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HITTING THE RIGHT BALANCE OF “IN” AND “OUT”

A CLOSER LOOK AT EVOLVING SOURCING MODELS

Using an impressive number of direction-related terminologies, the outsourcing industry has developed an exhaustive lexicon of business models and service offerings. The flexible and often overlapping business models aim at improving business efficiency and eliminating the risks associated with the outsourcing process, though unsurprisingly not all models are as successful as others. The question of how to limit the risks of outsourcing is at the very core of the industry. In fact, risk mitigation is what often determines whether to in-source or out-source.

The outsourcing lexicon has by now become confusing and almost directionless. Each new sourcing model sends you either in- or out-, off- or on-, near- or far...is there an over and under yet? There is no need for all the confusion; to understand outsourcing one must simply understand why people do it in the first place. In reality, companies out-source for two main reasons: to gain expertise and to cut costs.

The first consideration is the lack of expertise in a certain area. Any expertise can be found anywhere in the world, which is “just” a question of the second consideration – the cost. The two considerations create a milieu of problems as companies attempt to find the best available expertise for the cheapest possible price.

Of course, from the outset the purpose of outsourcing was to limit costs by giving responsibility for internal IT departments to experts like IBM or EDS. At first, companies outsourced their non-core competencies, but by 1990s with the Internet increasingly providing necessary technology foundation, more companies tried to outsource their (near-) strategic functions.

As such attempts became unmanaged with limited controls and standards, many outsourcing deals came to a halt. Trust in outsourcing diminished and the fear of unmitigated risks increased. Many companies learned the hard way that it is easier to fix problems in-house, rather than watch things go awry while coordinating with a third-party. Nevertheless, in order to resolve the need for expertise and cost efficiency, outsourcing was not abandoned as a business strategy. Instead, providers aimed to improve their service offerings. New guidelines were written as more accountable and outlined contracts were demanded. As a result, for almost 10 years the industry has been working with “scalable” outsourcing and pay-per-cost contracts. Yet again the demands of outsourcers and the industry as a whole are beginning to change as more flexible -- but still reliable – sourcing models are being introduced.

In recent years, there has been a sudden shift to providing high-value service and strong central governance based on customer needs. Other outsourcing providers called for a more integrated approach, where quality and risk can be managed more easily, coming up with contracts akin to joint ventures and partnerships. Yet other companies preferred to open their own offshore offices to cut costs but maintain quality.

In some cases companies desperately turned back to in-sourcing, for a moment ignoring the cost inefficiency. The main setback of in-sourcing thus became cost. Before understanding how to gain cost efficiency when using in-sourcing it is imperative to understand how in-sourcing is implemented.

First, a company can apply in-sourcing by employing its own people to do the job in-house, thus ceasing to outsource (this is also called back-sourcing if the company previously had outsourcing contracts). There is only one company in the picture, and it takes care of all of the processes: hiring, training, payroll, infrastructure and the work itself. This may create an advantage for the company in terms of mitigating risks and quality control, but it is not cost efficient.

The second in-sourcing method occurs when a company invites a third-party provider to come into their facility to complete the work. This kind of relationship can range



from a snack-stand operating within a stadium owned by a different company, to a team of software engineers working at another company's facility to operate an internal computer department. For some, such a solution is indeed the best possible solution to the expertise versus cost versus risk control. Indeed, this means that the third-party experts are working in-house, allowing both the desire for expertise and risk control to be satisfied.

REMOTE IN-SOURCING

In-sourcing can become most cost efficient when it is done remotely. This is where the evolution of sourcing models comes full circle: from internal departments, to a variety of on-, off-, near- shared services and partnerships, ending with remote in-sourcing.

The cost efficiency of in-sourcing is achieved by creating an in-sourcing team that is intimately integrated with the in-house staff, while being located in a remote location. The remote location is organized and maintained by a third party organization, eliminating any logistical hassles and costs for the firm. The key difference with captive or third party offshoring is in team integration. The company controls their remote staff like their own employees, without having to deal with any administrative, infrastructure, recruiting or operational issues.

Whether in-sourced or out-sourced, or whether the third party is located off- or on-shore, the decision on a specific sourcing model is made to limit the possibility of a project going sour. In general, any project will have a series of strategic, operational, financial and transactional risks.

These risks exist in outsourcing projects as well. Some of these risks, like IP protection, government and politics, warranties, termination, and dispute resolution can be eliminated by usual legal coverage and liability insurance. Others like quality management, infrastructure, business continuity, process integration, data security, privacy and financial stability can be mitigated by simply choosing an established third party organization with mature processes. However, there are more worrisome risks like loss of control, loss of knowledge, reputation, access to innovation, intended result achievement, employee morale, poor performance, quality, and organizational culture compatibility that have to be resolved by specific sourcing models.

In other words, most financial and transactional risks can be resolved by choosing an experienced provider, while the risks involving strategic and operational goals will be resolved by choosing an appropriate sourcing model. In effect, these risks are the main reason for the myriad of models and the source of constant innovation in the outsourcing industry.

The evolution of sourcing models was driven precisely by the consideration given to the various risks. Historically, starting from internal departments to shared services organizations to offshore production centers, to blended models of "on" and "off" shore delivery, to dedicated teams, and finally to remote in-sourcing, providers attempted to create a model with best delivery and highest quality married with cost efficiency.

In many ways, remote in-sourcing fills the gap between in-sourcing and out-sourcing. It provides the security of internal cooperation and strong governance as well as the desired level of expertise. The remoteness of this model is what also makes it a cost-efficient strategy. Veering away from traditional models of outsourcing, remote in-sourcing is in some ways not a form of outsourcing at all, since from the start it is based on a more integrated approach.

As the demand for risk control, cost efficiency, and expertise continues to grow, the difference between "in" and "out" may become more blurred – and finding the right balance will be the key to sourcing success.



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