourcing logistics, warehousing, real estate, payroll administration, maintenance repair and operations and IT Operations, for example, began to seek larger and more significant targets, but still only from a labor arbitrage and cost reduction perspective. More recently, process improvement emerged as a second rationale for outsourcing where additional performance goals above cost were driving decisions.

Now, leading companies realize that a more **strategic approach** to sourcing provides leverage that far exceeds what functional outsourcing alone can achieve. Strategic sourcing allows companies to take full advantage of cost, flexibility and new capability opportunities; whether delivered by traditional suppliers and BPO suppliers, trading partners, distributors, agents and even customer self-service models.

This paper first describes the strategic context for sourcing and the problems caused by looking at sourcing opportunities one decision at a time, often ignoring adjacencies and integration issues. We will illustrate the advantage of looking across the enterprise at a portfolio approach to sourcing. We then propose a capability-centered framework for decision making, and illustrate how a completed sourcing canvas leads to a stable operating environment that makes the move to new sourcing options a managed and predictable approach to performance improvement.



Strategic sourcing is rooted in the idea that a business must have a set of explicitly defined capabilities in order to execute its strategy successfully. In practice, however, strategic intent and objectives are often not articulated in clear operating language and decisions are made piecemeal; sometime with detrimental upstream or downstream impacts such as loss of speed or fraught with hidden costs of complexity or knowledge gaps.

Role of Business Capabilities in Sourcing

Capabilities – WHAT (people, process and technologies) the company needs to do to execute its business strategy, stated in measurable and actionable terms – are the key to alignment and successful execution. Capabilities exist across the value chain and in order to achieve high-performance a business must learn to manage capabilities that other parties in the value chain perform; from raw material suppliers, to logistics, to 3rd party distributors all the way to the end customer performing capabilities in a self-service mode that we may have once performed for them – we must learn to govern a network of capabilities.

A written strategy does not ensure strategic action. A framework for action is required that provides:

- Operating executives with a clear set of business capabilities that are necessary to win;
- CFOs with a method for aligning investments to the capabilities that will execute one game plan and eliminate confusion and waste in the organization;
- IT and other functional leaders with a focus to allocate precious resources by first defining desired capabilities that create competitive advantage and then building enabling systems and supporting infrastructure.

A complete picture of capabilities is the Enterprise Capability Model or ECM (see Figure 1). It is a blueprint for the business expressed in terms of the capabilities necessary to execute the stated strategy.

Figure 1: A Health Maintenance Organization (HMO) ECM

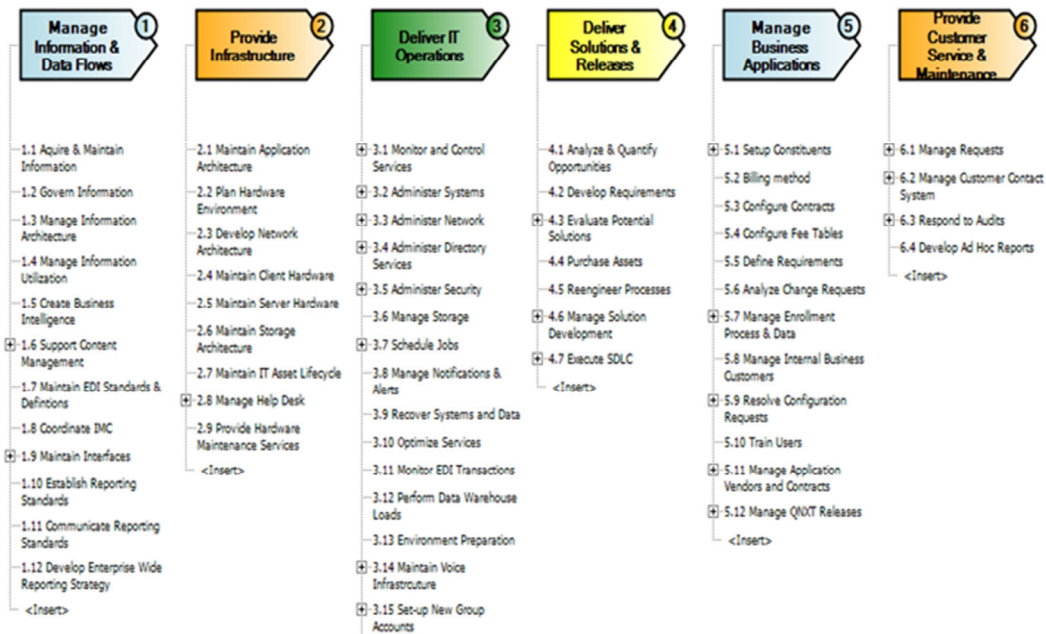


Three classes of capabilities make up an Enterprise Capability Model:

- **Strategic:** Capabilities in organizational planning, strategy, brand positioning and investment
- **Core:** The inventory of business capabilities that are identified as delivering the products and services that an organization offers to its market. **Enabling:** The inventory of business capabilities that are not directly related to products or services sold or offered to the market
 - Since IT (or parts of it) is often a target for outsourcing we will use an IT Capability Model example for the sourcing canvas.

We consider IT a service business within the core business so like the core capabilities in Figure 1, this illustration in Figure 2 is a composite of the IT capabilities. We will examine how this IT organization developed a sourcing canvas across all of the IT capabilities.

Figure 2: Illustrative IT Capability Model



Clarifying the Value Contribution (or strategic relevance) of each capability helps a business allocate the right level of time and resources — whether to strengthen, minimize or outsource. We suggest four levels of Capability Value Contribution:

- 1. Advantage (the capabilities that create competitive advantage and need to be performed at near world-class levels),
- 2. Strategic Support (the work that enables competitive advantage),
- 3. Essential (work that may not provide direct customer value, but has a big impact on the financials) and
- 4. Business Necessity (those capabilities that need to be performed only at industry parity and at low-cost).

Capability Value Contribution is not the same as traditional *value added analysis*. Determining the Value Contribution helps focus resources and sourcing alternatives on capabilities that create value and distinctiveness, or identifies where to target efficiency work, either through rigorous process improvement or sourcing to a low cost provider.

Decision Logic for Developing a Sourcing Canvas – An IT Case Study

Step 1: Build the Capability Model

A capability model organizes in a structured and aligned way the capabilities required for strategy execution (See Figures 1 and 2).

In a series of workshops, the key IT executives reviewed the company’s strategy and vision and developed an IT Capability Model shown in Figure 2. This is not trivial work. The more the leadership team has their fingerprints all over the model (developing and pressure testing it) the stronger the likelihood that it will serve as the basis for continuous alignment, structured learning, better sourcing and accelerated improvement.

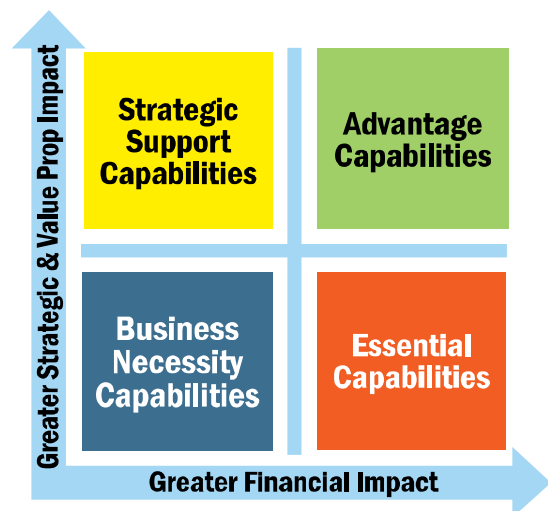
Step 2: Assess Capability Value Contribution

Capabilities contribute differently to strategic value and should be nourished and sourced accordingly. Some capabilities directly contribute to the customer value proposition (as depicted in a Value Map¹ or similar strategy summary. In our case study the IT organization Developed a Value Map to capture the strategy for the approach IT would take to serve its customer – the business at large.) and have a high impact on company financials. These “Advantage” capabilities are shown in the upper right of Figure 3. Value contribution is assured when performance is among the best in peer organizations at acceptable cost.

When possible, keep them inside and protect the intellectual property. Moving to the top left quadrant, Strategic Support capabilities have high contribution in direct support of Advantage capabilities. Keep them close. Value contribution is assured when performed above industry parity at competitive cost.

Other capabilities shown in the bottom right are Essential. They may not be visible to the customer but contribute to company’s business focus and have a big impact on the bottom line. Focus on efficiency improvement, especially in high volume work. Value contribution is assured when performed at industry parity levels, but below competitors’ cost. Other capabilities are “Business Necessity.” Value contribution is assured when performed at industry parity performance below competitors’ cost. They can be candidates for alternate sourcing.

Figure 3. Capability Value Contribution



¹ Blue Ocean Strategy: How to Create Uncontested Market Space and Make Competition Irrelevant, W, Chan Kim and Renee Mauborgne (Harvard Business School Press, 2005)

Step 3: Build the Business Case and Determine Sourcing Objective

Is the intent to close a capability performance gap quickly? Save money? Enhance agility?
 For each capability being considered for a sourcing change, a set of sourcing objectives should be articulated. The example below is for capability 2.8 Manage Help Desk from Figure 2:

Figure 4. Sourcing Objectives for Each Capability Being Evaluated – Example; Help Desk

Generic Rationale	Applies Yes/No	Specific Rationale
Speed: Close capability performance gaps quickly Supplier has unique IP/ distinct competency	Yes	<i>Managing the Help Desk is a capability where specialty firms like Microsoft or Dell are much better equipped and skilled to manage first level Help Desk Services than we can build locally</i>
Cost savings: Economies of scale and scope Moving assets 'off the books' Increase flexibility to focus on core	Yes	<i>There are a number of Help Desk specialty firms that can provide economies of scale and global 24X7 service that we cannot</i>
Improve responsiveness Self service to customer	Yes	<i>Vendors offer 24X7 global support service and next day laptop replacement which we cannot economically provide</i>
Improve quality Company is a CMM Level 5 ISO 9000	No	
Displace responsibility (reduce hassle factor): Access to business continuity facility 'Outsource' integration headaches Regulatory issues and compliance IT staff retention	No	
Enable Agility: Access to skilled resources Access to 'state of the art' technology Access to technology updates	Yes	<i>Vendors offer a variety of online support models where you can talk to an expert anytime day or night</i>

Figure 4 lists many of the reasons for sourcing. Creating clarity on the objective from the beginning and agreement from all stakeholders starts the process on the right track.

Step 4: Determine the Type of Knowledge Required by Target Capability

The next step is to appreciate the nature of the know-how required to perform the capability. Is it proprietary knowledge, part of the “secret sauce”?

We define Proprietary Knowledge as “Unique” company knowledge or “insider information” related to strategic intent such as:

- Core technology development
- Customer applications
- Financing arrangements
- M & A identification and development
- Market specific solution implementation
- Customer lists and profiles
- Strategic supplier sourcing relationships

On occasion proprietary knowledge, while initially only known to insiders, can be transferred to third parties (e.g., subcontractors) and protected from further disclosure by Non-disclosure Agreements (NDAs). In the case of an HMO patient and privacy laws also need to be considered whenever a capability is being sourced outside of the firewall and security policies and procedures.

Knowledge is said to be shareable if the non-proprietary knowledge is readily accessible to parties outside the business. Knowledge may be non-proprietary but not shareable for a number of reasons including, not formally documented, undocumented business rules and dependency on the “Tribal knowledge” of those personnel delivering the capability, etc.

Step 5: Plot on the Sourcing Canvas

Capability Value Contribution and the type of knowledge required form the axes of the Sourcing Canvas^{sm2} (Figure 5). Companies should start with the premise that they will in-source capabilities that deliver or enable a competitive advantage AND that require proprietary knowledge. Other capabilities can be located on the Sourcing Canvas and the initial suggestion “pressure tested” in discussions with senior management.

² WhatFirst is a Sharepoint 2010 solution for designing and managing Dynamic Business Architecture™. It allows the key stakeholders of an organization to collaborate on business architecture. WhatFirst supports capability modeling, value mapping, performance assessment, gap analyses and investment road mapping.



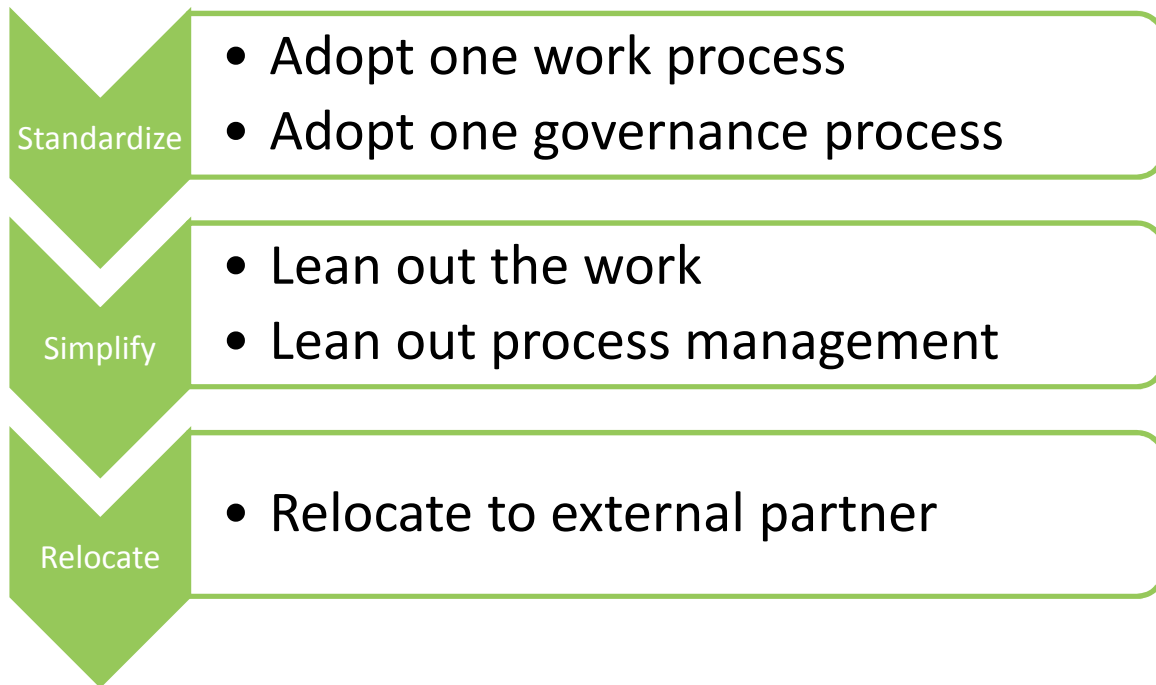
Figure 5. The Sourcing CanvasSM

Value Contribution	Knowledge		
	Proprietary	Not Readily Sharable	Not Proprietary AND Readily Sharable
Advantage Capabilities	Retain Develop/build the best internal capability possible		
Strategic Support Capabilities	Retain Develop/build the best internal capability possible	Remove Obstacles Aggressively remove obstacles then source for effectiveness	Strategically Source Develop ongoing, long term partnerships with the best capability available
Essential Capabilities			
Business Necessity Capabilities	Retain (Maintain) Manage internal capability to meet cost and quality standards	Remove Obstacles Aggressively remove obstacles then source for efficiency	Source Access the most efficient external vendor, monitor to ensure compliance with specs

Step 6: Review Sourcing Advice

The suggestions provided should be viewed as a “coarse screen”. In the case when the preliminary advice is to outsource, a finer screen may be required on the process maturity of the candidate capability. For example, if the process is unstable, consideration should be given to simplifying the process and improving documentation (if not a distraction, can be done timely, etc.) or assess the willingness to pay the vendor to do this for you. Outsource partners make their money standardizing, simplifying, and leveraging shared assets.

Figure 6: Preparing to Outsource

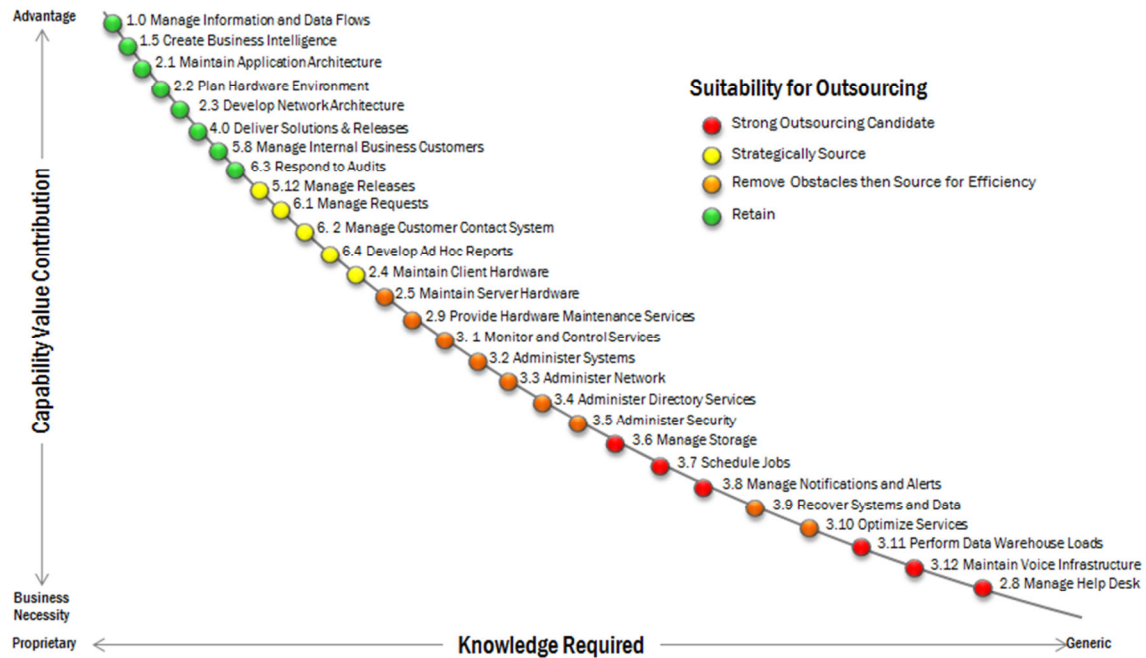


In some cases, if the suggestion is to keep the work in-house (e.g., an advantage capability), decompose the capability into more detailed, component capabilities and determine if there are components that could be outsourced because someone can do it better. . In theory, any company could use the cloud to obtain the same functionality, scale, and quality as an industry leader or use the same vendor. Think about differentiation in terms of how to exploit the information the service generates – keep that capability in-house.

Step 7: Assess Enterprise Portfolio of Sourcing Opportunities

Rather than looking at one sourcing decision at a time (often with different assumptions), the Sourcing Canvas paints a holistic picture of the business and how and where capabilities are delivered.

Figure 7: The IT Sourcing Canvas Revealed



Conclusions

Effective sourcing strategies maximize value by focusing on capabilities and how each capability creates value in different ways. Strategic sourcing maximizes that value. Choosing the correct arrangement and location of work also minimizes distractions. Sourcing choices impact management attention; “right sourcing” allows sharper focus on differentiating capabilities. Incorrect sourcing decisions limit agility and increase costs. At the heart of many missteps is a lack of a strategic sourcing framework.

The Sourcing Framework described here provides a principles-based canvas for sourcing, traceable to strategic intent:

- Sourcing decisions should be made at the highest level of capability possible.
- Insource capabilities:
 - that deliver or enable Strategic Support or Advantage business capabilities AND that require specific company knowledge
 - whose purpose is to maintain and improve capability performance
- Outsource capabilities:
 - that are simply necessary to do business (Business Necessity)
 - that do not require specific company knowledge, even if they deliver or enable Strategic Support or Advantage business capabilities



- temporarily that might otherwise be insourced if performance levels are inadequate
- if a compelling cost advantage can be found AND if proprietary knowledge can be safeguarded

About the authors:

Ralph Loftin (rdloftin@comcast.net) consults broadly on issues of strategic and tactical IT planning, organizational effectiveness, vendor relationships and contract management, operations performance, and capacity and resource management. Richard Lynch (Richard.Lynch@Accelare.com) is an acknowledged capability management expert and has written three books, including *Measure Up!* and *The Capable Company: Building the Capabilities That Make Strategy Work*. Jack Calhoun is the CEO of Accelare Inc., the creators of *WhatFirst 2010*, and author of the HBR article, *The Next Revolution in Productivity*.