Outsourcing vs. Insourcing in a Global World

Gartner® SYMPOSIUM ITXPO® 2007

Emerging Trends

April 22-26, 2007
San Francisco, CA

Symposium/ITxpo 2007

April 22-26, 2007
Moscone West
San Francisco, CA

Frances Karamouzis

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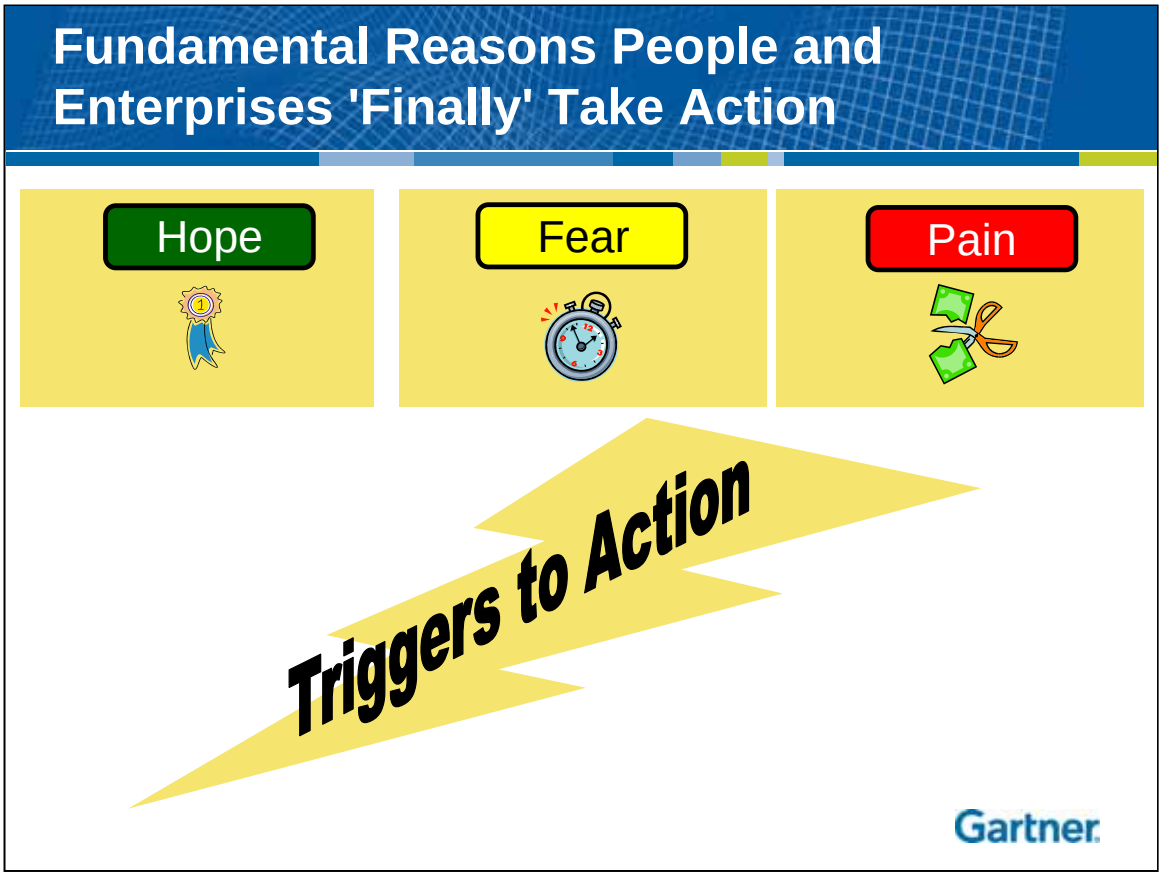
Strategic Imperative: The business value of any investment in strategy formulation depends on the surrounding culture. Context is everything. Enterprise personality profiling illuminates the context and culture that shape investments and help create a common language across multiple decision makers, audiences and influencers.



A core element that determines the success of any strategic exercise is understanding the internal organization's culture and the core reasons that trigger action. As such, context is everything. It's important to understand this to ensure an executable strategy.

One simple, but effective, way is to summarize why an organization (or individual) takes action, instead of just contemplating, discussing and analyzing it. Essentially, substantive action happens only when an enterprise or individual reaches a threshold of pain, fear or hope.

These three categories of action triggers align with the rating structure in Gartner's Enterprise Personality Profile framework. Using a detailed methodology, the framework seeks to assess how an enterprise behaves, why it behaves that way and the implications of that behavior.

Use enterprise personality profiling to illuminate the context and culture that shape investments and to create a common language across multiple decision makers, audiences and influencers. For insight into your enterprise, take Gartner's Enterprise Personality Profiling Assessment, http://survey.gartner.com/home/landing/epp/default.htm.

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Strategic Imperative: The business value of any investment in strategy formulation depends on the surrounding culture. Context is everything. Enterprise personality profiling illuminates the context and culture that shape investments and help create a common language across multiple decision makers, audiences and influencers.

An enterprise is an aggregation of people, characteristics, behaviors, temperaments, habits, culture and "quirks." Gartner's formalized Enterprise Personality Profile (EPP) assesses how an enterprise behaves, why it behaves that way and what the implications are of that behavior.

Early analysis of the Gartner EPP assessments reveals some general attributes of personality profiles. For example, many enterprises that score aggressively make decisions with a high degree of coordination. Moderate cultures operate in a more autonomous and disjointed fashion, and conservative cultures make decisions along a path determined by the hierarchical management structure. Aggressive companies pursue coordination, moderate companies look for autonomy and conservative companies want control.

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Key Issues

1. Why and how should companies re-evaluate their sourcing models?
2. What are companies seeking to insource vs. outsource, and why?
3. What has worked, what hasn't and why?

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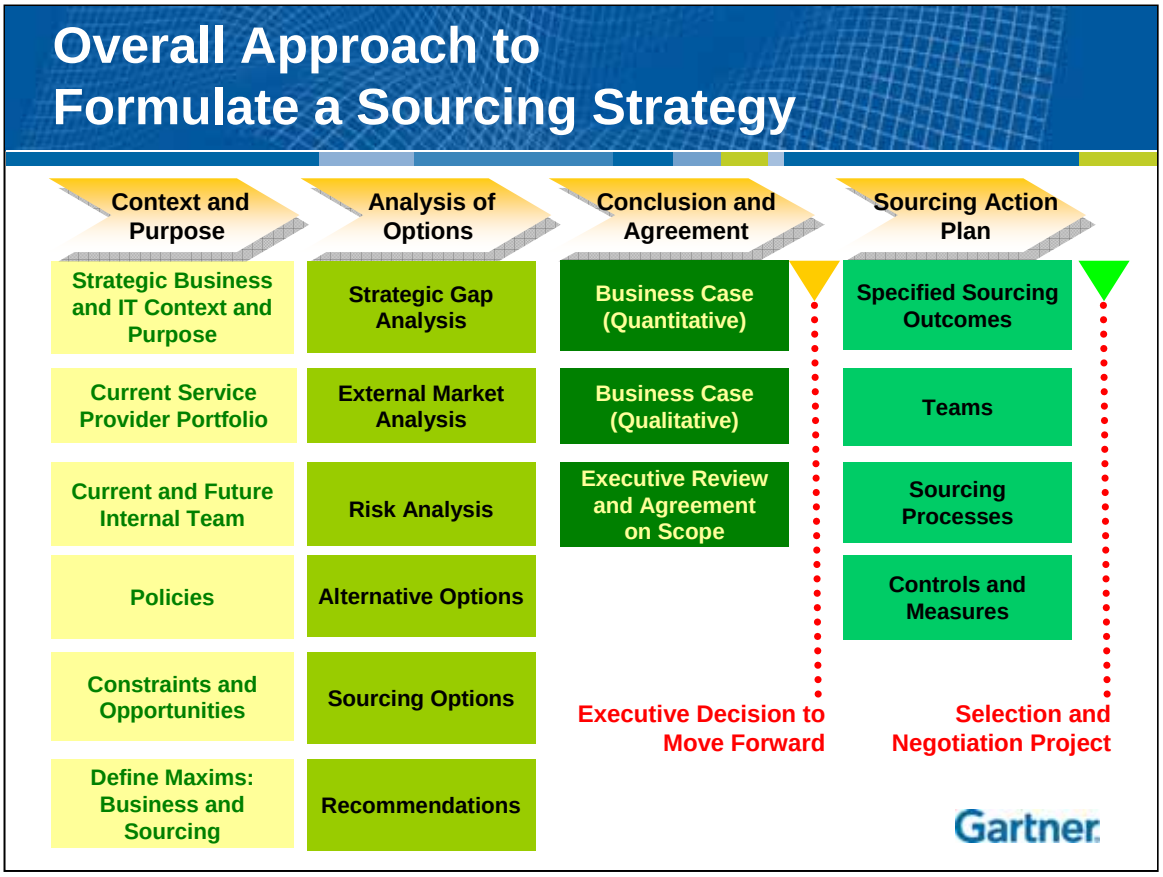
Tactical Guideline: To make sourcing activities successful, organizations must take time to conduct the requisite homework. This includes creating a framework that helps prepare, plan and execute actions necessary for success.



Why and how should companies re-evaluate their sourcing models?

This slide summarizes an approach and the foundation of Gartner methodology for a multistep process for IT organizations to build sourcing strategies that align to business needs. It is designed to act as a high-level recipe for enterprises embarking on the formulation of a sourcing strategy for the first time and for clients in update mode (revisiting the sourcing strategy) in light of changes in the business or previous sourcing choices.

This methodology is summarized in three key stages: 1) context and purpose, 2) analysis of options and 3) conclusion and agreement. Each stage is depicted in the graphic above and below each stage — the key tasks that need to be executed are depicted in distinct boxes. Once these tasks are completed, the executive decision to move forward is made and the enterprise goes into execution mode.

One underlying premise of the methodology is that organizations need a common, repeatable framework to consistently apply, on an iterative basis, execute and support ongoing management of their sourcing portfolio. Another critical outcome of this approach is a unifying set common management and operating processes to successfully mix multiple service providers with internal delivery of key service areas.

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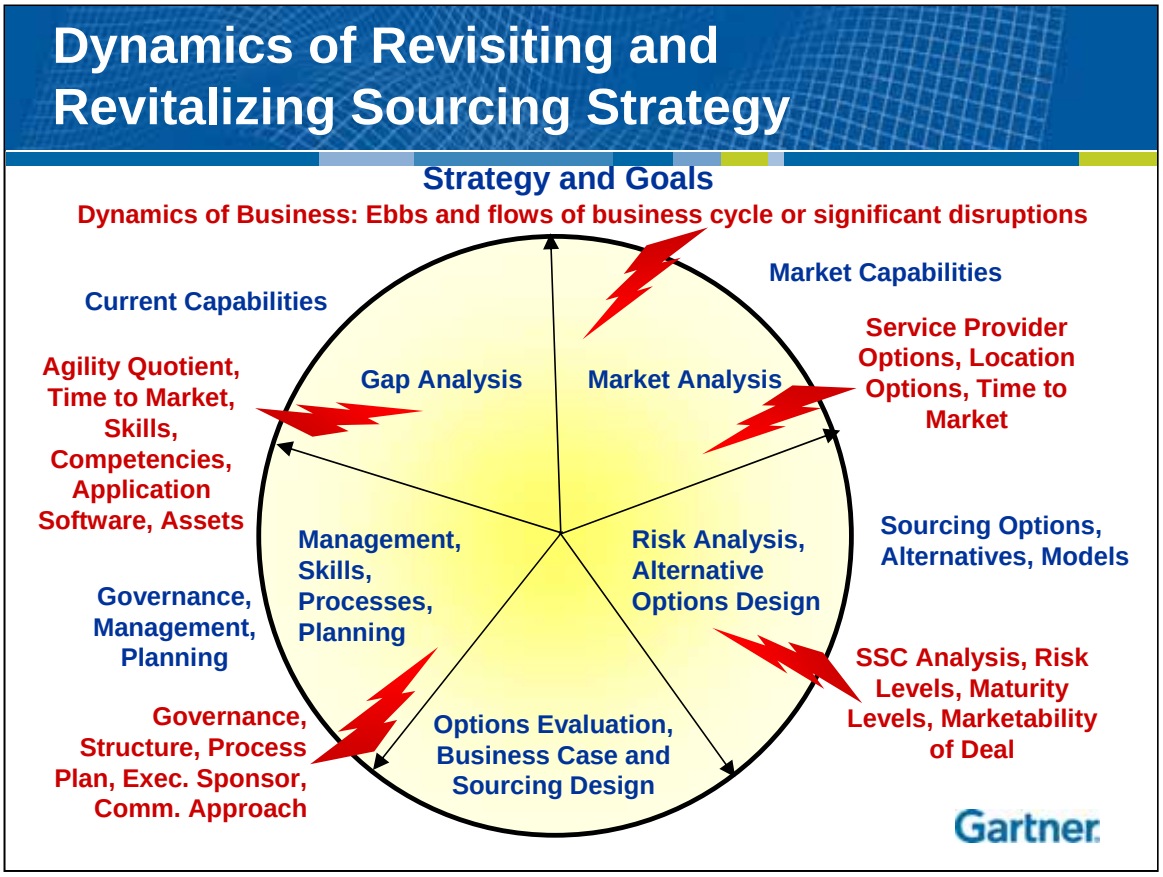
Tactical Guideline: When addressing the question of "How" organizations must look at both the changing dynamics of the external marketplace and the desired future state of the organization by examining elements of cost, governance, and change management and integration.



Stage 2 in the formulation of a sourcing strategy brings together critical internal and external data to inform a complex set of interconnected decisions across processes, software and hardware, with overarching business direction, risk factors and competencies. Key items are arrayed in the graphic and include a gap analysis of expected business goals in a given time frame. An analysis is also needed of current capability (internal and external), as well as the ability to change and the core/most competitive capability areas in which to invest. The gap between objectives and capabilities must be addressed, and the market may have the answer.

Enterprises must understand what the local, relevant service market (for IT services or business processes) can provide in the expected time. The evaluation must consider carefully the availability of a service, service maturity, quality and stability. There are many sourcing models, but not all are suitable for certain stages of an enterprise's strategy or market maturity, and only one can be the best choice. Timing is critical for initiatives and time to market, and because some sourcing models are unstable and must evolve. Risk is a fundamental element to understand, as are the issues and pitfalls of different sourcing scenarios and the alternatives. Therefore, risk is used extensively to shape and downselect the few potential final scenarios that comprise a formal business case analysis. After approval, implementation or update of sourcing governance, the implementation of the sourcing management organization, processes and skills must be defined, as well as the plan for execution.

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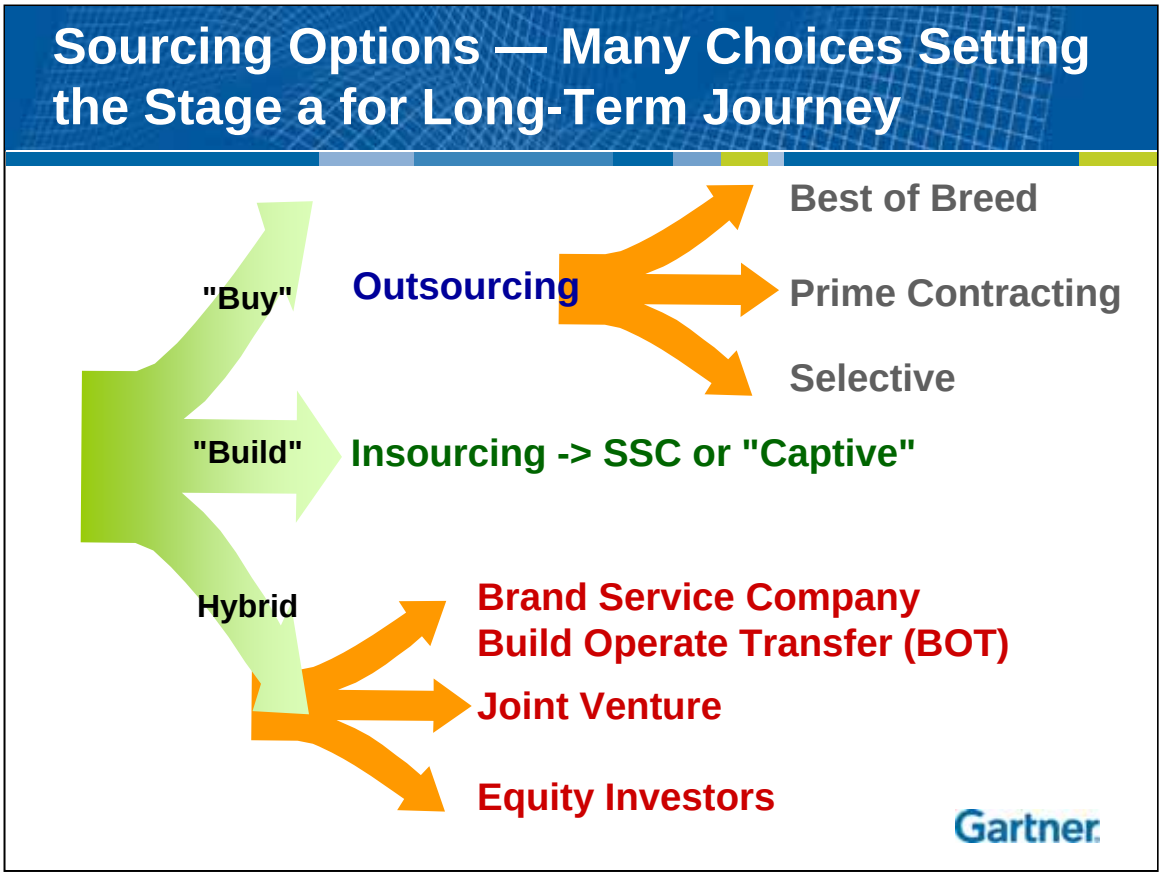
Market Reality: More than 60% of first-time global sourcing users will rely on traditional outsourcing models with ESPs; of these, only 20% will develop the right sourcing strategies and competencies to execute on them.



Every option presents a different balance and underlying set of business drivers that contribute the ultimate value and experience of the IT service's ultimate service recipient — the customer. All considerations eventually come back to the age-old choice of "buy" vs. "build," as well as hybrid variations of the two.

The "buy" option usually involves the use of a third party, which is legally and organizationally distinct from the service recipient's company. This is a form of outsourcing that an ESP usually delivers.

The "build" option normally entails the internal staff of the company delivering the IT service. This has commonly been called an "insourced option." More recently, another term — "captive center" or "captive facility" — has been widely adopted as an insourced option that's located outside the physical country borders of wherever the company is located.

The "hybrid" options represent some combination of insourcing and outsourcing based on legal, organizational or time-based resource shifts. Brand service company options, joint ventures and equity investment vehicles were common options used and constructed in many forms for several years. The relatively newer vehicle is the "build-operate-transfer" option, which is based on initially using an ESP and then shifting the ownership and delivery back to the client after a pre-defined period of time.

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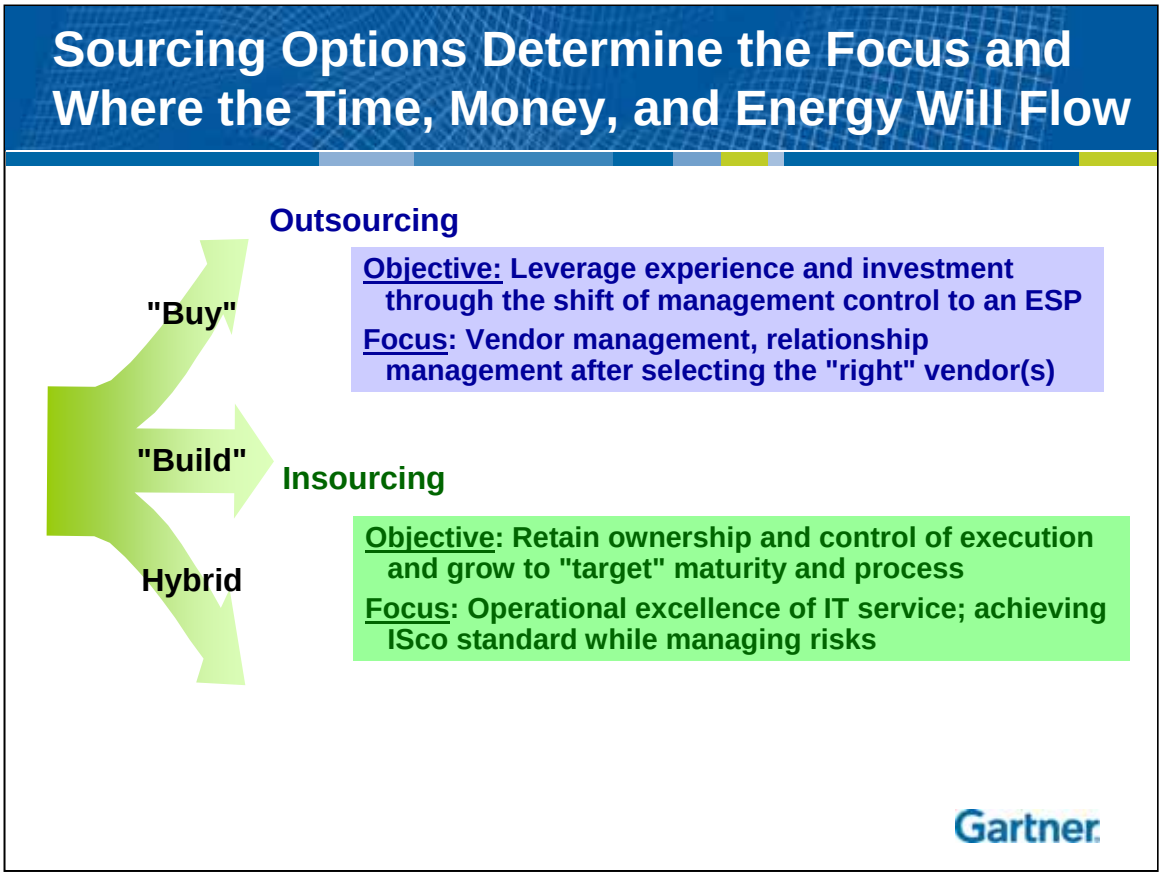
Imperative: Sourcing models are very different. Comparing them requires careful and formal analysis. The business objective for the decision will determine where the "focus" — namely the energy, money, resources and, ultimately, competency — will be directed.



To assist organizations in their evaluation and assessment of the most suitable global sourcing model to use, Gartner recommends a thorough review of each model in the context of the organization's sourcing strategy (Phase 1) against various attributes (which can be self-selected for appropriateness) for rating purposes. The chart above depicts a summary of two of these major choices: insourcing and outsourcing.

This summary is important because it highlights that each choice requires that an enterprise clearly understand what the key objectives will be if the organization select this approach or include this option within its sourcing portfolio. It is critical these objectives are understood, clearly articulated, communicated and, most importantly, aligned with the investment in execution, skills, competencies and tools.

The second part of the summary highlights the focus of the enterprise. The focus relates to the time, money, resources and overall energy that will be the primary direction that everyone should be moving toward.

These distinctions may appear simple and direct; however, they are often muddled — more than 60% of clients self-report that they do not have an overall sourcing strategy.

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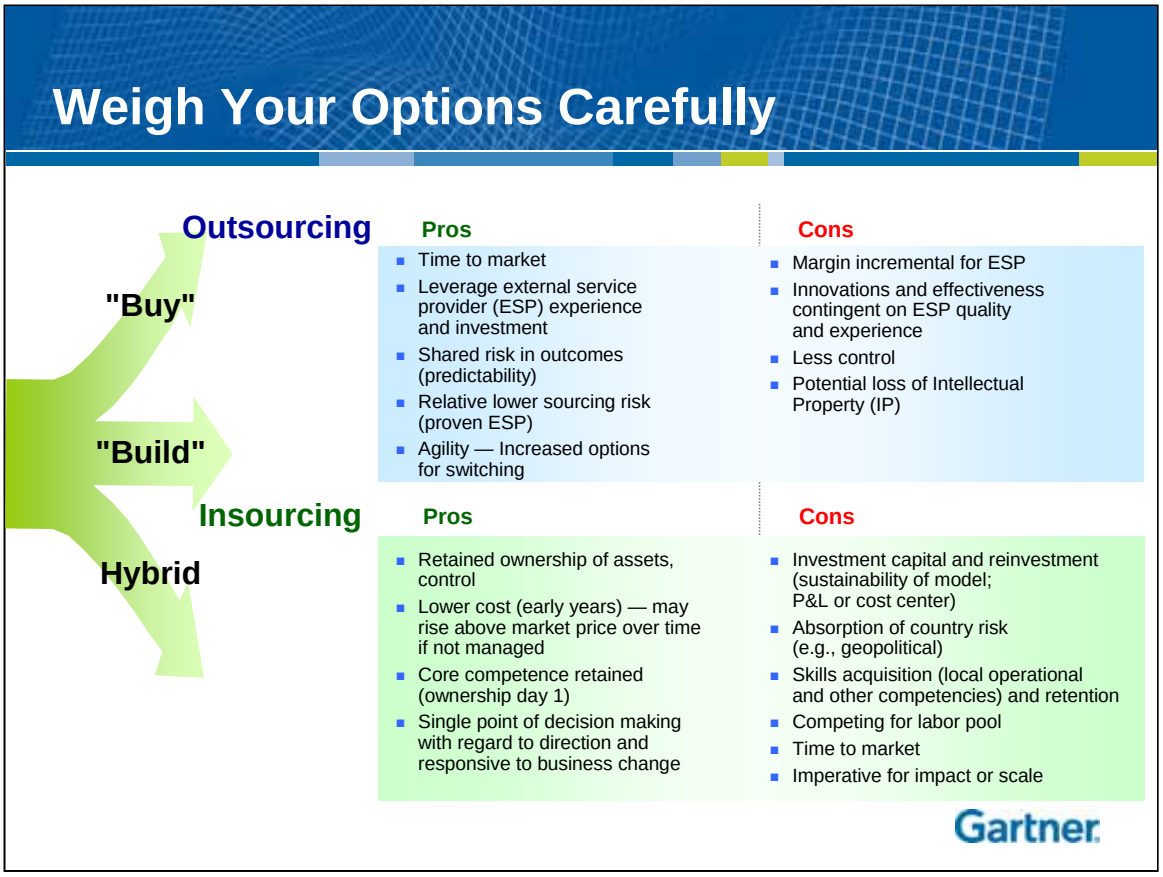
Imperative: Sourcing models are very different. Comparing them requires careful and formal analysis. It is critical to accurately and diligently compare the pros and cons of each option.



The more detailed phase of making the insourcing vs. outsourcing decision involves arraying the pros and cons of each option. The chart above depicts a summary of high-level pros and cons of each choice.

Understanding the potential benefits and drawbacks of the different global sourcing models will ensure informed decisions, awareness and preparedness to address potential problems, as well as commitment to the chosen model.

Gartner recommends that enterprises proactively develop their sourcing strategies to include formal review and analysis of global sourcing options. Ensure that you have built leverageable expertise with regard to realizing business value in a globally sourced environment.

A complete narrative summary of all the options along with detail are documented in the following research: “Weigh the Strengths and Suitability of Global Insourcing vs. Outsourcing.”

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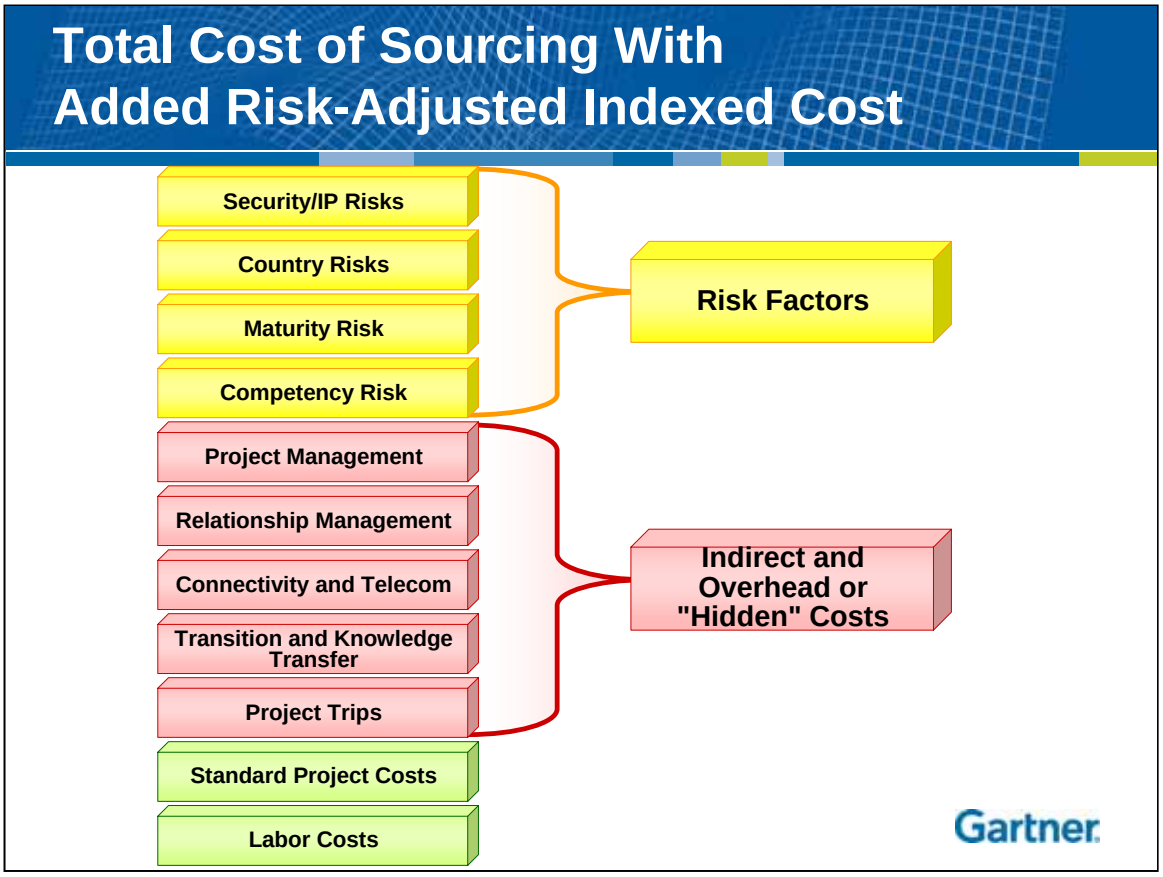
Tactical Guideline: The quantitative business case is made up of a rationale and a basis for future budgeting, as well as the underlying basis for moving forward with the sourcing decision.



Gartner has developed a risk-adjusted cost model to focus on analyzing the total cost of a deal beyond just the labor cost, including the indirect or hidden cost of globalization, as well as the associated cost of specific risks. This model brings together security risks, country risks, maturity risks and competency risks.

The costs at the top of this stack are the hardest to calculate, because they make up the risk factors that organizations take on when they decide to outsource a job to a new provider in a foreign country.

The costs at the bottom of the stack are well-known. They include the costs to set up the project and pay the workers, including standard project costs, such as real estate allocation, asset allocation, telecommunications, governance and contract negotiation, as well as evaluation and selection costs.

As we move up the stack to indirect or hidden costs, many enterprises are not aware that these costs will be part of the engagement or do not factor them in the base case.

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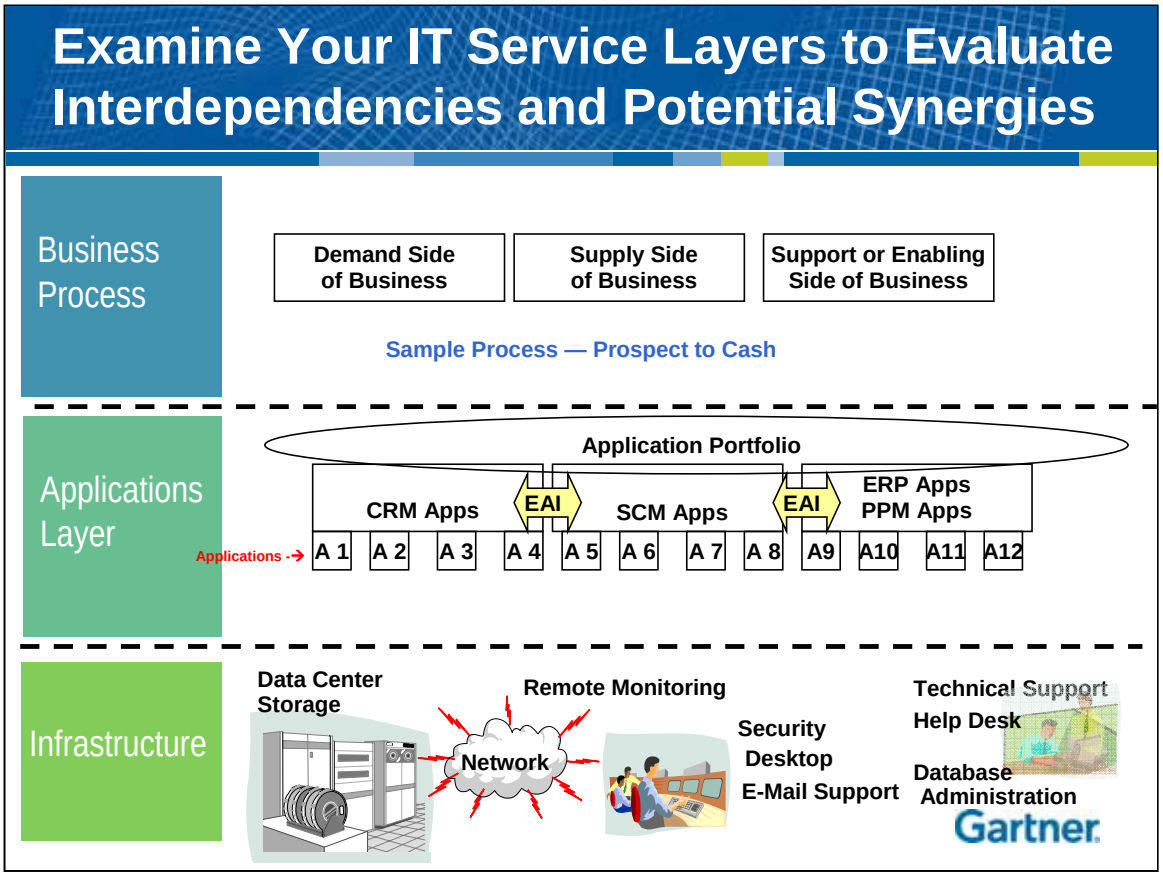
Strategic Imperative: CIOs and sourcing officers must understand and account for the interdependencies across each of the three layers of IT services especially as elements are parsed out and sourced across different options. All three layers must come together to execute on the business functions of the organization.



What are companies seeking to insource vs. outsource, and why?

The three major service layers for IT services are business process, applications and infrastructure. Each includes a people/process component. All three execute on the business functions of the organization.

Business Process Layer: This layer includes process workflows — the sequence of actions or structured activities designed to execute a functional set of procedures. It yields a product or service for a designated constituent, such as a customer, partner or employee. The process layer addresses highly visible, functional components of an organization's business model.

Application Layer: This layer encompasses all types of software across the traditional application stack. Several categories or types of applications make up the application stack: the OS, at the core level; middleware and enterprise applications, which may be custom or packaged; and application integration software. This layer also includes enterprise application integration software, which links applications together and form the "glue" for discrete application software elements.

Infrastructure Layer: This refers to foundational assets and architecture used to store and access data and for connectivity to transport. Infrastructure layer elements include servers, storage, network components (transmission equipment such as telecommunications switches and PBX), desktop components, help desk and e-mail support, database administration, and security monitoring/reporting.

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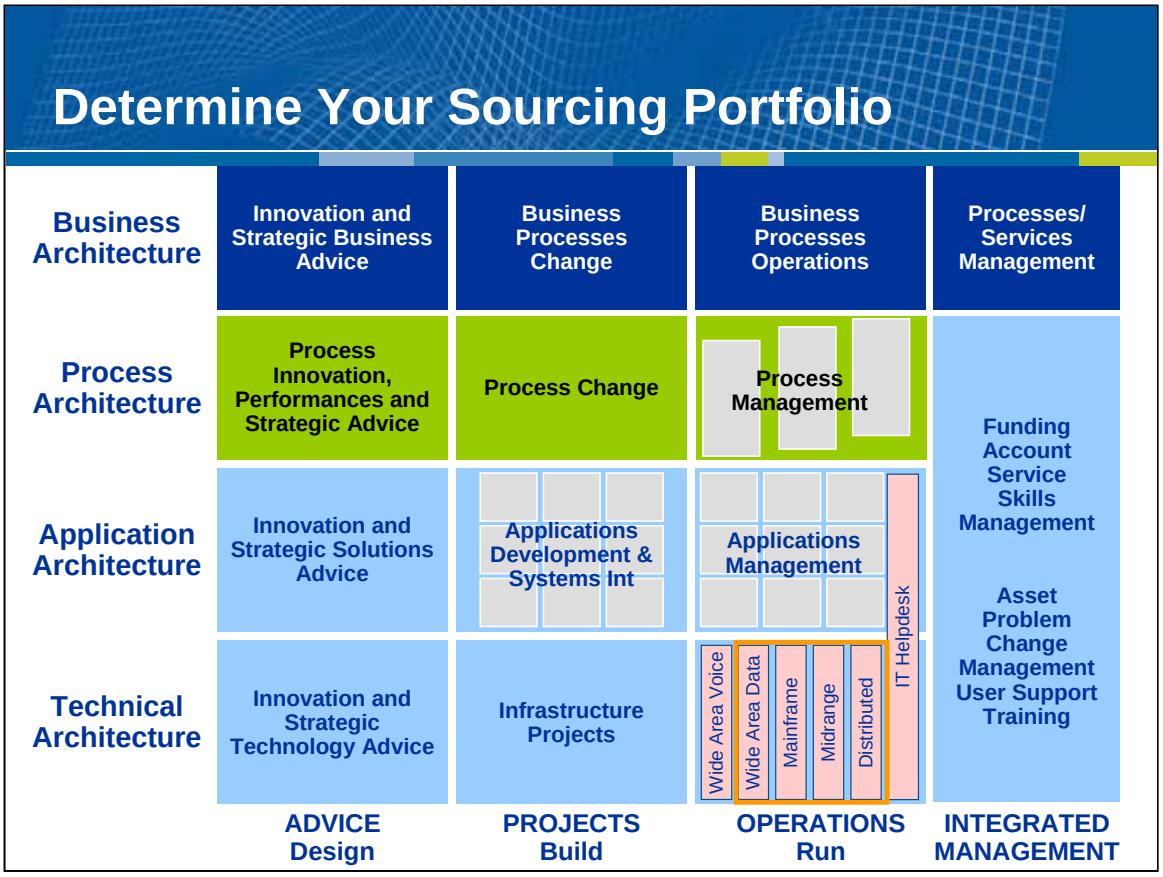
Strategic Guideline: Consider internal or external sourcing decisions in light of their fit within the overall operating structure for IT and IT-intensive services. Consider how changes, innovation and advancement are designed and implemented. Consider how internally and externally delivered services are executed in a congruent architecture.



What are companies seeking to insource vs. outsource, and why?

In its broadest sense. a sourcing strategy is about the design, implementation, management and evolution of this structure so that it delivers increasing efficiency and flexibility. We recommend that organizations start using such structures to verify and map the use of service providers to create a baseline for the delivery structure.

Although business organizations in Europe and North America use, on average, four providers for IT (outsourcing ITO), which is the delivery of ongoing IT management services, the number of service providers (internal and external) can be far higher — on the order of dozens or hundreds of providers. This happens when adding consultants and system integrators, software houses and geographically dispersed service providers, product-related services (maintenance and support), business consulting firms, process-oriented firms (ITIL specialists, auditors and security advisors) and special arrangements for internal delivery, such as shared service and offshore captive centers.

Large organizations with individual business units or a multinational composition may create a dispersed set of multisourcing relationships that increases overhead and mangement costs, decreases efficiency and economies of scale, and prevents change and flexibility.

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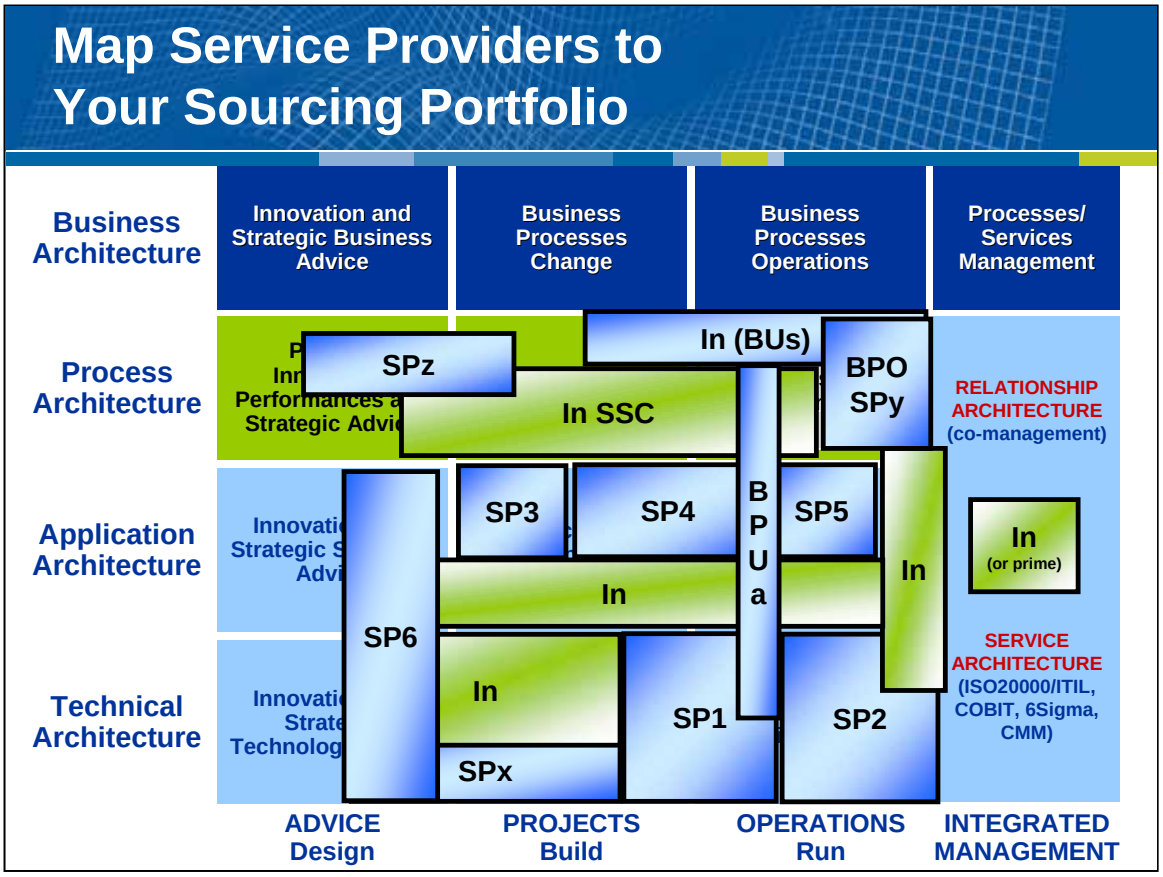
Tactical Guideline: Organizations can underline areas for improvement or exploitation by using this approach to baseline and graphically represent utilization of external and internal service providers.



What are companies seeking to insource vs. outsource, and why?

This is an example of a multisourcing map:

Two main service providers (SP1 and SP2) operate significant parts of the IT infrastructure (management of centralized IT and supporting the distributed environment), while other small service providers (SP3, etc) are used in large change implementations under the control of internal delivery. A Level 2 help desk is kept internally to provide contact with internal and external users, and a credible advisor is engaged in architectural innovation, for applications and technologies evaluation.

Critical applications are maintained, managed and developed internally, while two major application areas are managed by two providers, and another (SP3, offshore) provides additional development capabilities.

At the business process layer, an internal shared service center delivers most of the back-office services, while SPy delivers a vertical-specific outsourced process. Other vertical processes are directly handled by the business units. Leadership and business unit management use external business consulting firms for strategic advice.

The relationship and service frameworks are managed internally, but the organization is looking at moving to a prime contractor model in infrastructure or applications.

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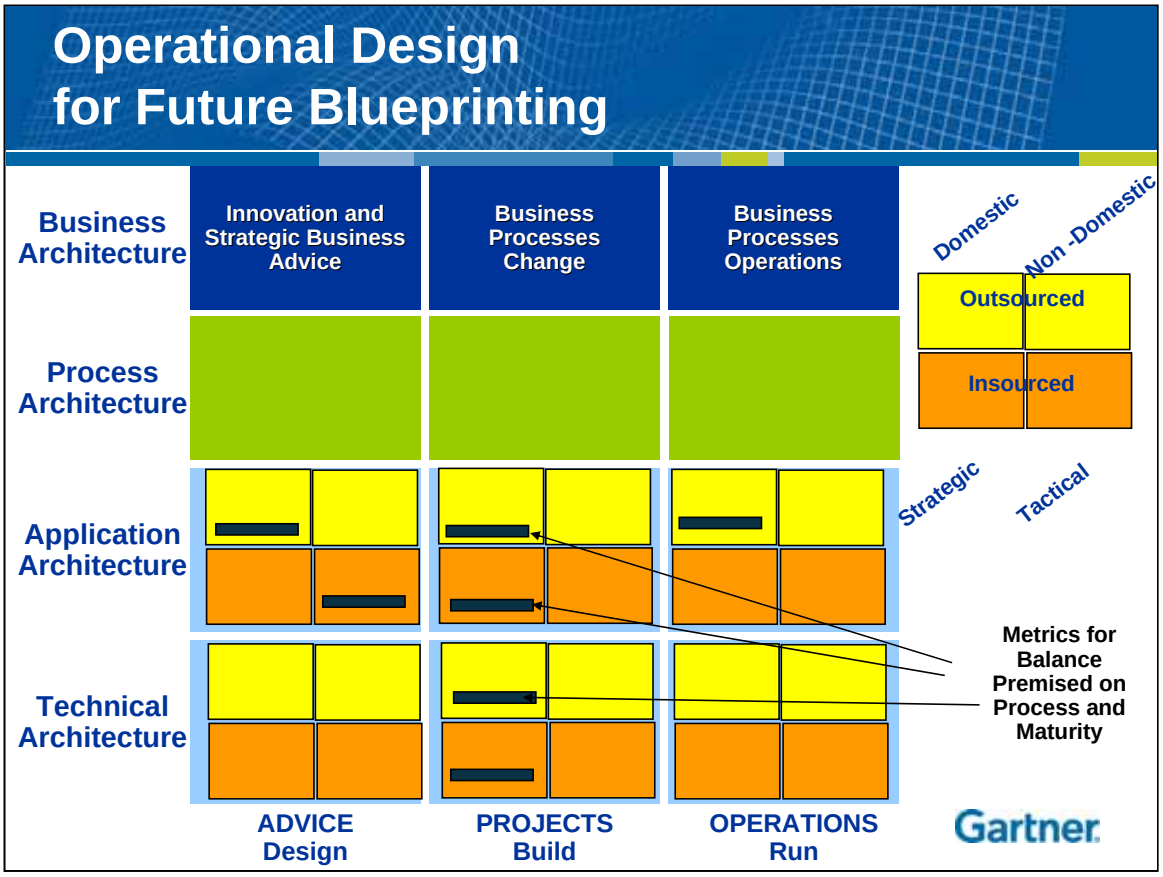
Strategic Guideline: Focus on baselining the current operational choices of internal or external sourcing decisions in each segment. Consider how the overall goals of the sourcing strategy are aligned with the current baseline. Build a set of metrics to monitor and eventually shift to ensure the success and appropriate agility.



As organizations analyze their sourcing blueprints, they need to operationalize their sourcing strategies. One parameter involves the level of internal vs. external sourcing. Questions include, What internal factors will influence the extent and success of delivery? These will involve an organization's goals and objectives; whether it should focus on cost, skills, speed, productivity, resource agility, process effectiveness, its geographic locations or some combination. It must also consider its ability to deliver projects and programs via this delivery model. Considerations include level of delivery experience, internal commitment/preparedness, the organization's risk tolerance, existing management/governance, changing roles and responsibilities of the internal team, and level of internal process maturity. What external factors will influence the use and success of delivery? This will require assessment of the suitability of the potential vendor options, including cultural fit with the internal team, maturity level, viability, quality, ability to deliver, cost, compliance issues and security concerns. Organizations should consider the services (application services, infrastructure management and BPO) available from the ESP.

Another parameter is the location of delivery domestic vs. non-domestic sourcing or other alternative relevant dimensions such as strategic vs. non-strategic. The questions that need to be asked in this area include, Where should the delivery centers be located? Many organizations, particularly those that are multinational or global, will begin to use nearshore and offshore delivery locations (in addition to having work delivered from within their own premises or country) in a more-integrated way.

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Strategic Imperative: CIOs, sourcing officers and IT managers responsible for application portfolios, infrastructure services and the underlying technology-enabling business processes must stay abreast of changes in the market for application, business process outsourcing (BPO) and infrastructure services. Use a Gap Analysis Framework to stay current on the evolution of each IT service category.

Definitional Overview to Determine Gaps of What Worked vs. Still Evolving?

Industry/Domain	Industry-specific expertise, including skilled experienced resources, depth in subsegments, leverageable intellectual property, solution-based offerings
Process/Function	Process/functional-specific expertise, including skilled experienced resources, depth across the entire functional value chain, leverageable intellectual property
Technical	Technical expertise may include one or more of the following: application-specific expertise, architecture and platform knowledge, and integration knowledge
GDM	Optimized delivery structure: access to global resources, process maturity, global infrastructure, scale, support systems, security, business continuity/disaster recovery
Regulatory	Regulatory areas include industry-specific regulatory requirements, compliance issues, as well as intellectual-property exposure and security issues
Complexity	Multiple stakeholders, Valuation of deal — transaction-based, Subscription-based Wide span of functional areas, etc.

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What has worked, what hasn't and why?

A number of different parameters form the foundation of understanding the evolution of a specific service category, as new global delivery models (GDM) take hold within their life cycle of maturity. For analytical purposes, Gartner has grouped these parameters into six major areas, as depicted above.

Using these six parameters (industry/domain, process/function, technical, GDM, IP/regulatory, complexity), the evolution of a specific service category can be analyzed by comparing the current offerings in the market against the client demand articulated by clients. The difference between these two positions constitutes the current gap between client need and available offerings. It is important to understand these gaps as clients embark on the execution of their sourcing strategy.

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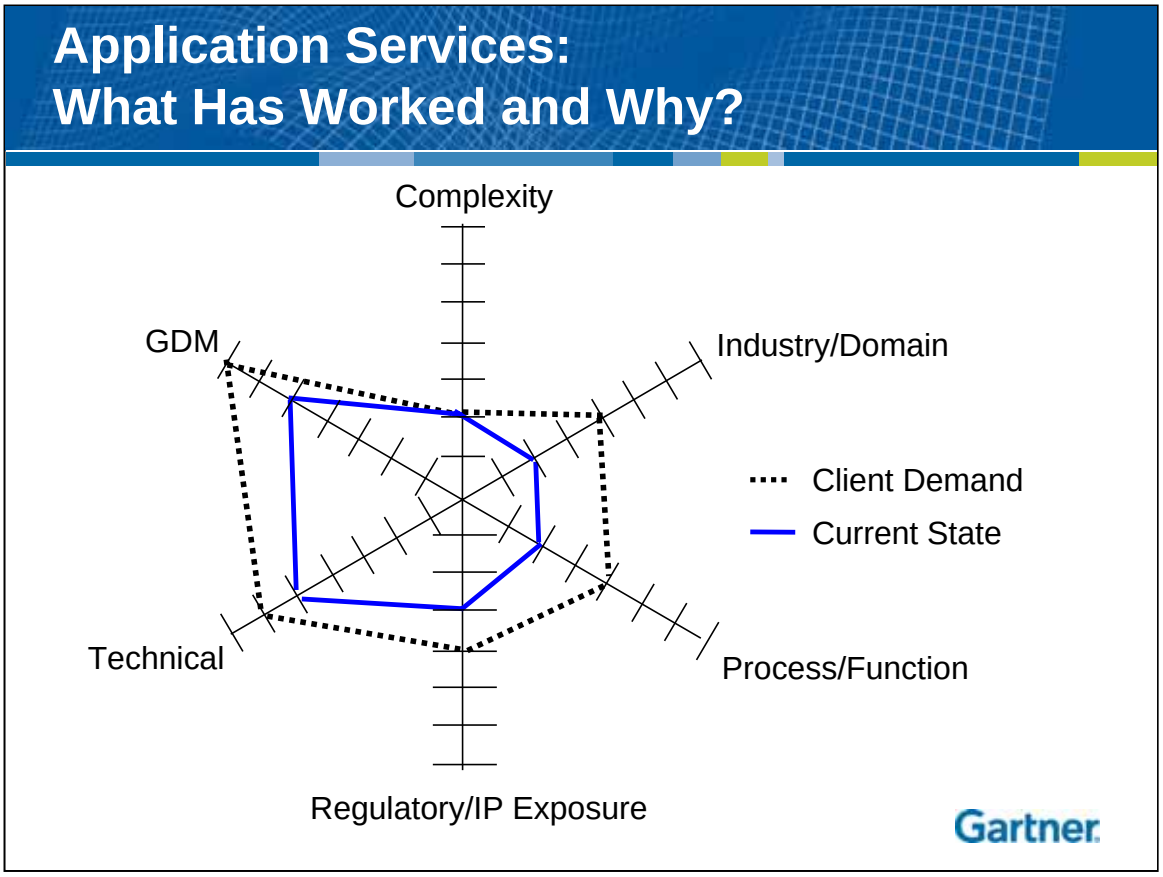
Market: The technical and GDM parameters of application services are the most mature and continue to be the biggest drivers for typical application service deals.



Using the six parameters (industry/domain, process/function, technical, GDM, IP/regulatory, complexity) for understanding the evolution of a specific service category, the diagram above depicts Gartner's current assessment for the client demand and current state for the application service layer.

Gaps appear between what providers offer and what clients demand for other parameters, because:

- Most pure-play providers have not built critical mass in industry and process skills, while the traditional providers have not been able to build seamless handoffs to their colleagues in global delivery centers.
- Regulatory and IP exposure is generally being managed to align with the appetite for risk of any client organization. New tools, techniques and workarounds continue to be evaluated to enable safe and secure access and the use of sensitive data. As more applications are globally sourced and demand continues to grow, the scores in this parameter will become higher, and competency of the current state will grow to meet the demand.

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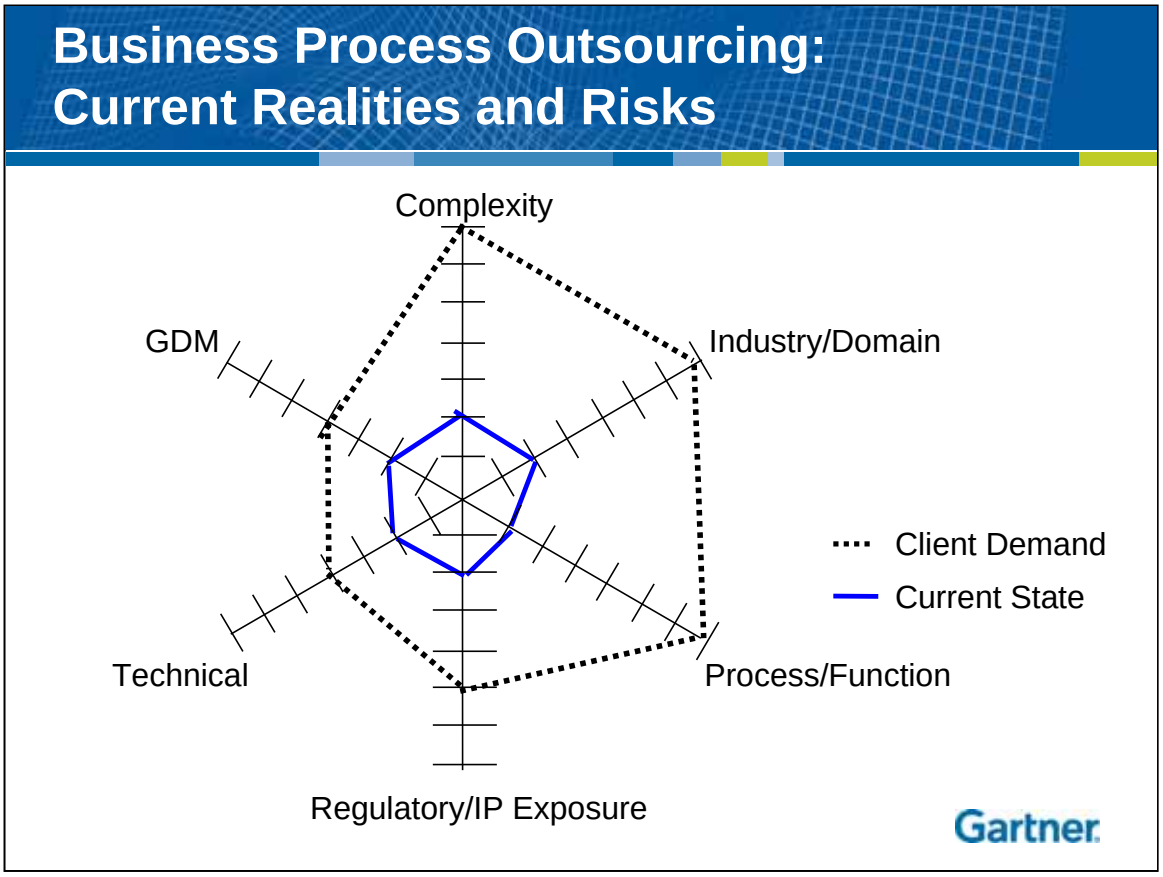
Strategic Imperative: It is important to recognize that all service categories do not have the same level of maturity in a GDM paradigm. BPO delivered in an offshore model is still nascent.



BPO delivered in an offshore model is still nascent; hence, the much bigger gap between demand and current state on this chart. A summary of the key areas for consideration includes:

- The combination of complexity factors, industry and process skills is by far the largest focus area that will define the BPO market. It is also the area where most of the pure-play providers have the largest gap, while traditional global, multinational providers, such as IBM, EDS and CSC, have more of a foundation from which to build.
- Regulatory and IP exposure analysis is extremely embryonic. Many regulators have not kept pace with global delivery and cross-border collaboration, forcing organizations to make difficult choices in "gray areas" where clearly defined direction is limited. This includes the ability for service providers and organizations to come together to decouple processes in a way that enables maximum leverage and agility.
- The technical and GDM parameters are subsumed in BPO deals. They need to be fairly seamless and part of a tightly coupled area of the bundled package of the overall BPO deal. Most BPO deals, even those involving the traditional providers, wrap some level of offshore delivery into their overall offerings.

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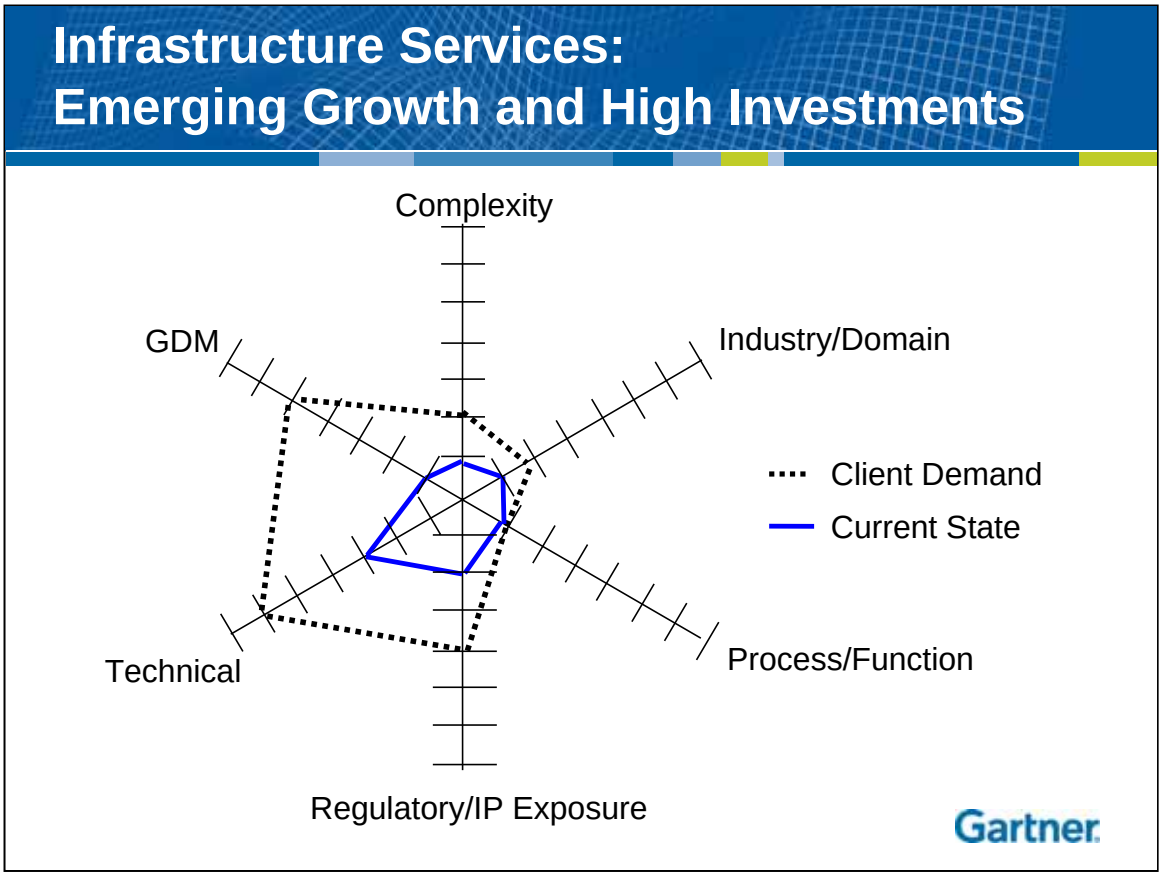
Market: In the U.S., infrastructure has been a longstanding option for outsourcing and is fairly mature. Through a GDM, infrastructure is early in its life cycle, between infancy and adolescence. It's up and coming, yet represents only about 2% of total deals in the market.



There are four main reasons that current infrastructure offerings are different from client demand.

1) The technical and GDM parameters require the most investment and will be the "make or break" factors for uptake of infrastructure services. The challenge is to build a level of credibility and trust in a new kind of paradigm for delivering infrastructure services. The technical side of the equation is primarily driven by the investment in building automation tools to change the paradigm for execution of processes. The paradigm shift is primarily across three dimensions: on-site location-based delivery to remote virtual delivery, manual response or reactive addressing of issues to proactive predictive alerts and monitoring, and significant reduction in labor. 2) The complexity factor is significantly lower for infrastructure because the primary source of buyers is still within a narrowly defined band of professionals in the IT infrastructure ecosystem. The major issue will be the potential size of the deals shifting to pure-play providers. Similarly, industry and process skills play a significantly lower role, because they tend to be a more horizontal-centric set of buying patterns.

3) Regulatory and IP exposure is important from an access perspective. Most infrastructure deals involve providing specific exposure to many of the server, storage and mail exchange systems. Consequently, it's difficult for enterprises to entrust service providers with this important role. 4) There is less focus on industry and domain expertise, because of the horizontal nature of infrastructure services.

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Recommendations

- ✓ A sourcing strategy is the most reliable way to ensure the ability to adjust for continuous business change into the delivery arrangements at the speed they are needed.
- ✓ The longer-term view of global sourcing strategy and plans has never been more critical.
- ✓ The service market has exploded with diverse offerings with varying maturity levels. Risk management is critical in any evaluation of sourcing options.
- ✓ Account for a rapidly evolving maturity life cycle for the newer service lines.

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