The Handbook of Global Outsourcing and Offshoring

Ilan Oshri, Julia Kotlarsky
and Leslie P. Willcocks

The Handbook of Global Outsourcing and Offshoring

This page intentionally left blank

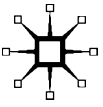
The Handbook of Global Outsourcing and Offshoring

Ilan Oshri
Associate Professor of Strategy and Technology Management, Rotterdam School of Management, Erasmus University, The Netherlands

Julia Kotlarsky
Associate Professor of Information Systems and Management, Warwick Business School, UK

Leslie P. Willcocks
Professor of Technology, Work and Globalization London School of Economics and Political Science, UK

palgrave
macmillan



Softcover reprint of the hardcover 1st edition 2009 978-0-230-23550-2

First published 2009 by
PALGRAVE MACMILLAN

Palgrave Macmillan in the UK is an imprint of Macmillan Publishers Limited, registered in England, company number 785998, of Houndmills, Basingstoke, Hampshire RG21 6XS.

Palgrave Macmillan in the US is a division of St Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

Palgrave Macmillan is the global academic imprint of the above companies and has companies and representatives throughout the world.

ISBN 978-1-349-31390-7 ISBN 978-0-230-25107-6 (eBook)
DOI 10.1057/9780230251076

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

A catalog record for this book is available from the Library of Congress.

10 9 8 7 6 5 4 3 2 1
18 17 16 15 14 13 12 11 10 09

CONTENTS

List of Tables

List of Figures

Acknowledgments

We were inspired by the insights and learning we gained from being a part of a group of passionate individuals whom we met in several events, conferences and while doing work together.

One event that in particular inspired us to start working on this book is the annual Global Sourcing Workshop (www.globalsourcing.org.uk) that we organize with our good friend Joe Rottman. This annual gathering of researchers and practitioners created a small community that discusses social, technical, and managerial aspects of global sourcing. We have learned a lot from each participant and will ever be grateful for sharing with us your experience and research. Special thanks goes to Accenture, in particular Dr. John Hindle for partially sponsoring our First and Third Workshops and for delivering great key-note speeches on both events.

Another stimulating event is the NYU-IBM global sourcing workshop organized by Prof. Natalia Levina which we attended in May 2008. One of the tracks was devoted to teaching Global Sourcing. This track helped us think about the outsourcing profession and the future needs of outsourcing professionals. In particular, we would like to thank Natalia and Prof. Erran Carmel for sharing with us their views and class experiences. We also thank Erran for contributing to this book two case studies.

We would like to thank Eleni Lioliou, Yingqin Zheng, and Maha Shaikh who helped in various ways to bring this project into conclusion. Our thanks go also to Mary Lacity, David Feeny, and Peter Reynolds, for contributing case studies to this book.

Last but not least, we thank all the practitioners and academics with whom we have held fascinating discussions about outsourcing and off-shoring. Many of them are good friends with whom we hope to continue exploring this topic.

Note on Case Study Contributors

Erran Carmel is a tenured full Professor at the Kogod School of Business, American University, Washington D.C. Professor Carmel's area of expertise is globalization of technology work. His 1999 book *Global Software Teams* was a pioneering book on the topic. His second book *Offshoring Information Technology* (2005) is used in many global sourcing courses. He has written over 80 articles, reports, and manuscripts. In 2008–2009 he was the Orkand Chaired Professor at the University of Maryland University College. He has been a Visiting Professor at Haifa University (Israel) and University College Dublin (Ireland).

David Feeny is Professor of Information Management, and Fellow at Templeton-Green College, University of Oxford. He has published widely on CIO and retained capability, strategy, and the management of Information Technology, especially in Harvard Business Review and Sloan Management Review as well as many highly ranked IS journals. His current research interests are in the evaluation of executive education and innovation. Previously he was a senior executive for over 20 years at IBM.

Mary Cecelia Lacity is a Professor of Information Systems at the University of Missouri-St. Louis, Research Affiliate at Templeton College, Oxford University, and Doctoral Faculty Advisor at Washington University. Her current research focuses on global outsourcing of business and IT services, IT's contribution to business performance, innovation diffusion, and turnover among IT professionals. She has given executive seminars world-wide and has served as an expert witness for the US Congress. She was the recipient of the 2000 World Outsourcing Achievement Award sponsored by PricewaterhouseCoopers and Michael Corbett and Associates. She has written 40 refereed articles and seven books.

Peter Reynolds is a Research Fellow in the Department of Information Systems at The University of Melbourne, Australia. His research focuses on business and IT strategy alignment, IT-enable business transformation,

IT sourcing and IT organization design. Peter is on the editorial board of the Journal of Information Technology (JIT). Peter has spent over 10 years as a member of various CIO management teams, including 5 years as Head of IT Strategy and then Chief Technology Officer for the Commonwealth Bank of Australia.

Introduction

By end of 2009, Information Technology outsourcing (ITO) revenues exceeded US$ 250 billion while those for Business Process outsourcing (BPO) were more than US$ 140 billion. The revenues from offshore outsourcing of business and Information Technology (IT) services exceeded US$ 60 billion, and over the next five years the compound annual growth rate for offshore outsourcing is expected to be about 20%. By 2006, over 200 firms from the Forbes 2000 companies and nearly 50% of the Fortune Global 250 had offshored IT and business process activities. In 2008 India posted some 65% of the ITO and 43% of the BPO market (Willcocks and Lacity, 2009). It is common to talk of Brazil, Russia, India and China as the BRIC inheritors of globalization, offering both offshore IT and back-office services, and also, with their vast populations and developing economies, huge potential markets. In 2008 India exported US$ 40 billion of such services, while China, Russia, and Brazil managed US$ 5 billion, US$ 3.65 billion, and US$ 800 million respectively. But the phenomenon of offshoring and offshore outsourcing is certainly expanding, with, on our count, some 120 centers developing around the world. Therefore it has become increasingly important to understand the phenomenon, not least as a basis for suggesting what directions it will take, its impacts, how it has been conducted, and how its management can be better facilitated.

These points are particularly pertinent because recent evidence has suggested that a number of offshore outsourcing relationships and offshoring projects have failed to live up to some of their promises. The reasons for this are many, ranging from poor quality delivered by vendors to rising management costs that result in frustration and disappointment. Collaboration between remote sites and the ability to share and transfer knowledge between dispersed teams have also been mentioned as imperative to successful offshore outsourcing projects. In addition, our own research highlights certain capabilities that vendors and clients should develop, the governing structures that they need to put in place, and the bonding activities that they need to promote and make time for. While offshore outsourcing brings its own distinctive issues, it is the case that the principles for running any ITO/BPO venture also continue to apply to offshoring and offshore outsourcing arrangements. However, offshoring is increasingly part of most deals of any significant size, so it becomes very necessary to see and manage outsourcing within a global context.

The main objectives of this book

Therefore, this book offers a broad perspective on various issues relating to the sourcing of systems and business processes in a national and global context. The key objectives of the book are to:

1. assess the impacts of global sourcing on business;
2. assess the risks and benefits for the firm from engaging in sourcing activities;
3. devise a plan to outsource a system or a process from a client viewpoint;
4. devise a plan to offer services from a vendor viewpoint;
5. ensure sustainability over the lifecycle of an outsourcing relationship;
6. raise awareness to recent developments in the global sourcing arena.

This book will, therefore, examine both the client's and the vendor's involvement in sourcing relationships by emphasizing not only the capabilities that each side should develop prior to entering a relationship but also what they should develop as a result of their interactions with each other.

Key definition: Sourcing

The field of sourcing is replete with jargon and acronyms. For example, the term "bestshoring" has become one of the recent "buzz" words which, while widely used by managers, are poorly defined by the professional press and academic publications. Even more worrying is the inaccurate use of the terms "outsourcing" and "offshoring" by both managers and academics. These terms and others will be defined in Chapter 1. Here we wish to explain what we mean by the term *sourcing.*

> *Sourcing is the act through which work is contracted or delegated to an external or internal entity that could be physically located anywhere. Sourcing encompasses various in-sourcing and outsourcing arrangements such as offshore outsourcing, captive offshoring, nearshoring and onshoring.*

Clearly, almost any firm is somehow engaged in sourcing activities; however, each of these firms applies a sourcing arrangement that suits its particular needs.

The structure of the book

The book is organized into 10 chapters to address the aims outlined above. We distinguish three key sections in this book. Chapters 1–3 are about *making a sourcing decision*. Chapters 4–6 are about *building sourcing competencies,* and Chapters 7–10 are about *managing sourcing relationships*. Some chapters can be read as a stand-alone body of knowledge (e.g. Chapter 1 and Chapter 10), while others are more connected with other chapters.

Chapter 1 provides a historical perspective on outsourcing and offshoring, the marketplace, and the incentives for firms from around the global to tap into sourcing opportunities. Chapter 2 discusses the various types of IT and business processes that could be sourced globally. It also examines the various sourcing arrangements available according to the nature of work outsourced. Chapter 3 considers the geographical aspect in the sourcing decisions and the factors that both client and supplier companies should consider when deciding on where activity X should be located. Chapter 4 provides an overview of the vendor's landscape, by examining certain vendor characteristics and the desired core capabilities of the vendor. Chapter 5 examines the notions of expertise and knowledge in sourcing relationships from both the vendor and client perspectives, and discusses issues related to the knowledge transfer process. Chapter 6 considers the vendor selection strategy from a client's viewpoint. This includes the evaluation of vendors, the outsourcing arrangements, the retained organization capabilities, and legal issue. Chapter 7 considers the outsourcing lifecycle and its key activities from a client's perspective. It also provides an overview of key transition issues. Chapter 8 addresses the key challenges faced by both client and vendor regarding governance of various outsourcing projects. Chapter 9 focuses on the management of globally distributed teams from a sourcing relationship perspective. Finally, Chapter 10 reviews recent trends and emerging issues in the arena of global sourcing.

CHAPTER 1

Overview of the global sourcing marketplace

Introduction

With the advent of globalization and enhanced levels of competition, many organizations have started to have considerable difficulties in developing and maintaining the range of expertise and skills needed to compete effectively. The emergence of American, European, Japanese, and Third World multinationals has created a new competitive environment, requiring the globalization, or at least semi-globalization of corporate strategy. This need has led many companies to engage with various kinds of sourcing strategies, such as outsourcing, offshoring, offshore outsourcing, nearshoring, and onshoring. Therefore, this chapter will focus on:

- the key terminologies used in the sourcing literature;
- the key drivers of global sourcing;
- the benefits for clients and vendors from engaging in global sourcing;
- present market trends in the global sourcing market;
- future developments of the global sourcing market.

Definitions

Sourcing is the act through which work is contracted or delegated to an external or internal entity that could be physically located anywhere. Sourcing encompasses various in-sourcing (keeping work in-house) and outsourcing arrangements such as offshore outsourcing, captive offshoring, nearshoring and onshoring.

Outsourcing is defined as contracting with a third service provider for the management and completion of a certain amount of work, for a specified length of time, cost, and level of service.

Offshoring refers to the relocation of organizational activities (e.g. IT, finance and accounting, back office, human resources) to a wholly owned

subsidiary or an independent service provider in another country. This definition illuminates the importance of distinguishing whether the offshored work is performed by the same organization or by a third party. In the first case, where the work is offshored to a center that is owned by the organization, we are referring to a *captive* model of service delivery. In the second case, where the work is offshored to an independent third party, we are referring to an *offshore outsourcing* model of service delivery.

In the case where organizational activities are relocated to a neighboring country, we use the term *nearshoring* (e.g. US organizations relocating their work to Canada or Mexico).

Global sourcing background

Offshoring strategies appear to be promising in terms of the reduction of costs, as certain organizational activities would be moved to a subsidiary or an independent service provider in a country with favorable conditions. The US is a major player in the offshoring of IT and business process applications. However, over the past few years offshoring has appeared to be gaining momentum in Europe as well.

Table 1.1, originated by Lewin and Peeters (2006), depicts the results of their survey of 90 companies among 650 US Forbes Global 2000 companies with regard to the major functions offshored at that time. The survey further investigated the offshoring plans of the participant companies in the next 18 to 36 months following the survey. According to these results IT was the most frequently offshored function, with 66% of participants offshoring one or more IT-associated processes. Finance and accounting

Table 1.1 Offshored functions-current landscape and expected evolution

Functions	Companies that offshore the function (in %)	Expected growth rate in #implementations (next 18–36 months)
IT	66	52
Finance/Accounting	60	43
Contact centers	54	48
Engineering services	44	55
Research	32	81
Human resources	24	75
Procurement	24	42
Other	18	N/A

Source: Adapted from Lewin and Peeters, 2006

Table 1.2 Locations of offshoring

Locations	Existing implementations (in %)	New implementations (next 18 to 36 months) (in %)
India	69	66
China	7	7
Other Asia	7	16
Latin America	6	1
Philippines	4	3
Canada/Mexico	4	1
Eastern Europe	3	6

Source: Adapted from Lewin and Peeters, 2006

were the next most common functions to be offshored; contact centers followed with 54%, engineering services with 44%, and research with 32%. With regard to the future plans of the participant companies, major increases were related to the offshoring of research (81% growth rate) and human resources (75%).

According to the same survey, India was by far the most attractive destination for IT and business process applications offshoring. More specifically, 69% of surveyed implementations were located in India, 7% in China, and 7% in other Asian countries. Table 1.2 presents the major destinations of offshoring.

The same survey revealed important findings with regard to the chosen service delivery model of the participant companies (captive versus offshore outsourcing). More specifically, the results showed that 35% of implementations were offshored to captives, while 65% were offshored to a third party. The study also revealed that the choice of service delivery model was highly correlated with the type of function being offshored. On this basis, 89% of IT and 90% of contact centers were offshored to an independent service provider. On the other hand, 69% of finance and accounting implementations were offshored to captives. Figure 1.1 illustrates in detail the results of the survey in relation to the chosen offshoring service delivery model.

Drivers, benefits, and risks of global sourcing

The growth of global sourcing has been attributed to many factors. First, technological advances in the telecommunications industry and the Internet have shrunk space and time and have enabled the coordination

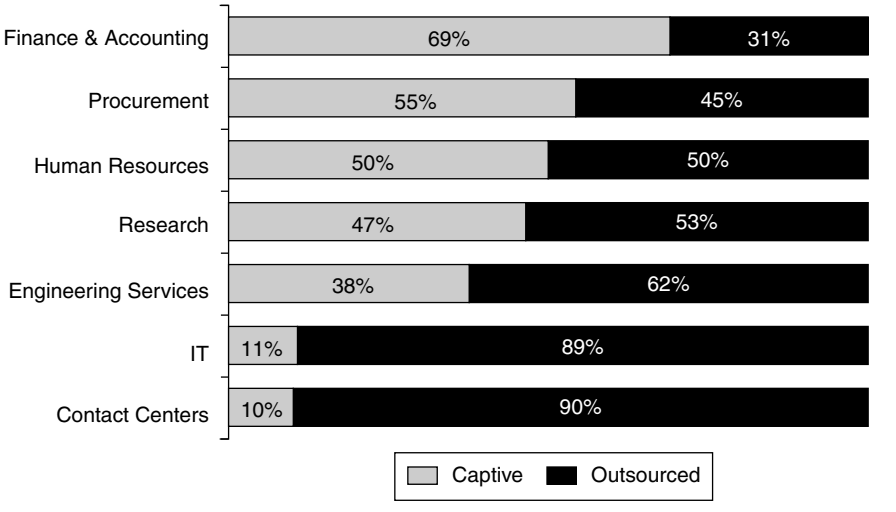


Figure 1.1 Percentage of captive and outsourced implementations per function

Source: Adapted from Lewin and Peeters, 2006

of organizational activities at the global level. Other reasons include the supply of skilled, yet low-cost, labor in countries such as India; the investments in infrastructure; the improved business, economic, and political climate in a number of developing countries; and the standardization of IT processes and communication protocols that contribute to the efficiency of interorganizational activities.

Along these lines, many countries invested heavily in improving their telecommunications infrastructure, which is essential for electronically transmitted services. For example, Barbados has had a fully digitalized communications system with direct international dialing since the beginning of the 1990s. Jamaica constructed its "Digiport," with a 20,000-telephone-line capacity and speeds of 1.5 Mbps. Furthermore, many countries provided specific tax advantages to attract offshoring. For example, the standard tax rate in Ireland is 43%, but BPO firms get a favorable rate of 10% until 2010. Jamaica has a 34% tax rate, but the "Digiport" BPO free trade zones are tax free. The US tax code also favors offshoring over keeping work domestic. US corporations are allowed to defer taxes on offshore units until the money comes back to the USA. Thus, firms are given an interest-free loan on taxes owed if they offshore work.

Global sourcing may offer several benefits which are basically associated with the advantages of outsourcing in general. Along these lines, a company may accomplish significant cost advantages through the creation of economies of scale, access to the unique expertise of a third party, and the reduction or stabilization of overhead costs.

Furthermore, a company may benefit from outsourcing by concentrating on core activities, on organizational specializations, or focusing on achieving key strategic objectives. More specifically, following a "core competency through outsourcing strategy" may enable a company to focus its resources on a relatively few knowledge-based core competencies where it can develop best-in-the-world capabilities (Quinn and Hilmer, 1994). Concentration on a company's core business may allow it to exploit distinctive competencies which will constitute significant competitive tools.

Another major benefit of outsourcing is that it can give the organization access to the service provider's capabilities and innovative abilities, which may be expensive or impossible for the company to develop in-house (Quinn and Hilmer, 1994). Some analysts contend that an important source of user value is the firm's access to economies of scale and the unique expertise that a large provider can deliver. Since providers are typically servicing many clients, they often achieve lower unit costs than any single company can (Alexander and Young, 1996).

Even more, a network of suppliers can provide any organization with the ability to adjust the scale and scope of their production capability upward or downward, at a lower cost, in response to changing demand conditions, and at a rapid rate. As such, outsourcing can provide greater flexibility (McCarthy and Anagnostou, 2003). Furthermore, outsourcing can decrease the product/process design cycle time, if the client uses multiple best-in-class suppliers, who work simultaneously on individual components of the system, as each supplier can contribute greater depth and sophisticated knowledge in specialized areas and thus offer higher quality inputs than any individual supplier or client (Quinn and Hilmer, 1994). On this basis, having several offshore centers can provide around-the-clock workdays. In other words, development and production can take place constantly by exploiting the time difference between different countries.

However, there exist several disadvantages to adopting sourcing strategies. Loss of critical skills or overdependence on an outside organization for carrying out important business functions may evolve into significant threats to a company's well-being. Furthermore, security and confidentiality of data can be a major issue for many companies. Another major issue is losing control over the timing and quality of outputs since these will be undertaken by an outside vendor which may result in a poorer quality of

the final product or service and may generate effects which could be very negative to a company's image.

Even more important is the fact that, unless the buyer's core competency is a true block to entry into the marketplace, some suppliers after building up their expertise with the buyer's support, may attempt to bypass the buyer directly in the marketplace (Quinn and Hilmer, 1994). On these grounds, it is critical that a company manages its sourcing strategy in a way that is not nurturing a future competitor.

With regard to outsourcing arrangements, it is important to note that there are some risks that are specifically linked to these. For example, outsourcing is usually followed by changes in the organizational structure. Redundancies and layoffs are commonplace in outsourcing situations. Research and experience indicate that outsourcing effectively signals to employees their employer's intention to initiate a change that may involve de-skilling and redundancies (Kakabadse and Kakabadse, 2000). Such initiatives generate internal fears and employee resistance.

Moreover, Hendry (1995) highlighted the fact that outsourcing can be associated with problems related to the company's ability to learn, as it can increase the insecurity and decrease the motivation of the workforce, reducing willingness to question and experiment (Hendry, 1995). While interactions among skilled people in different functional activities often develop unexpected new insights or solutions, there is the fear that outsourcing will make such cross-functional synergies of ideas and knowledge less likely (Quinn and Hilmer, 1994).

With regard to offshore outsourcing, Rottman and Lacity (2006) offered a comprehensive list of risks which are specifically associated with such ventures. These include different kinds of business, legal, political, workforce, social, and logistical risk, and these are illustrated in Table 1.3.

With regard to the strategic drivers and risks of offshoring, the results of the study of Lewin and Peeters are particularly revealing. As illustrated in Table 1.4, the major strategic driver for offshoring is the need to cut down costs, cited by 93% of the respondents. Other significant drivers appear to be competitive pressure with 69%, the need for improved service levels with 56%, and the need for accessing qualified personnel with 55%.

Table 1.5 presents the perceived risks of offshoring. Poor service quality was cited by 61% of the respondents as the most important offshoring risk, followed by lack of cultural fit with 54% and loss of control with 51%.

Table 1.3 Offshore outsourcing risks

Risk category	Sample risks
Business	No overall cost savings Poor quality Late deliverables
Legal	Inefficient or ineffective judicial system at offshore locale Intellectual property rights infringement Export restrictions Inflexible labor laws Difficulty obtaining visas Changes in tax laws could significantly erode savings Inflexible contracts\Breach in security or privacy
Political	Backlash from internal IT staff Perceived as unpatriotic Politicians threaten to tax US companies that source offshore Political instability within offshore country Political instability between United States and offshore country
Workforce	Supplier employee turnover Supplier employee burnout Inexperienced supplier employees Poor communication skills of supplier employees
Social	Cultural differences Holiday and religious calendar differences
Logistical	Time zone challenges Managing remote teams Coordinating travel

Source: Adapted from Willcocks and Lacity, 2006

Table 1.4 Strategic drivers of offshoring

Offshoring strategic drivers	Respondents citing driver as important (in %)
Cut down costs	93
Competitive pressure	69
Improving service levels	56
Accessing qualified personnel	55
Changing rules of the game	41
Industry practice	37
Business process redesign	35
Access to new markets	33
Enhancing system redundancy	27

Source: Adapted from Lewin and Peeters, 2006

Table 1.5 Perceived risks of offshoring

Risks perceived	Respondents citing risk as important (in %)
Poor service quality	61
Lack of cultural fit	54
Loss of control	51
Lack of client acceptance	49
Lack of data security	46
Weakening employee morale	45
Employee turnover in offshore service center	44
Operational inefficiency	41
Infrastructure instability in host country	40
Intellectual property loss	39
Political instability in host country	39
Political backlash	35
Disaster recovery	26

Source: Adapted from Lewin and Peeters, 2006

The future of outsourcing and offshoring

By the end of 2009, ITO revenues exceeded US$ 250 billion while those for BPO were more than US$ 140 billion. The revenues from offshore outsourcing of business and IT services exceeded US$ 60 billion, and over the next five years the compound annual growth rate for offshore outsourcing is expected to be about 20%. Willcocks and Lacity (2006) identify the following 11 trends for the future of global sourcing markets:

1. *Spending will continue to rise in all global sourcing markets despite 2004–2005 media attention on backsourcing:* Irrespective of some major backsourcing ventures (such as JP Morgan in 2004 and Sainsbury in 2005), Willcocks and Lacity maintain that these do not represent a major trend towards backsourcing, and they specifically emphasize that on their figures "the most popular course of action at the end of a contract will continue to be contract renewal with the incumbent supplier." The authors also estimate that a quarter of contracts will be re-tendered and awarded to new suppliers and only a tenth will be backsourced.
2. *Developing countries beyond India will become important players in the global business and IT services market:* Countries that appear to have the potential to follow India as attractive destinations for global sourcing include the Philippines and China. On the other hand, large

Indian suppliers have gained much expertise and experience in dealing with and building relationships with US customers, which will enable them to demand higher prices. In the US, the recent Central American Free Trade Agreement (CAFTA) is expected to further open up IT and Business Process outsourcing in Cost Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic. In Western Europe, companies are expected to increasingly source IT and business providers to Eastern Europe and North Africa.

3. *Large companies will give application service provision (ASP) a second look:* Large organizations will reconsider ASP for several reasons. First, large companies will want net-native applications that can be delivered only through ASP. Second, large companies appear more willing to give up on their expensive proprietary suites for more cost-efficient ASP alternatives.

4. *Business process outsourcing will overshadow IT outsourcing:* According to Willcocks and Lacity, the market for mainstream BPO expenditure is likely to grow worldwide by 10% a year from US$ 140 billion in 2005 to over US$ 220 billion by 2010. The major business functions to be outsourced include human resources, procurement, back office administration, call centers, legal, finance and accounting, customer-facing operations, and asset management. The business logic that is expected to drive BPO is that organizations recognize back office administration as a secondary activity and do not wish to invest in back office innovations. Suppliers, on the other hand, are rapidly trying to build capabilities that will enable them to offer beneficial alternatives to inefficient processes and functions. Along these lines, many BPO deals are expected to dominate much of the back-offices IT systems.

5. *IT outsourcing will continue to grow but with new value propositions from the market:* One example of new, innovative value propositions may be the consolidation of networks in the same way suppliers consolidated data centers during the 1990s. The reason for this is that it is becoming increasingly expensive for companies to manage private networks while there are a lot of opportunities to consolidate private networks among a few large suppliers.

6. *Selective sourcing with multiple suppliers will remain the dominant trend:* According to Willcocks and Lacity, over 75% of organizations in the developed economies outsource 15%–50% of their IT budgets, typically with multiple suppliers. They also predict that the average

percentage of corporate IT budgets is set to rise, with IT outsourcing reaching 34%, IT-intensive BPO 15%, and offshoring 9% of the IT budget.

7. *Clients will control in driving and designing deals:* Contrary to the 1990s, when most deals were designed by suppliers, clients are recognizing the need to understand and control the conditions under which the outsourcing venture is executed. Over 80% of contracts are now being drafted by the client, or based on appropriate templates, a change that represents a significant power shift towards clients. On this issue one supplier recently noted "we own 80% of market here, yet clients are now dictating to us, if we want to stay in business, we have to do it on their terms." However, client control can have reverse effects if it results in the suppliers winning a "cursed" deal.

8. *Clients will invest much more in contract management:* According to Willcocks and Lacity, the cost of getting to contract is between 0.4% and 2.5% of the contract value. Ongoing management costs are between 3% and 8% of contract value. These costs are expected to increase. This is primarily because of three reasons. The first is related to the rise of offshoring, where management costs typically fall between 12% and 15% of contract value. Second, clients will try to build their internal core capability to levels that give better payoffs from outsourcing. Third, contract management is a major determinant of outsourcing success.

9. *Outsourcing will help in-sourcing:* In-house operations are increasingly adopting the techniques of the market. One such example is the use of Service Level Agreements (SLAs). SLAs define the services provided, the metrics used to evaluate services, as well as the reporting and governance put in place. While prior to outsourcing only a few organizations employed the SLA technique internally, after outsourcing nearly 60% have some form of internal SLA.

10. *Outsourcing failures and disappointments will continue:* Outsourcing will continue to be a venture which is very promising in terms of rewards, but which also carries high amounts of risk. Extrapolating past evidence into 2006–2011, Willcocks and Lacity estimate that 70% of selective sourcing deals will be considered relatively successful. In contrast, they estimate that only 50% of large-scale deals involving complex processes that represent more than 80% of the relevant budgets will be successful.

11. *Clients will move en masse from "hype and fear" into maturity:* According to Willcocks and Lacity, the typical learning curve for outsourcing includes four stages. In the first stage senior executives become aware of an outsourcing market through marketing "hype" or irrational propaganda. In the second stage most senior executives initially engage in outsourcing to seek lower costs. In the third stage senior executives recognize outsourcing as a strategy aiming at quality of operations as well as the reduction of costs. In the fourth stage, more mature adopters use outsourcing to strategically enable corporate strategies, such as increasing business agility, accessing new markets, creating new markets, and so forth. On this basis, the authors suggest that IT outsourcing organizations are at different points in this model, but the mass are in phases 3 and 4. In fact, with offshore and business process outsourcing, the bulk of organizations are much lower down this learning curve. However, as outsourcing moves in 2006–2011 to become a core part of budgets and organizational management, learning and cross-learning in all three areas (IT, business process, and offshore outsourcing) will increase and organizations will become more mature in managing their outsourcing ventures.

Summary

In this chapter we explained the key terminology relating to global sourcing. This chapter also provides an extensive review of past, present, and future trends in the area of global sourcing. It is clear that more and more firms have introduced business solutions relating to global sourcing to reduce costs or to access scarce skills. Furthermore, there is a growing interest in outsourcing business processes that makes the sourcing phenomenon a challenge of any manager within the firm.

CHAPTER 2

Sourcing models: What and when to outsource/offshore

Introduction

While global sourcing has been gaining wider recognition as a significant approach to boost the efficiency and competitiveness of the firm, various types of global sourcing models have begun to emerge. These include domestic outsourcing, offshore outsourcing, domestic insourcing, and captive models. The major distinction between these models lies in whether the function is performed by a subsidiary business unit of the firm or by an external vendor, and also whether the function is performed in the country where the organization is located or in an offshore location. More specifically:

- *Domestic outsourcing* refers to contracting with a third party who is situated in the same country as the client organization for the completion of a certain amount of work, for a specified length of time, and at a certain cost and level of service.
- *Offshore outsourcing*, on the other hand, refers to outsourcing arrangements with vendors who are situated in a different country from the client organization.
- *Domestic insourcing* refers to managing the provision of services internally, within a business unit that is located in the same country as the organization.
- *Captive models* refer to the strategic choice to locate organizational activities within a wholly owned subsidiary in another country.

The focus of this chapter will be on the:

- various sourcing models available for clients and vendors;
- IT and IT-enabled services and processes that can be outsourced;
- factors that should be considered when making a decision about outsourcing and offshoring;
- processes which are most suitable for offshoring.