

Outsourcing, today and tomorrow  
Insights from Deloitte's 2012 global  
outsourcing and insourcing survey



# Contents

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Outsourcing: A continual work in progress	3
Outsourcing has gone mainstream but is far from reaching its full potential	4
Rhetoric aside, outsourcing does not necessarily mean offshoring	8
The cloud is expected to revolutionize outsourcing – soon	11
Cost drives adoption, but service drives satisfaction	14
When outsourcing doesn't work, consider insourcing	18
Innovation and improvement are everyone's job	20
Afterword: Outsourcing's secret sauce	24
Appendix: Survey demographics	25
U.S. and Global contacts	26

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# Outsourcing: A continual work in progress



According to one estimate, organizations around the world will outsource some U.S. \$480 billion worth of business and information technology (IT) services in 2012 alone.<sup>1</sup> That's a lot of money to bet on outsourcing's<sup>2</sup> ability to deliver the desired results. That so many organizations are willing to make that bet testifies to outsourcing's hard-won credibility as an effective service delivery model. In the 1990s, when outsourcing first attracted widespread attention, the "own, manage, and directly control" management ethos of the day prompted many leaders to view outsourcing with skepticism.<sup>3</sup> Now, while some may be more comfortable with its use than others, many leaders readily acknowledge outsourcing's potential value as a way to obtain cost-effective services in areas that lie outside a business' core concerns.

For all the reliability of the outsourcing model, however, the outsourcing industry is still undergoing constant change. Vendors are adding new service capabilities and locations

to address expanding client demands and expectations. The nature of the outsourcing relationship is continually evolving as vendors and clients refine and redefine their preferred terms of engagement. And the highly variable economic, political, social, and technological context for outsourcing creates a kaleidoscope of potential threats and opportunities for both sides of the relationship, with consequences that are often as unpredictable as they may be profound.

Deloitte's 2012 global outsourcing and insourcing survey<sup>4</sup> offers a glimpse into the current and expected future outsourcing practices of 111 survey participants. In this publication, we explore several of the survey's topics in more depth, drawing on our results as a starting point for each discussion. We hope you find the views expressed here a useful contribution to the conversation about outsourcing, and that they aid you in furthering your organization's outsourcing objectives.

<sup>1</sup> "Introduction to the Outsourcing & Offshoring Industry," Plunkett Research®, Ltd. Accessed on July 2, 2012 at <http://www.plunkettresearch.com/outsourcing-offshoring-bpo-market-research/industry-and-business-data>.

<sup>2</sup> Throughout this paper, the word "outsourcing" refers specifically to business process and IT services outsourcing, and specifically excludes the practice of moving manufacturing operations abroad.

<sup>3</sup> Robert Handfield, "A Brief History of Outsourcing," The Supply Chain Research Cooperative, June 1, 2006. Available online at <http://scm.ncsu.edu/scm-articles/article/a-brief-history-of-outsourcing>.

<sup>4</sup> An executive summary of survey results is available at [http://www.deloitte.com/view/en\\_US/us/Services/additional-services/Service-Delivery-Transformation/c78f7ebb3c356310VgnVCM2000001b56f00aRCRD.htm](http://www.deloitte.com/view/en_US/us/Services/additional-services/Service-Delivery-Transformation/c78f7ebb3c356310VgnVCM2000001b56f00aRCRD.htm).

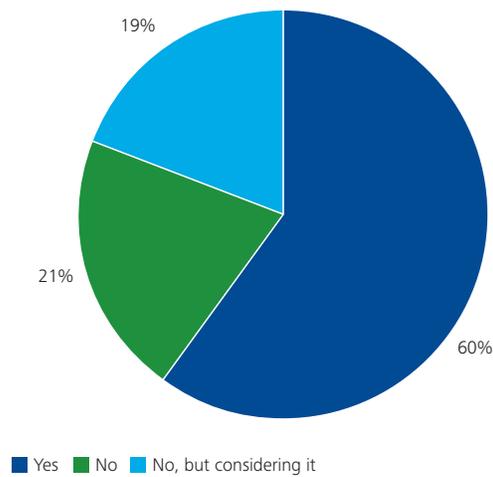
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# Outsourcing has gone mainstream but is far from reaching its full potential

At many companies, including many of those in the survey, outsourcing is a fact of life. Eighty percent of survey respondents reported that they used outsourcing; 60 percent agreed with the statement that “Outsourcing is now a standard operating practice at my company” (Figure 1). Current outsourcing rates ranged from 11 to 76 percent in each of eight business functions, with a higher percentage of respondents expecting to outsource in each function in the future (Figure 2).

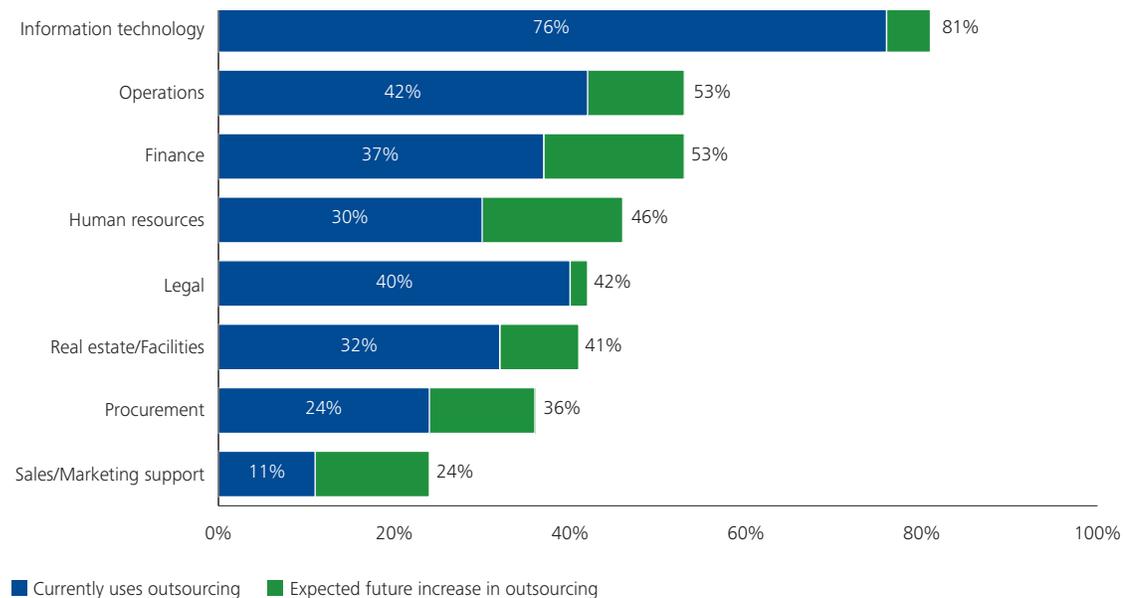
Perceptions of outsourcing, moreover, appear to be generally more favorable than not. According to survey respondents, internal stakeholders in several commonly outsourced functions were more likely to support outsourcing than to oppose it (Figure 3).

**Figure 1. Is outsourcing a standard operating practice at your company?**



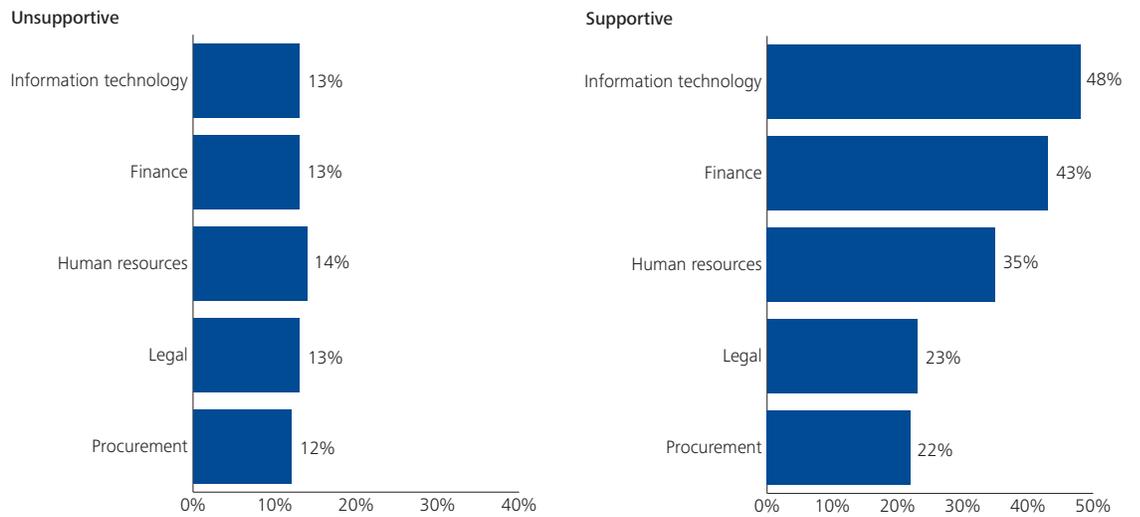
Percentages represent the percentage of respondents.

**Figure 2. Which option best describes your company’s current and future sourcing plan for the following business functions?**



Percentages represent the percentage of respondents.

**Figure 3. How supportive of outsourcing are the following functions?**



Percentages represent the percentage of respondents.



Do these findings mean that outsourcing has, indeed, gone mainstream? It depends. Clearly, outsourcing's 80 percent adoption rate among respondents indicates extensive use of the model. Yet, the fact that only 60 percent of respondents said that outsourcing was "standard business practice" implies that even some companies that use outsourcing view it as an exception to the in-house service delivery "rule." While certainly not definitive, the 20 percent gap between perception and practice hints that the potential outsourcing client population has not yet embraced outsourcing as fully as it might.

Outsourcing should at least be considered, if not pursued, in a company's service delivery strategy. Leaders deterred by the idea that vendors for anything but basic transactional work are few and far between should consider updating their view of the marketplace. At one recent client, executives conducted a detailed vendor capability analysis and were surprised to learn that reliable vendors could be found in specialties including engineering, research and development, legal, sales and marketing, business analytics, and more. They were also surprised by the maturity of "vertical" outsourcing offerings whereby vendors offer end-to-end process execution for specialized industry needs. The perception that outsourced services tend to be less satisfactory than in-house execution is similarly unfounded. Many of the outsourcing clients in the survey (76 percent) were either extremely satisfied or satisfied with their latest outsourcing initiative.

The choice to forego outsourcing should be made by design, not by default. Outsourcing's potential to drive meaningful cost savings and/or service enhancements is simply too great for responsible leaders to dismiss out of hand.

Corporate leaders at companies that outsource extensively, or that anticipate outsourcing a great deal in the future, can take several steps to enhance outsourcing effectiveness. At a strategic level, many leaders may find it helpful to consolidate oversight of their company's total service delivery operations – in-house as well as outsourced – under a single services executive. This oversight function

is typically responsible for charting the company's overall service delivery strategy, coordinating the company's service delivery initiatives to pursue synergies and guard against duplicative investments, and adjusting the enterprise's service delivery operations to accommodate changing business needs. When effective, centralized service delivery oversight can drive substantial benefits in cost avoidance and strategic alignment – although many companies find it difficult to effect the necessary cultural change until a clear and costly lapse in coordination highlights the potential advantages.

Tactically, too, corporate leaders can develop supports that aim to embed important outsourcing skills, knowledge sets, and "leading practices" into outsourcing efforts throughout the enterprise. For instance, leaders may want to provide guidance and/or resources such as:

- A standard outsourcing process that prescribe "leading practices" at each stage of the outsourcing lifecycle
- Project management capabilities for shepherding local teams through the outsourcing process
- Capabilities for identifying end-user business requirements at an appropriate level of detail
- Familiarity with the vendor marketplace in the service(s) being outsourced, including knowledge of prevailing norms around service levels and pricing
- Standardized high-level performance metrics
- Vendor management capabilities
- Mechanisms for internal (user) and external (vendor) governance
- Tools and templates to help enable the above

How leaders can bring these elements to an enterprise's outsourcing relationships depends on factors such as current and anticipated future outsourcing volume, organizational structure, and corporate culture.

Creating standardized processes, templates, and tools is an important first step, but only a first step. As some companies discover the hard way, a "playbook" of outsourcing policies and procedures is usually much easier to write than to socialize and enforce, and its practical benefit can be limited by stakeholders' ability to execute. Savvy outsourcing clients should therefore buttress their outsourcing playbook with mechanisms to provide governance, training, and hands-on assistance.

One approach, especially for large companies that outsource extensively, can be to consolidate outsourcing oversight and support capabilities into one or more corporate-level teams. Centralizing company-wide vendor management activities, for instance, can give leaders greater visibility into the company's outsourcing efforts. For more strategic and/or specialized work, a company may establish an outsourcing "center of expertise" (CoE), staffed with outsourcing professionals who could advise corporate leaders on outsourcing strategy, own and update the outsourcing "playbook," and help execute certain outsourcing tasks, such as project management, business requirements definition, contract negotiation, and performance improvement. Beyond helping to increase efficiency and consistency, formally consolidating a company's outsourcing specialists into the same organizational unit can make it much easier for them to compare notes, learn from each other's experience, and thereby continuously improve their performance.

Companies that lack the outsourcing volume needed for a centralized outsourcing team(s) can help stakeholders adhere to the outsourcing playbook by creating knowledge-sharing and training procedures through which those experienced in outsourcing can pass on their knowledge to less-experienced colleagues. The goal is to capture the company's institutional knowledge about outsourcing on an ongoing basis and provide it to the people who execute each outsourcing relationship. Leaders should consider deploying at least one resource with prior outsourcing experience to each contract, if only in an advisory capacity.

However leaders choose to go about it, building an institutional capability for effective outsourcing can be fundamental to a service delivery strategy in which outsourcing plays a major role. With outsourcing now seen as a mainstream business practice and expected to become even more so in the future, the time may be ripe for companies to recognize outsourcing as a discipline that requires specialized skills and competencies – and to invest in those skills and competencies in a manner that helps stakeholders execute outsourcing in a manner that can provide the expected results.



# Rhetoric aside, outsourcing does not necessarily mean offshoring

In the U.S. and elsewhere, outsourcing and offshoring have been the focus of intense debate about their potential social and economic impacts. The issues raised by both practices touch a wide range of stakeholders, including businesses, workers, and governments as well as outsourcing vendors and their clients. Whatever the differences in stakeholders' views on outsourcing and offshoring, thoughtful discussion is imperative to understanding the issues and finding possible paths to resolution.

There is concern about the widespread but mistaken use of the word "outsourcing," which deals with *who* provides a service, as a synonym for "offshoring," which deals with the completely different issue of *where* the service is performed. Given the importance of dialogue on these topics, and the essential need for clarity in that dialogue, this pervasive terminological error is of more than pedantic interest. It may well reflect an equally pervasive popular confusion about what outsourcing does and does not entail, even in the business community, that can raise an unfortunate and unnecessary bar to communication about the underlying issues. The survey sought to explore this possibility, as well as to gauge the extent to which the perception that "outsourcing" entails "offshoring" accurately reflects current business practices.

## A note on location terms

The survey instrument defined the terms "within country," "nearshore," and "offshore" as follows:

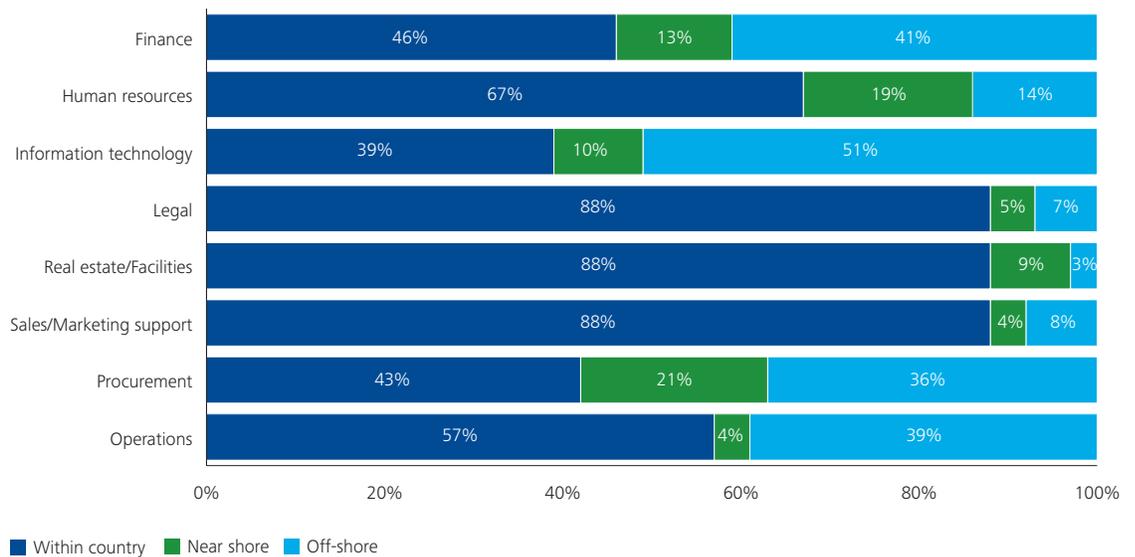
- **Within country.** Service is generally performed in the same country as the service is received or in a country where labor rates are generally consistent with those where the service is received (e.g. US-to-US, US-to-UK, Sweden-to-UK, etc.).
- **Nearshore.** Service is generally performed in another country near where the service is received (usually within or close to the same time zone) and where labor rates are generally lower than those where the service is received (e.g. Mexico-to-US, Eastern Europe-to-UK, etc.)
- **Offshore.** Service is generally performed in another country where labor rates are typically significantly lower than those where the service is received and there may be a significant difference in time zone (e.g. India-to-US, Philippines-to-UK, etc.)



The results of the survey lend credence to the idea that the misuse of “outsourcing” for “offshoring” reflects a deeper conceptual issue than simple terminological laxity. When asked to identify their organizations’ approach to evaluating outsourcing opportunities, 54 percent of the survey respondents said that their organizations looked at outsourcing and offshoring “as a single consideration.” This finding, remarkable in itself, is especially surprising in light of the survey respondents’ actual outsourcing practices, which displayed a clear preference for “within country” vendors in every function except for Finance, IT, and Procurement (Figure 4). Although these vendors may not literally operate in the same country as their customers (see sidebar, “A note on location terms,” for the definitions used in the survey), the predominance of “within country” outsourcing in most functions indicates that “offshoring,” in the sense of sending work abroad to pursue labor arbitrage savings, is not the current norm.

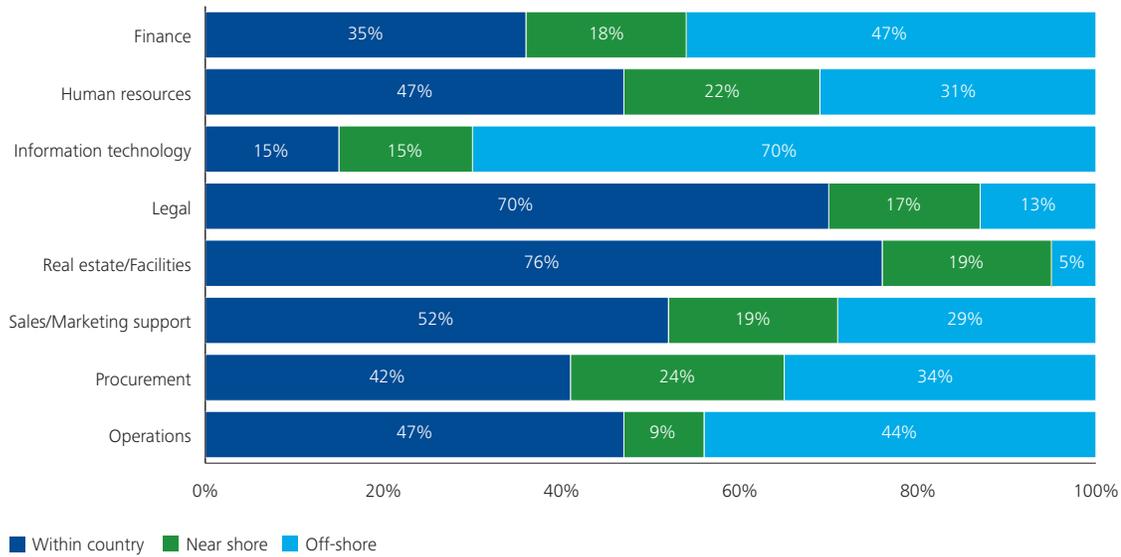
The figures for respondents’ anticipated *future* outsourcing locations (Figure 5) paint a slightly different picture. The percentage of respondents who expected to employ “within country” vendors for the majority of each function’s outsourced work decreased in every function. HR and Operations joined Finance, IT, and Procurement as functions where more than half of the survey respondents planned to offshore or nearshore the majority of the function’s outsourced work. These results likely demonstrate respondents’ evident confidence in the offshore and nearshore outsourcing industries, despite the likelihood that wage increases in popular offshore destinations is expected to continue to erode a part of labor arbitrage savings. The anticipated rise in offshore outsourcing also suggests that many decision-makers consider its benefits to outweigh the risk of negative publicity associated with the effort, which reflects positively on the value the survey respondents expect today’s offshore vendors to deliver.

**Figure 4. For those business functions where you currently employ outsourcing, where does the majority of your outsourcing occur?**



Percentages reflect the percentage of respondents who outsourced the “majority” of work in each function to each type of location.

**Figure 5. For those business functions where you plan to employ outsourcing, where will the majority of your outsourcing occur?**



Percentages reflect the percentage of respondents who plan to outsource the “majority” of work in each function to each type of location.

What about the prevalence of outsourcing itself? Here, the survey results show that outsourcing, regardless of its destination, is on the rise: Anticipated outsourcing rates exceeded current incurring rate for every function surveyed (Figure 2). Also notable was how few respondents planned to insource (bring outsourced work back in-house) in any function – although, as we will explore in more detail later, insourcing can be the preferred option under some circumstances.

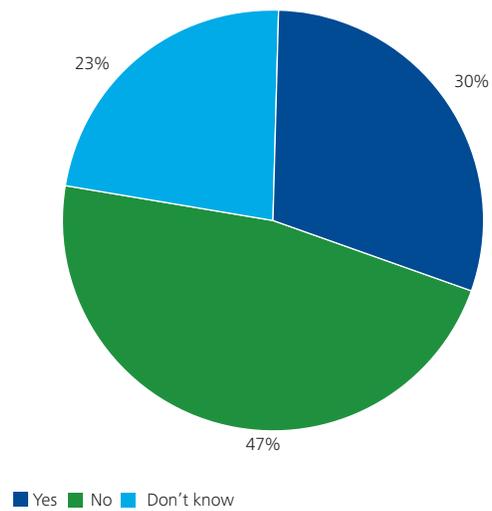
If the survey respondents are typical, several trends are anticipated/expected to emerge over the next few years. First, outsourcing will likely continue to expand, both to companies outsourcing work for the first time and to additional functions and activities at current outsourcing clients. Second, the percentage of work outsourced to out-of-country providers is likely to grow as clients become more comfortable with the concept of a regional or global delivery model – which means that “within country” outsourcing, while possibly still predominant, may constitute a relatively smaller part of the total.

Considering the highly sensitive nature of these topics, it is suspected that the combination of growing outsourcing volumes and shrinking “within country” outsourcing rates may garner political and societal reactions that could affect the entire outsourcing industry. This is why outsourcing vendors and clients have a vested interest in engaging stakeholders in dialogue on outsourcing and offshoring – and in advocating for the correct use of the words “outsourcing” and “offshoring” as a starting point. The issues raised by outsourcing and offshoring are real and important, but they are not identical. The more consistently stakeholders recognize the distinction in their language, the more quickly they can engage in substantive, constructive dialogue.

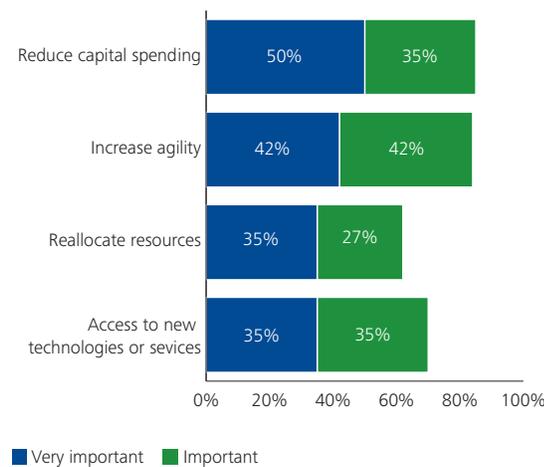
# The cloud is expected to revolutionize outsourcing – soon

To hear some tell it, cloud computing is the most disruptive business innovation since the Internet. Many don't necessarily disagree. However, whatever shifts may be on the horizon, the results suggest that they are only beginning to reshape the outsourcing industry. Just 30 percent of the survey respondents said that their companies currently used cloud computing services, most often for IT and/or telecommunications (Figure 6). When asked whether their companies planned to use cloud computing services within three years, most of the non-cloud-using respondents simply did not know, although about a third (38 percent) answered in the affirmative. Very few respondents (6 percent) definitively stated that their companies would not adopt cloud computing services within the next three years, for reasons including the novelty of the concept, data security, and data privacy (Figure 7).

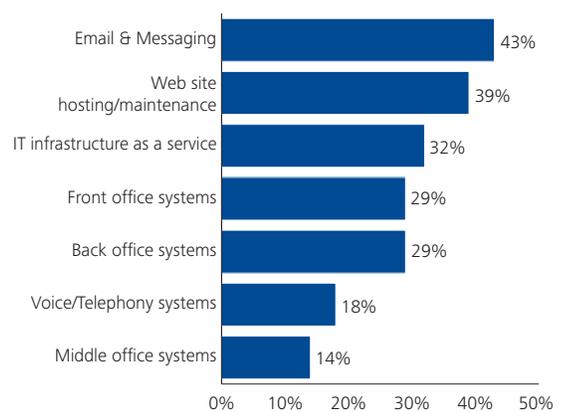
Figure 6. Adoption and drivers of cloud computing services



How important were the following factors in your decision to use cloud computing services?

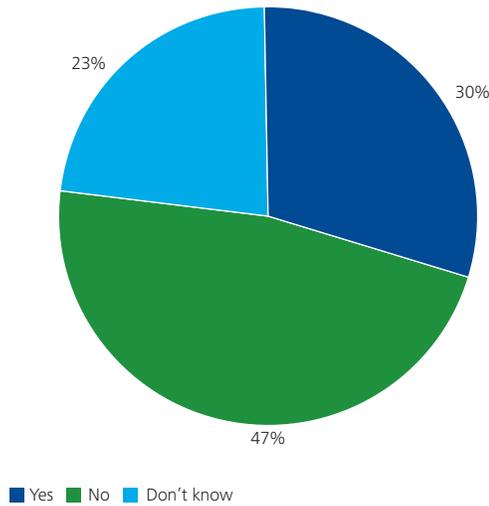


Which cloud computing services have you implemented?

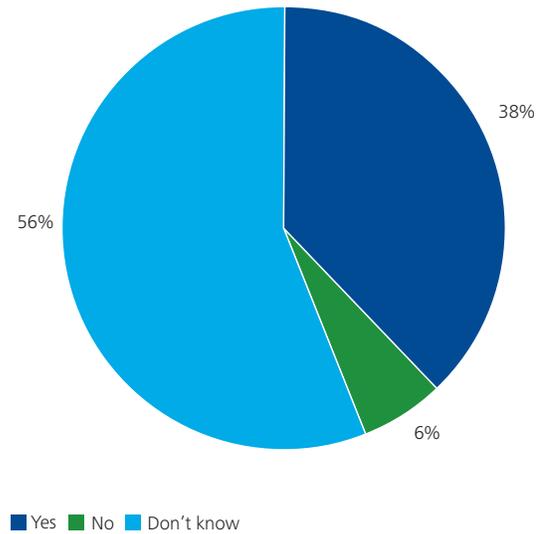


**Figure 7. Anticipated future adoption of cloud computing services**

Is your company currently using cloud computing services?

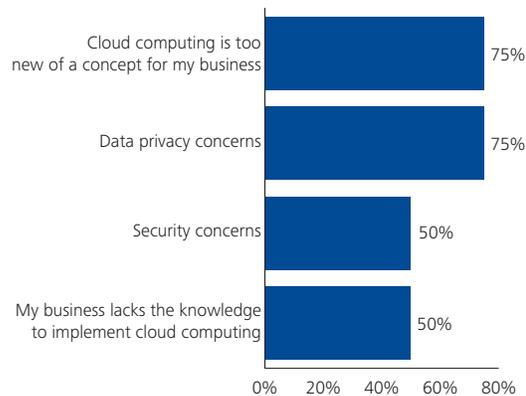


Do you plan on using cloud computing within 3 years?



These results give the distinct impression that outsourcing clients are approaching cloud computing with an abundance of caution, as befits the embryonic nature of cloud computing in general and its application to outsourcing in particular. Today, cloud computing is most evident in the IT outsourcing (ITO) sector, where a number of vendors offer cloud-based services such as those many of the survey respondents reported using. Cloud-based business process outsourcing (BPO), in contrast, is still largely theoretical, in spite of the emergence of several software-as-a-service (SaaS) vendors in the business process applications space.

If no, why do you believe you will not use cloud computing?



Like most observers, the current marketplace hesitancy regarding cloud-based outsourcing is likely the calm before the storm. Cloud computing’s highly publicized advantages over traditional computing – in cost, capacity, scalability, and accessibility – are already creating demand for cloud-based ITO services, to which cloud computing technology is most obviously applicable. As a result, established ITO vendors in virtually every segment of the industry are mobilizing to counter a host of emerging and anticipated

threats from cloud-enabled entrepreneurs. BPO vendors, meanwhile, are seeking to capitalize on cloud computing’s ability to both enhance traditional business models and enable new ones (see sidebar, “The potential of cloud computing and outsourcing”).

## The potential of cloud computing and outsourcing

Cloud computing is expected to have a profound impact on the outsourcing industry. Among the many possible cloud-driven developments:

- **The end of IT infrastructure outsourcing as we know it.** New entrants to IT infrastructure outsourcing, unencumbered by prior investments in traditional computing assets, could develop cloud-based infrastructure-as-a-service (IaaS) offerings that equal or surpass the services available from vendors using a traditional computing environment – at a much lower cost. To compete, established ITO vendors will likely need to find ways to effectively/efficiently transition their operations to a cloud computing environment themselves, protecting market share in the meantime with tactics such as reconfiguring their legacy IT assets to deliver cloud-like performance at cloud-like prices.
- **An application development population explosion.** The advent of platform-as-a-service (PaaS), in which users buy access to cloud-hosted development platforms and tools on a subscription basis, has lowered the barrier to entry to the application development business almost to triviality. By reducing the need for large up-front investments in servers, data centers, and platforms, PaaS makes it possible for anyone with an Internet connection and a credit card to set up an application development shop.
- **“Bring your own software.”** Although most BPO vendors today prefer to bundle the execution of a process with the technology used to enable it, it’s also possible to find vendors that can contract to execute a process using the technology of the client’s choice. This model, known as a “service center wrap” or a “wrap-around,” may gain more traction if SaaS-based business process applications become popular enough to create a critical mass of demand among the BPO client base.
- **An expanding Chinese menu.** Online auctions for services are not new, but the sheer capacity of cloud computing technology can allow them to take place on a massive scale. As more people and organizations trade services on the cloud, the range of available capabilities is expected to grow ever greater. Companies may find it easier to find multiple options for outsourcing even highly specialized work as long as the work can be done or delivered via the Internet.
- **The virtual vendor.** With the cloud opening the door to outsourcing practically anything that can be done or delivered on the Internet, business models such as “vendor as broker” and “vendor as retailer” may become economically feasible. Instead of scouring the Internet to find esoteric service capabilities, outsourcing clients may prefer to leave the searching and evaluating to a third party that can either resell the service outright or broker connections with appropriate service providers.
- **“Department in a box.”** Conceivably, one or more vendors may combine BPO with cloud technology’s computing horsepower to offer clients the ability to outsource an entire business function, or almost all of it, at one fell swoop.
- **Blocs and behemoths.** Strategic alliances and partnerships are apt to proliferate as outsourcing vendors and cloud computing providers seek to ride each other’s coattails to new markets. Alternatively, or additionally, they may engage in M&A deals to pursue similar ends.

How can the outsourcing industry prepare for the changes that cloud computing could drive? Even without being able to predict the future in detail, it’s fair to expect cloud computing to vastly increase the complexity of the outsourcing “supply chain.” Vendors will be able to network, partner, and subcontract with each other “on the cloud” far more easily and in far greater numbers than has historically been practical. Consequently, transparency into vendor operations is expected to become even more important, both in evaluating vendor capabilities and in driving continuous improvement, than it is today – as well as more challenging.

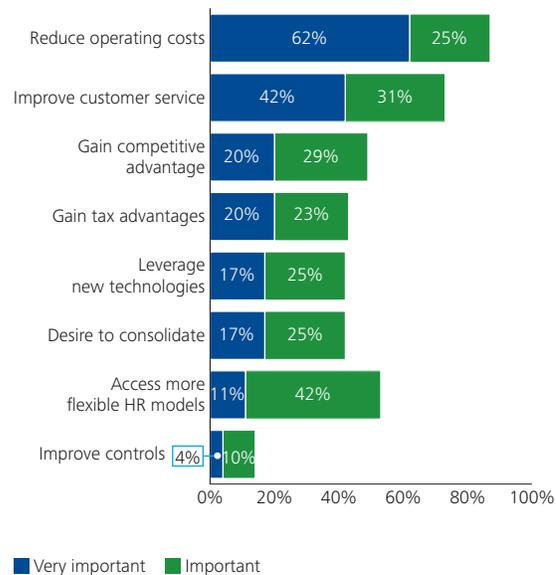
Whether cloud computing is as disruptive as the Internet may be debatable, but its potential to revolutionize outsourcing is beyond serious question. The day is fast approaching when cloud computing will be integral to the outsourcing industry. Until then, the effective use of cloud computing can give both vendors and clients an opportunity to gain competitive advantage. Vendors and clients should discuss the implications of cloud computing openly and often, applying both technological and service delivery knowledge to the question of how the cloud’s technical capabilities could transform outsourced service delivery in a mutually advantageous way.

# Cost drives adoption, but service drives satisfaction



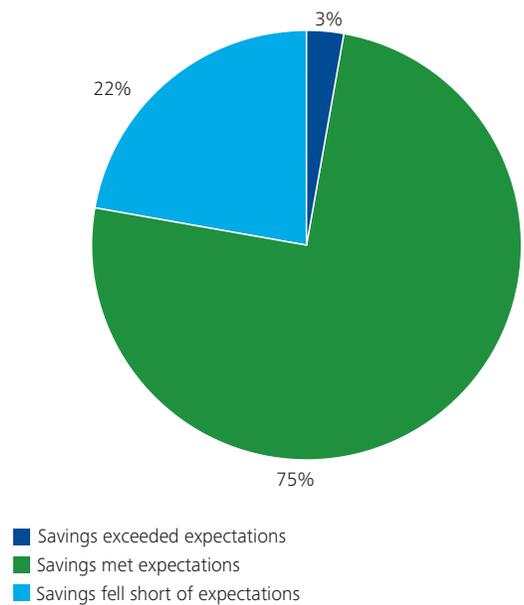
“Quality is remembered long after the price is forgotten.” Give or take a few nuances, the Gucci family’s classic slogan sums up the survey findings on outsourcing cost and service quality in a nutshell. On the one hand, the results confirmed that cost reduction is the most common motive for outsourcing: Eighty-seven percent of our respondents cited it as an important or very important objective in their most recent outsourcing initiative (Figure 8). On the other hand, respondents’ satisfaction with outsourcing relationships were based much less on their cost than on factors related to service quality: accuracy of scoping, service-level attainment, and overall quality of service.

**Figure 8. How important were each of these objectives in your most recent outsourcing effort?**



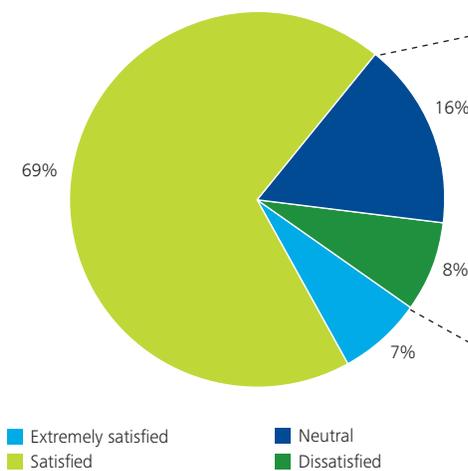
That cost reduction is rarely sufficient for client satisfaction should come as no surprise. More startling is the possibility that cost reduction may be much less necessary to satisfaction than is commonly believed. Fully 76 percent of the survey respondents were satisfied or very satisfied with their most recent outsourcing effort's results (Figure 9) – yet only 42 percent of these initiatives reduced costs by 10 percent or more. Further, of the relatively few respondents who were dissatisfied with their latest outsourcing initiative, only 24 percent attributed their dissatisfaction to lack of business-case attainment. One executive even reported satisfaction with an outsourcing relationship that increased costs (although, cost reduction was only a “moderately” important goal for this particular initiative – and the business case acknowledged the likelihood of higher costs from the start). Interestingly, almost a quarter of the outsourcing efforts for which the survey respondents reported both actual and anticipated savings fell short of the business case’s projected cost reductions (Figure 10), making cost’s relative unimportance in outsourcing satisfaction perhaps more fortunate than otherwise.

**Figure 10. Actual versus anticipated cost savings of most recent outsourcing effort**

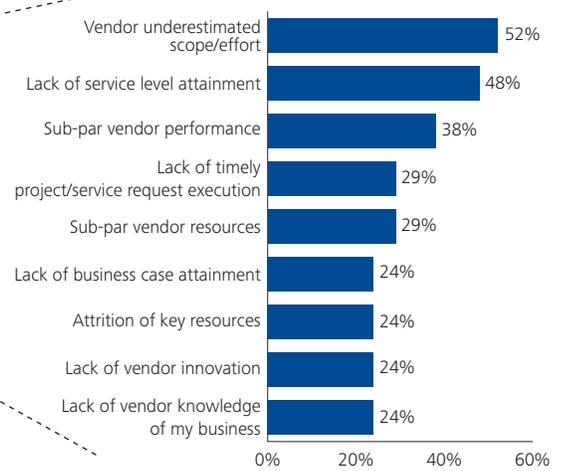


**Figure 9. Outsourcing satisfaction and reasons for dissatisfaction**

How satisfied are you with the outcome of your most recent outsourcing initiative?



What factors led you to be less than satisfied with your most recent outsourcing initiative?

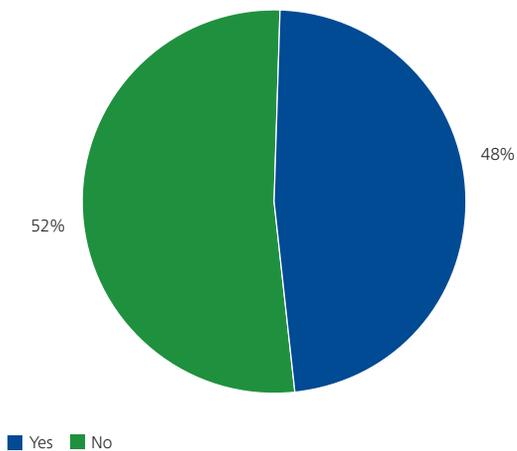


The evidence is equally strong that service and performance are drivers of outsourcing satisfaction – or at least of dissatisfaction. The surprise here was that so many respondents actually considered improving customer service to be an explicit outsourcing objective, suggesting that many outsourcing clients not only appreciate but expect high-quality service from their vendors. The survey respondents’ top reported reasons for dissatisfaction (Figure 9), moreover, highlight the importance of quality-related factors such as accuracy of scoping and service-level attainment. Perhaps most revealing, of those respondents who had ever terminated an outsourcing contract for cause or convenience, 71 percent pointed to overall quality of service as an important reason they ended the contract(s) early – more than twice the percentage that cited any other factor (Figure 11).

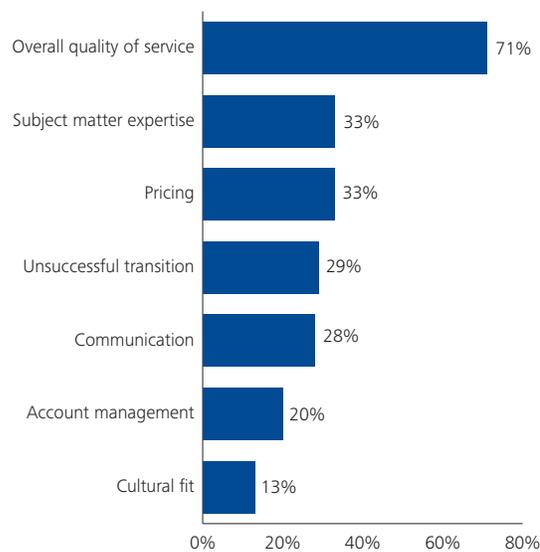
These results reinforce that that quality of service influences clients’ satisfaction with outsourcing much more greatly than cost. High quality, therefore, can be a more potent competitive differentiator than low cost – not just for outsourcing vendors, but also for their clients. Vendors that compete primarily on cost may win contracts only to lose them to others that provide more-satisfactory service at still-acceptable prices. And clients that view outsourcing’s value primarily in terms of its cost-cutting potential run the risk of falling behind competitors whose outsourcing contracts may deliver a higher net return on investment.

**Figure 11. Frequency and drivers of early contract termination**

Have you ever terminated an outsourcing contract for cause or convenience?



Which factors were most important in your decision to terminate the contract(s) early?



The good news is that both vendors and clients have opportunities install a number of checks and balances into their relationship to help promote high-quality service delivery. Many of these opportunities arise during the transition to outsourcing, when appropriate actions (or their lack) can have a dramatic impact on a relationship's eventual effectiveness. Experienced vendors and clients use the transition period to identify potential concerns and create mechanisms for addressing them *before* they become chronic problems. Some of these tactics are self-evident, such as securing executive alignment, setting realistic user expectations, investing in change and communications, formalizing performance metrics and procedures for tracking and reporting them, and so on. Less well-known but equally important are actions such as determining (and planning around) the client's operational readiness to outsource the relevant processes; preparing the retained organization for its new service delivery role; developing clear roles, responsibilities, and governance processes; and implementing executive reporting processes to keep both client and vendor leadership appropriately informed.

A more general observation, though admittedly speculative, is that the cost-reduction focus that so often drives a decision to outsource may actually work against both vendors' and clients' long-term interest in developing a mutually satisfactory service relationship. The way many outsourcing contracts are typically sourced, sold, and negotiated can exacerbate this risk. When a vendor's sales incentives revolve around the number of deals closed, and client sourcing personnel are expected to bargain for the lowest possible price, the contracts that result often reflect unrealistic client expectations, strain vendors' service-delivery capabilities, or both. The pressures surrounding the inception of an outsourcing relationship should not be allowed to sabotage its broader business purpose.

# When outsourcing doesn't work, consider insourcing

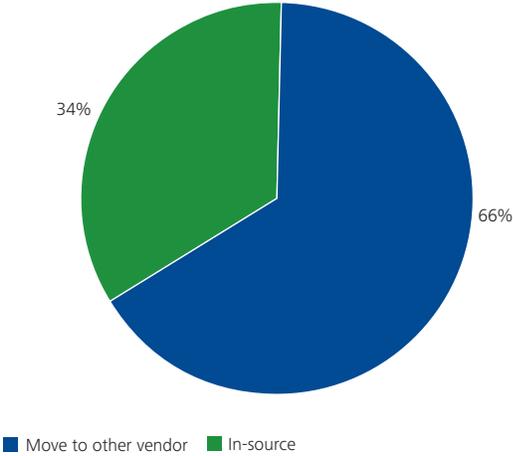


There's little doubt that outsourcing can provide satisfactory results most of the time, as evidenced not just by respondents' high rate of outsourcing satisfaction but by the sheer growth of the global outsourcing industry. Nevertheless, the other side of the coin also exists. Outsourcing relationships sometimes do fail, and outsourcing is not always a company's most effective choice. The survey respondents' approaches to cases where outsourcing did *not* produce the desired results show that insourcing,<sup>5</sup> while rare in the context of all outsourcing contracts, occurs much more often when a client terminates an outsourcing contract for cause or convenience. Furthermore survey results show that companies that insource are usually happy with the results.

In general, the results indicate that, once work is outsourced, it almost always stays outsourced. A paltry 7 percent of our respondents anticipated insourcing at least some IT processes in the future; the figures for other functions ranged between 0 and 2 percent (Figure 2). But among the subset of respondents who had ever terminated a contract for cause or convenience, fully 34 percent chose to insource the work after terminating the contract(s) rather than seek another vendor (Figure 12). Moreover, 79 percent of the insourcing respondents were satisfied or extremely satisfied with the outcome, and the rest were neutral – a dissatisfaction rate of zero (Figure 13).

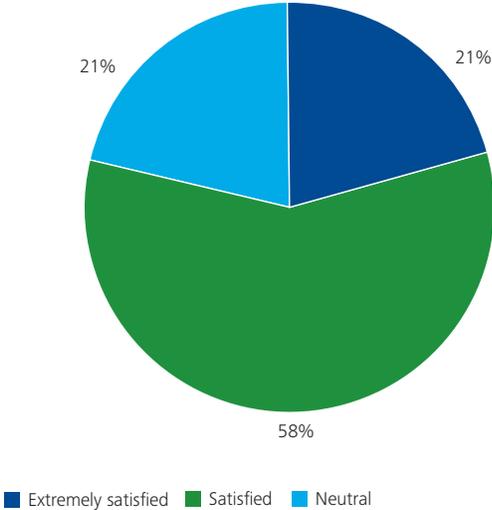
<sup>5</sup>We use the term "insourcing" to refer to bringing work partially or fully back in-house after having previously outsourced it. This contrasts with "in-house service delivery," which is used to for work done in-house that has never been outsourced.

**Figure 12. What was your post-contract termination strategy?**



The fact that most respondents that ended a contract early chose to find another vendor rather than insource the work is readily understandable. Reversing the decision to outsource can be professionally uncomfortable for the sourcing initiative’s leaders, and the dismantling of relevant in-house capabilities often makes insourcing infeasible in many cases. More difficult to explain is the high satisfaction rate among respondents who insourced after ending an unsatisfactory outsourcing relationship: Why, if insourcing yields acceptable results, was the work ever outsourced in the first place? One conjecture is that in at least some instances, the unsatisfactory outsourcing experience prompted a realization that outsourcing may have been a poor, or at least premature, decision. For instance, at one company that insourced after terminating an HR outsourcing contract, leaders frankly acknowledged that their own inexperience in outsourcing was at the root of the relationship’s shortcomings. Decision-makers recognized that insourcing would remain the preferred option until the company had developed the skills and processes it needed to outsource work more effectively.

**Figure 13. How satisfied are you post-insourcing?**



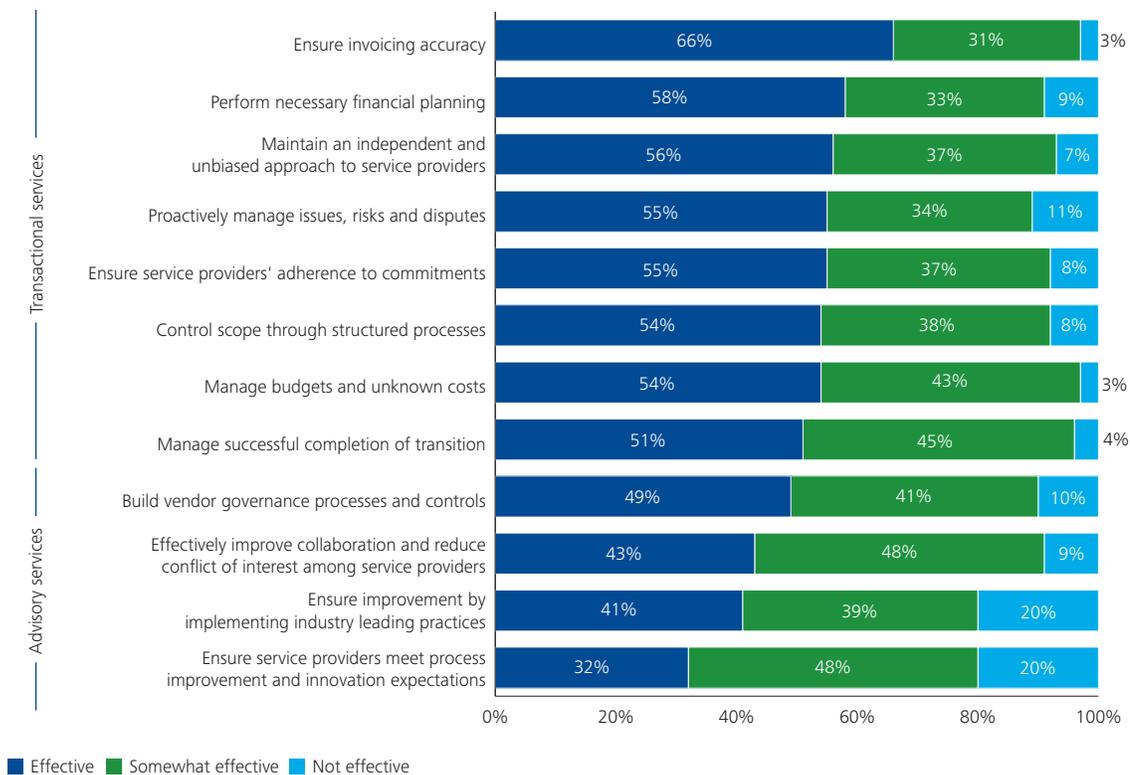
Two rules of thumb should be considered for outsourcing clients with regard to insourcing. First, leaders should evaluate insourcing as an option at the end of any outsourcing relationship, especially for relationships that may be terminated due to unsatisfactory performance. And second, of the many factors to consider when deciding whether to insource or re-outsource work – as, indeed, when deciding whether to outsource the work to begin with – one of the most important is the client’s own capabilities for engaging with vendors to pursue a satisfactory outsourcing relationship. The skills and techniques needed for effective services outsourcing are not always apparent to those who have never done it before. Experience is often the best teacher – and sometimes, the lesson is to prepare more thoroughly before trying again.

# Innovation and improvement are everyone's job

Innovation and continuous improvement – more precisely, innovation as part of continuous improvement – are written into virtually every outsourcing contract we have ever seen. For good reason. As discussed in the previous section, quality is fundamental to outsourcing's long-term value, and few outsourcing clients are content for quality to remain static during the three to five years of a typical contract. In the future, as wage inflation in popular offshore destinations continues to erode part of the potential for labor arbitrage-driven savings, quality is likely to become even more central to outsourcing's value proposition, and innovation and improvement will become even more important.

Because most outsourcing clients make their vendor management (VM) organizations responsible for driving innovation and improvement, these objectives were included when asking respondents to rate VM effectiveness in a number of common outsourcing objectives. The results were not entirely encouraging. While respondents gave their VM organizations generally high marks overall, innovation and improvement were the areas in which VM was least often viewed as "effective." Both also received a markedly higher percentage of "not effective" ratings (20 percent each) than any other activity (Figure 14).

**Figure 14. How effective is your vendor management organization/function in meeting the following objectives?**





At face value, the survey findings seem to indicate a need for many VM organizations to enhance their capabilities around both innovation and improvement. The flaw in this conclusion, however, is that the capacity for innovation and improvement – while often viewed strictly as steady-state pursuits – depends on a much more systemic effort involving multiple parties at different stages of the outsourcing lifecycle. While a VM organization can and arguably should coordinate improvement efforts during the contract term itself,<sup>6</sup> decisions that occur before a vendor even reaches VM can do much to either hobble or facilitate improvement efforts. And even under favorable preceding circumstances, very few VM organizations are likely to be able to effect improvements unless both peers and leaders are actively engaged.

To understand a VM organization’s limitations in effecting improvements, it’s helpful to identify some of the underlying factors that can affect an outsourcing relationship’s capacity for improvement in the first place. One common handicap to improvement, for instance, can be the lack of sufficient detail in the client’s specifications for executing the outsourced process(es). While most outsourcing clients take considerable care in deciding on the scope of work to outsource, many then go on to select and hire vendors without thinking through the mechanics of each process with equal care. As a result, they may establish contracts that, while clear about what the vendor is expected to deliver, contain only a vague description of how the work should be done. A client may hire a vendor for “recruitment” or “accounts payable,” for instance, without specifying who should be responsible for which parts of the process, how and when hand-offs will occur, or what should be done when something goes wrong – all of which are integral to smooth process execution (except in the very rare case where the client expects to have no involvement whatsoever). The absence of clarity about how the work should be done can not only compromise process effectiveness, but also spawn multiple variants and work-arounds that can stand in the way of improvement.

<sup>6</sup> For brevity’s sake, the rest of this discussion will use “improvement” as shorthand for “innovation and improvement.”

The contract negotiation approach is another factor that can affect long-term performance and the prospects for improvement. We have already mentioned the possible conflict of interest between the desire to reduce costs that prompts most outsourcing efforts and the desire for high-quality service during the outsourcing contract. Additional complications may arise if the client personnel sourcing and negotiating with vendors do not understand the end users' business requirements and/or, as discussed above, their preferred approach to execution. Lacking a firm grasp of user needs and expectations, and under pressure to bargain for low prices, the client team negotiating contracts may make trade-offs on scope or service levels that drive costs down but compromise relationship performance.

Turning now to actual contract terms, clients can help foster vendor engagement in improvement by avoiding the use of input-based pricing models, which pay vendors based on the number of full-time employees (FTEs) they deploy to the client's account. Efficiency improvements are often operationalized as a reduction in the required number of FTEs – and input-based models, of course, give vendors an economic incentive not to decrease the number of FTEs needed for the job. Output-based pricing models, which are based on throughput volumes rather than on vendor headcount, can remove this headcount-driven disincentive, although they involve the challenge (for clients) of determining baseline volumes and projecting expected future volumes. Outcome-based pricing models, which pay vendors in proportion to the value realized by the client, can offer vendors an even greater incentive for improvement, which makes them worth exploring for the relatively few services for which a vendor's work can be tied directly to a client value metric.

The contract language related to innovation and improvement is also important. Frequently, the clauses addressing these areas, especially innovation, are too vaguely worded to hold either party accountable for the process or the results. An effective contract will specify the mechanisms, such as regular meetings between designated client and vendor personnel, through which opportunities can be identified and pursued. It's also wise to include language around how cost- and gain-sharing will be

handled, perhaps in the form of an agreed-upon process for negotiating these terms if and when the need arises. Each party may also commit itself in writing to maintaining internal continuous improvement programs – though such commitments, being difficult to monitor and enforce, may be more valuable as a gesture of goodwill than as a pragmatic spur to improvement.

To effectively find and execute improvements, clients should assign ownership of the effort to an individual(s) who understands the relevant outsourced process(es) well enough to discuss them intelligently with vendors and look for ways to enhance them. For processes that involve multiple vendors, this may mean deploying someone with an end-to-end process view, with others to advise him or her on specific process steps as necessary. Some clients may also wish to manage the improvement process using a formal continuous improvement methodology, such as Lean or Six Sigma; if so, an appropriately skilled continuous improvement resource should be part of the effort as well. Regular, focused dialogue between vendor and client is paramount in all cases, as is establishing accountability among all participants.

The steady-state continuous improvement process is where a VM organization can make its greatest contribution, provided that the outsourcing relationship in question was set up in a way that favors improvement (or at least does not hinder it). In broad terms, the VM organization's main responsibilities should be to oversee and facilitate the improvement process for all outsourcing relationships, with the aim of driving consistency across relationships and helping stakeholders bring the appropriate capabilities to each relationship. In its capacity as overseer, a VM organization may monitor ongoing relationship performance, identify remediation and improvement needs, and develop and collect standardized progress metrics from the various efforts underway. As a facilitator, a VM organization could house standardized tools and templates, provide project management support, and even literally facilitate vendor-client ideation sessions to help keep the discussion focused.

Should the VM organization help execute the improvement process as well as oversee and facilitate it? That's up to each outsourcing client to decide – and, practically speaking, the question is somewhat academic. Whether capabilities such as process knowledge, continuous improvement, and project management reside within VM or outside it is less important than the ability to bring the necessary capabilities to each improvement process. The value of having a continuous improvement professional on a company's VM team may depend on whether the company also maintains a dedicated continuous improvement group, as well as on that group's capacity. Some companies may prefer to have its VM professionals rely on end users for process-specific knowledge, while others may view process knowledge as a required VM skill.

No matter what the VM organization's responsibilities, however, it cannot and should not be VM's job to make sure everyone else does theirs. That responsibility lies squarely with executive leadership, who should install strong internal governance around stakeholders' contributions to improvement. Among other things, leaders may wish to enact and enforce policies that formalize their expectations on roles, responsibilities, processes, and metrics related to improvement; write specific improvement responsibilities into appropriate job descriptions; and tie performance evaluation and compensation to the fulfillment of these responsibilities. Granted, it's not always easy to establish and enforce accountability, especially when trying to align stakeholders from the multiple groups whose skills may be needed for effective outsourcing improvement. But considering service quality's vital importance in realizing outsourcing's value – and the potential competitive advantage that outstanding quality can bring – many leaders may find it well worth the effort.

# Afterword: Outsourcing's secret sauce

We wish we could wrap up this paper with a pithy summary of the secrets of effective outsourcing, boiled down into a neat list of easy-to-digest bullet points. Unfortunately, if such secrets exist, no one has yet discovered them. The more likely truth, as many satisfied outsourcing clients can confirm, is that effective outsourcing requires a clear understanding of the business drivers and goals, a commitment to seeing the effort through, careful planning and oversight, meticulous attention to detail – and a lot of very hard work. In our years of outsourcing advisory work, by far the most common lament we've heard outsourcing clients express is not that outsourcing presented unexpected challenges, but that the magnitude of the expected challenges was greatly underestimated.

That said, we do want to suggest one possible candidate for outsourcing's secret sauce that, to date, has gained only limited marketplace currency. That's the recognition that outsourcing, like other complex business practices such as supply-chain management and continuous improvement, is a discrete business discipline requiring specialized skills that cannot easily be developed on the fly. Very few companies today would entrust supply-chain management or continuous improvement to anyone without carefully verifying his or her competence in the field. The same, should be true for outsourcing, even in the absence – so far – of a widely recognized standard for what the relevant competencies might be.

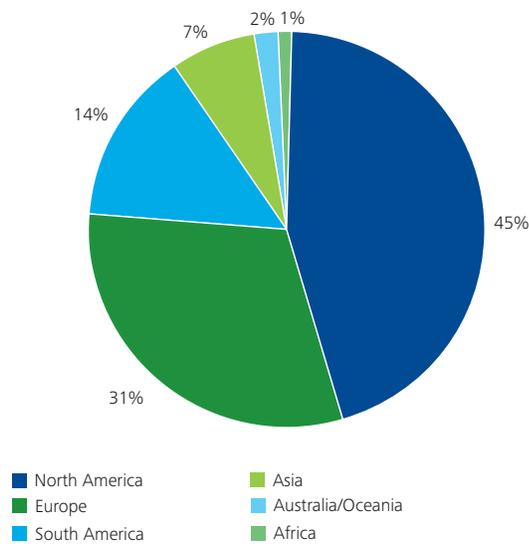
Outsourcing can offer the potential for great value. How much of that value is likely to be realized hinges on the ability, on both sides of the relationship, to make outsourcing work. For this reason, the future of outsourcing will likely belong to those who appreciate the distinctive demands of effective outsourcing – and who invest in helping their organizations address them.



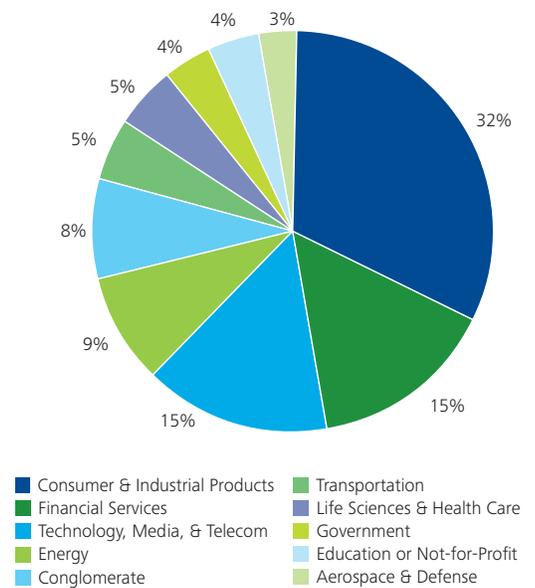
# Appendix: Survey demographics

Deloitte's 2012 global outsourcing and insourcing survey polled 111 services professionals using an online questionnaire distributed in January 2012. Respondents were employed by companies that either currently outsourced business and/or IT services or could potentially outsource such services in the future.

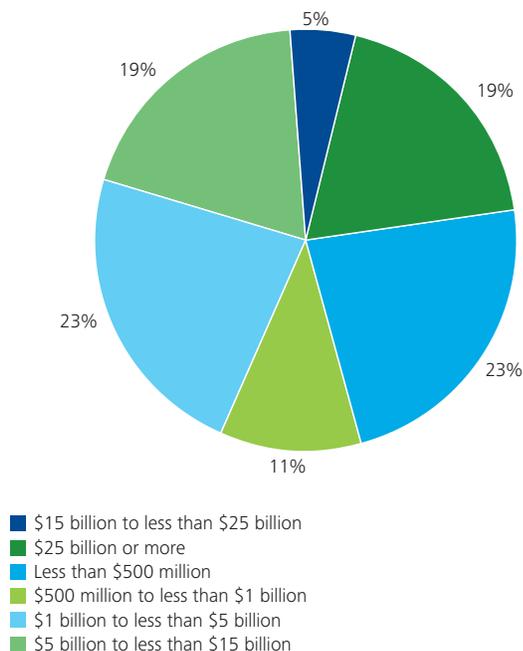
**Figure 15. Respondent headquarters location**



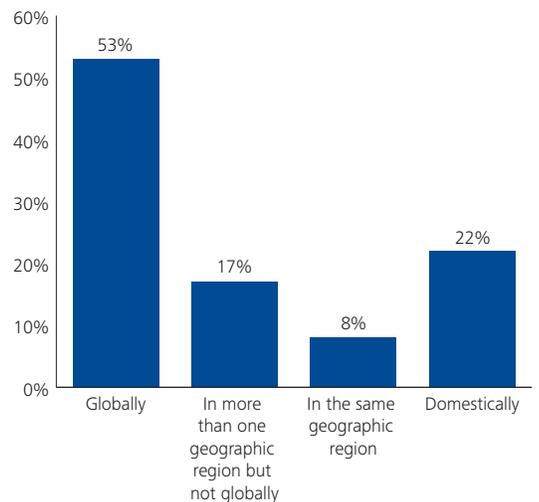
**Figure 16. Respondent industry breakdown**



**Figure 17. Respondent annual revenue**



**Figure 18. Respondent geographic footprint**



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