THE HANDBOOK OF GLOBAL OUTSOURCING AND OFFSHORING

FOURTH EDITION

ILAN OSHRI, JULIA KOTLARSKY AND LESLIE P. WILLCOCKS

The Handbook of Global Outsourcing and Offshoring

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One event that in particular inspired us to update this book is our annual Global Sourcing Workshop (www.globalsourcing.org.uk). This annual gathering of researchers and practitioners is now in its fifteenth year and has created a community that discusses strategic, operational, technical, and social aspects of global sourcing. We have learned a lot from each participant and will ever be grateful to them for sharing with us their experience and research.

We are also thankful to colleagues who adopted this book in their teaching and corporate training.

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Part I

Making a Sourcing Decision

1

Overview of the Global Sourcing Marketplace

With the advent of globalisation and heightened levels of competition, many organisations are having considerable difficulty developing and maintaining the range of expertise and skills they need to compete effectively. The emergence of American, European, Japanese, and other Asian multinationals has created a competitive environment requiring the globalisation, or at least semi-globalisation, of corporate strategy. Moreover, with developments in information and communication technologies (ICT), firms do not need to be large multinationals to compete globally. These developments have led many companies to turn to various sourcing strategies such as outsourcing, offshoring, offshore outsourcing, nearshoring, and onshoring. This chapter therefore focuses on:

- The key terminologies used in the sourcing literature
- The background to global sourcing
- The key drivers, benefits, and risks of global sourcing
- Market trends and future developments in global sourcing.

Definitions

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

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- *Outsourcing* is defined as contracting with a third-party supplier for the management and completion of a certain amount of work, for a specified length of time, cost, and level of service.
- *Offshoring* refers to the relocation of organisational activities (e.g., information technology, finance and accounting, back office and human resources) to a wholly owned subsidiary or an independent service provider in another country. This definition illuminates the importance of distinguishing whether the offshored work is performed by the same organisation or by a third party. When the work is offshored to a centre owned by the organisation, we refer to a *captive* model of service delivery. When the work is offshored to an independent third party, we describe this as an *offshore outsourcing* model of service delivery. And when organisational activities are relocated to a neighbouring country (e.g., US organisations relocating their work to Canada or Mexico), we use the term *nearshoring*.
- *Digital sourcing is* defined as the process of finding and approving vendors using technology to streamline the process and move away from legacy manual operations.

These definitions include various sourcing models, for example, staff augmentation, domestic and rural outsourcing, crowdsourcing, cloud services, microsourcing, bundled services, out-tasking, and shared services (terms explained in Chap. 2). In addition, various common buzzwords such as *best-sourcing* (or *best-shoring*, *right-shoring* and *far-shoring*—as opposed to nearshoring) are coined and used by supplier companies. Finally, there is also the backsourcing trend, which involves bringing work back in-house.

Global Sourcing Background

The global IT outsourcing (ITO) market has grown each year since 1989, when global ITO was only a 10 billion USD market. By conservative estimates, the global contract value of outsourced IT services was about 396.3 billion USD by the end of 2021[1] and business process outsourcing (BPO) was estimated to be worth 245 billion USD.[2] According to some estimates, the ITO market will see compound annual growth of 8.2% through to the end of 2027.

[1] Statista: https://www.statista.com/outlook/tmo/it-services/it-outsourcing/worldwide

[2] https://www.grandviewresearch.com/industry-analysis/business-process-outsourcing-bpo-market

Companies across Europe (excluding the UK) spent 26 billion USD on IT and business process outsourcing in 2021. Spending on cloud-based services has continued to increase, closing the gap with traditional IT outsourcing.[3] The UK, the second largest global IT outsourcing market, has continued to see year-by-year increases in spending on IT outsourcing, with the figure reaching 28.8 billion USD in 2022. Statista, a market research firm, predicts the UK will be spending a total of 115 billion USD on various IT services (e.g., IT consulting, BPO and ITO) by 2027.[4]

Spending on ITO and business process outsourcing in the USA in 2021 reached 144 and 52 billion USD, respectively, with an annual growth rate of 7.2%. The ITO market volume is expected to grow to 208 billion USD by 2027.[5] These figures represent strong growth in outsourcing spending across traditional markets and an acceleration in outsourcing spending as compared to ten years ago.

Not surprisingly, spending on IT consulting topped all other functions outsourced to a third-party service provider by leading multinationals in Western economies.

While outsourcing has accelerated, we have also seen growth in the area of shared services and captive centres, with more than 100 captives set up in India in 2021.[6]

Cost reduction remains the main driver for outsourcing.[7] However, client firms are increasingly also focused on other objectives such as access to skills and flexibility in how human capital is utilised.

While many wondered whether automation might see the erosion of offshore outsourcing, in practice offshore outsourcing has been growing worldwide. Ncube, a market research company, reports that the global spend on offshore outsourcing of IT had increased to 11% of the total IT spend by 2020.[8] The offshore outsourcing strategy has always appeared promising in terms of reducing costs due to certain organisational activities being moved to an independent service provider in a country with favourable conditions. In more recent years, clients have pursued a cost-plus agenda when offshore

[3] https://www.computerweekly.com/news/252511911/IT-and-business-services-hit-record-levels-in-2021

[4] https://www.statista.com/outlook/tmo/it-services/united-kingdom#revenue

[5] https://www.statista.com/outlook/tmo/it-services/it-outsourcing/united-states

[6] https://economictimes.indiatimes.com/tech/information-tech/over-100-new-global-captive-units-expected-in-india-in-2021/articleshow/83235922.cms

[7] https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Process-and-Operations/gx-2020-global-outsourcing-survey-how-much-disruption.pdf

[8] https://ncube.com/blog/current-state-of-it-offshoring-review

outsourcing, and increasingly for large multinationals, offshore outsourcing has to fit within a larger global sourcing strategy that mitigates risk and links different sourcing options in a coordinated manner. The USA is a major player in the offshore outsourcing of IT and business-process applications. However, offshore outsourcing appears to be gaining momentum in Europe, where the UK is the lead consumer of such services. We cover offshore outsourcing in more detail in Chaps. 2 and 3.

Drivers, Benefits, and Risks of Global Sourcing

The growth of global sourcing has been attributed to many factors. First, technological advances in the telecommunications industry and the Internet have shrunk space and time, enabling coordination of organisational activities at the global level. Other reasons are the supply of skilled yet low-cost labour in countries such as India and the Philippines, and subsequently in over 125 further locations; investments in infrastructure; the improved business, economic and political climate in a number of developing countries; and the standardisation of the IT processes and communication protocols that contribute to the efficiency of inter-organisational activities.

Along these lines, many countries have invested heavily in improving their telecommunications infrastructure, which is essential for electronically transmitted services. For example, Barbados has had a fully digitalised communications system with direct international dialling since the beginning of the 1990s. Around the same time Jamaica formed Digiport, providing capacity for 20,000 telephone lines and speeds of 1.5 Mbps. Furthermore, many countries have provided tax breaks to attract offshoring. For example, Bulgaria offers a flat 10% enterprise tax rate that drops to 0% in areas with high unemployment and the Digiport BPO free trade zones in Jamaica are also tax free. In South Africa, government and provincial grants are available to support job creation based on attracting offshore work to the country. South Africa's immigration laws have also been made more supportive of the industry. Other countries like China, Morocco, Egypt, and Kenya have invested heavily in business parks and ways of supporting offshore industry growth. Chapter 3 deals with these topics in more detail.

Global sourcing offers several potential benefits associated with the advantages of outsourcing in general. A company can reap significant cost advantages through the creation of economies of scale, access to the unique expertise of a third party and the reduction or stabilisation of overhead costs. In addition, a company may benefit by concentrating on core activities, organisational

specialisations, or by focusing on achieving key strategic objectives. More specifically, a strategy of building core competencies and outsourcing the rest may enable a company to focus its resources where it can develop best-in-the-world capabilities that could lead to a significant competitive advantage.

Another major benefit of outsourcing is that it gives the organisation access to supplier capabilities and innovative abilities that may be expensive or impossible to develop in-house (Oshri et al., 2015).

Even more important, a network of suppliers can provide any organisation with the ability to quickly adjust the scale and scope of its production capability upwards or downwards, and at a lower cost, in response to changing demand. In this way, outsourcing potentially provides greater flexibility. Furthermore, outsourcing can speed up the product or process design cycle. If the client uses multiple best-in-class suppliers working simultaneously on individual components of the system, each supplier can contribute greater depth and sophisticated knowledge in specialised areas and thus offer higher quality inputs than one individual supplier or client. On this basis, having several offshore centres can provide around-the-clock workdays. In other words, development and production can occur constantly by exploiting the time difference between different countries.

While firms seek to reduce costs and access skills and ideas from outsourcing engagements, the value appropriated from such relationships is not always clear. In their study of value in outsourcing, Oshri and Kotlarsky (2009) concluded the vast majority of client firms are in the dark when trying to measure and quantify the return on their outsourcing investment. In fact, less than half the firms in the study (43%) had attempted to calculate the financial impact of outsourcing on their bottom line, indicating the financial benefits are difficult to quantify (51%). When asked about cutting back on or bringing operations back in-house, executives cited 'unclear value for money' as the main driver.

Adopting a sourcing strategy poses several other disadvantages. The loss of critical skills or overdependence on an outside organisation to carry out important business functions may evolve into significant threats to a company's well-being. Also, the security and confidentiality of data can become major issues for many companies. Another significant issue is losing control over the timing and quality of outputs when tasks are undertaken by an outside supplier. A poorer quality final product or service may sully the company's image.

The following case illustrates the challenges faced by companies such as BSkyB when pursuing a sourcing strategy. It highlights the client and supplier responsibilities when signing an outsourcing contract and the implications for both parties when things go wrong.

Case Study

BSkyB: The Bumpy Road of Outsourcing

In 1983, Rupert Murdoch purchased Satellite Television, a company founded in 1981 by Brian Haynes, and renamed it Sky. After years of competition between British Satellite Broadcasting (BSB) and Sky, the two companies merged on 30 October 1990 to form BSkyB. By 2007, BSkyB had become the UK's largest independent broadcasting operation, supplying a broad range of programmes, channels, and services to more than ten million people around the world.

In 2000, BSkyB was looking for a company to redesign and implement a new Customer Relationship Management (CRM) system that would form the heart of its business. The system needed to be built around Chordiant Software and would run on Sun Microsystems hardware. BSkyB's contact centres in Livingston and Dunfermline in Scotland would use the new CRM system.

To achieve this objective, BSkyB conducted a competitive tender exercise to find a supplier able to meet its criteria. Several bidders emerged during the tendering process, including PricewaterhouseCoopers and Electronic Data Systems (EDS). In the end, EDS was chosen as the supplier of the CRM system.

EDS had been founded in 1962 by Henry Ross Perot, a former salesman for IBM. Perot came up with the idea that as well as providing computer equipment, IBM should also deliver electronic data processing services to its customers. When IBM rejected the idea, Perot resigned and founded EDS. In 2008, Hewlett-Packard (HP) acquired EDS, which was now delivering a broad range of infrastructure technology, applications, and business process outsourcing services. In 2009, EDS changed its name to HP Enterprise Services.

The initial idea was that EDS would provide a technically advanced solution to make BSkyB an industry leader in customer service and maintain Sky Digital's number one position for customer retention. BSkyB's customers would be able to access account, billing and other information and services by phone, the Web or via the television service itself.

On 30 November 2000, BSkyB and EDS signed a contract with an estimated value of £48 million. As there was uncertainty about the cost of the work (due to uncertainty regarding the amount of work required to develop the solution), BSkyB employed EDS on a time-and-materials basis. EDS committed to going live in nine months and completing delivery in 18 months. However, just five months later, in March 2002, BSkyB terminated its relationship with EDS because according to BSkyB, EDS had not fulfilled its contractual obligations. BSkyB switched to in-house development and the residual work was taken over by BSkyB's subsidiary, Sky Subscribers Services Ltd.

By 2004, BSkyB had invested over £170 million. In addition, its IT department budgeted £50 million over the next four years to complete the implementation. By March 2006, BSkyB had successfully completed the project after spending £265 million.

(*continued*)

(continued)

Back in 2004, BSkyB had initiated legal action against EDS, claiming EDS had not been honest during the competitive tender about its resources, technology, and the methods it planned to use to deliver the system within the defined time frame and budget. BSkyB claimed it would probably have chosen PricewaterhouseCoopers for the work if EDS had not given a false sales pitch overstating its capabilities. For its part, EDS argued that BSkyB had not specified the project properly and thus it did not know exactly what BSkyB wanted or needed. The trial started at the High Court in London in October 2007 and concluded in July 2008. On 26 January 2010, 18 months after the end of the trial, the High Court issued its ruling on the dispute between BSkyB and EDS (now part of HP). It found EDS had been deceitful when claiming it had carried out an accurate analysis of the time needed to complete the project and go live, and that it would be able to deliver the system to the agreed schedule. According to the ruling, the CRM manager for EDS had known it was not possible to finish the project on schedule and had not made an accurate analysis of what needed to be done. In addition, BSkyB proved that EDS had violated the contract. BSkyB was therefore awarded damages up to the liability cap set out in the contract. The ruling also stated that although the contract did not cover responsibility for deceitful misrepresentations, nor was this explicitly excluded by the same contract.

One major outcome of the trial was that because BSkyB was able to prove EDS had made a deceitful sales pitch, the liability cap was not applicable. On 3 February 2010, the Technology and Construction Court ordered EDS to make an interim payment of £200 million for damages.

An additional outsourcing risk is organisational change. For example, outsourcing is usually followed by changes in organisational structure, with associated redundancies and layoffs. Research and experience both indicate that outsourcing effectively signals to employees their employer's intention to initiate a change that may involve deskilling and redundancies (Kakabadse & Kakabadse, 2000). Such initiatives can therefore generate fear and employee resistance.

Moreover, as highlighted by Hendry (1995), outsourcing may lead to problems relating to the company's ability to learn due to increased insecurity in the workforce and decreased motivation, meaning employees become less willing to question and experiment as a result. There is also a danger that interactions among skilled people in different functional activities, which often lead to unexpected new insights or solutions, will become less likely.

With regard to offshore outsourcing, Rottman and Lacity (2006) offer a comprehensive list of risks associated with such ventures. These include different kinds of business, legal, political, workforce, social, and logistical risks (see Table 1.1).

Table 1.1 Offshore outsourcing risks

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

Source: Adapted from Willcocks and Lacity (2006)

The 2020 Pandemic and Global Outsourcing and Offshoring

The COVID-19 pandemic may have changed everything and created a new reality in its wake, but one key priority it hasn't altered is the need for business to deploy smart sourcing strategies. If anything, the 2020 pandemic which has and still is dramatically affecting businesses as this book goes to press has only underlined how critical it is for client firms to manage service-providers strategically if they wish to use digital technologies to survive crises, such as pandemics and recessions, and, at the same time, transform themselves into tomorrow's digital leaders.

A BCG report detailed that many client firms have been hit hard by the COVID-19 crisis,[9] but the experience has only reinforced their symbiotic relationship with service-providers. The report shows that client firms will

[9] https://cdn.auckland.ac.nz/assets/auckland/business/our-research/docs/CODE/bcg-postpandemic-outsourcing-trends-for-ceos-feb-2021.pdf

continue to depend on service-providers in the future although they will also invest more in developing in-house capabilities. The key findings from the 2021 study of 200 client firms around the globe point out that:

- Client firms that developed in-house capabilities (67%), increased insourcing levels (66%), and used a global footprint of service-centres (60%) were able to cope with the pandemic.
- In the next two years, enterprises will use the same locational mix as they did in 2020, spending 46% of their IT budgets onshore, 23% nearshore, and 31% offshore.
- During the first year of the pandemic, 61% of companies accelerated parts of their digital transformation while 42% slowed them down. About 96% of the client firms expect to accelerate digital transformation while 76% expect to slow down.
- Almost four-fifth (79%) of corporations asked service-providers for help during 2020, and 62% expect to re-negotiate contracts with them.
- Over 50% of companies expect to increase investments in captive centres, less than 20% plan to invest less, and fewer than 10% are planning divestments.
- The report offers a set of recommendations for client firms and suppliers that will improve their ability to cope with systemic crisis at the magnitude of COVID-19[10]:
- Focus on resilience: All survey respondents said they have a business continuity plan in place, which is great if only a country or region is off the grid. But if a company's global network falters—as we saw throughout 2020—businesses feel far less prepared. What Covid-19 has shown is that resilience must stay high on company agendas, and suppliers are often best placed to bridge any gaps.
- Selective partnerships: The vast majority of our survey respondents were satisfied with the performance of their suppliers. Yet we are seeing a trend in which companies are forming fewer yet deeper supplier partnerships. This is the right approach; it is taxing, expensive, and complicated to orchestrate a large supplier ecosystem, and selective—and deep—partnerships are far more productive.
- Future-proof contracts: Companies must try to change their supplier relationships to focus on outcomes, rather than inputs. Our survey shows that 47% of executives expect a rise in the use of outcome-based contracts. Similarly, joint ventures are back on the agenda, with 47% of executives expecting a rise in these.

[10] https://www.computerweekly.com/opinion/Reimagining-outsourcing-after-Covid-19

- Persist with transformation agendas: There is still undoubtedly—and rightly—a focus on digital transformation. But over the next two years, leaders must decide which transformation projects they invest resources and capital into and which they cancel or delay. In doing so, they will be able to plug capability gaps and determine the kinds of suppliers they will need to partner with to achieve their transformation goals.
- Bridge talent gaps: Our survey showed some shifts towards bringing IT capabilities in-house, but we would describe the trend as 'selective insourcing': it has been feasible to bring some capabilities in-house, but others were outsourced and offshored. Moves to bring talent in-house are driven by a desire to reduce the risk of transformation projects stalling, leaving businesses to rely on service providers in areas where they suffer from talent gaps. This tandem approach, in which internal capabilities are boosted alongside the engagement of service providers, is a trend that is likely to grow in the years to come.

The Future of Outsourcing and Offshoring

Drawing on a number of research streams, we can identify eight trends for the future of global sourcing markets.

Trend 1: Spending Will Continue to Rise in All Global Sourcing Markets

We anticipate that ITO and BPO expenditure will rise in the 2022–2027 period. The consumption of outsourcing services is being driven by digital advancement across industries and geographies, which in turn is motivating firms to seek access to innovative technologies, products, and services. Digital transformation has become necessary to the ability to compete in the market and client firms can often find themselves lacking the in-house expertise and capabilities to digitally transform their businesses and will thus seek solutions in the market. Much of this demand is met by technology vendors offering standard and customised outsourcing services, either through the cloud or as on-premise delivery. This trend will continue in the coming years as the impact of the pandemic continues to shape enterprise IT spend, with cost saving remaining a key driver, but agility, security and business continuity assuming greater importance.

Trend 2: The ITO and BPO Outsourcing Markets Will Continue to Grow Through Both Smaller and Mega Deals

Although ITO and BPO spending is increasing, the average size and duration of individual contracts have been decreasing. For example, the IDC Services Contracts Database reports that the number of deals classified as small (less than 10 M USD) jumped from 66% in 2016 to 74% in 2019. This increase in small contracts can be attributed to two recent trends. First, client firms have been setting up eco-systems in which they retain one or two large vendors to provide standard outsourcing services while adding small and specialised vendors to address specific technology needs. The resulting increase in the number of small vendors within the eco-system is driving the increase in lower value contracts. The second trend is client firms experimenting with new technologies, probably at a greater rate than we have seen in the last decade. The wave of new technologies such as robotic process automation, machine learning, and artificial intelligence, among others, is requiring client firms to first explore these solutions by piloting them, inevitably resulting in a large amount of small contracts with vendors. For some of these technologies, the solutions developed are based on a joint project setting between client firms and vendors, thus reducing the contract fees for such projects.

Interestingly, mega deals have also been on the increase globally, particularly as many client firms are pursuing digital transformation initiatives and due to the large-scale shift of applications to the cloud. *Computer Weekly* reported a record of 525 contracts and four mega deals, worth over 100 million USD each, for the traditional outsourcing segment in the first three months in 2021. Cloud-based services accounted for 11.2 billion USD in 2021, a 38% increase in the value of contracts compared with 2020.[11]

One recent example is a multi-billion-dollar deal between Infosys and Daimler in 2021 to transform technology infrastructure and applications and migrate to a hybrid cloud environment. Tata Consultancy Services also signed a long-term mega-deal with Deutche Bank AG and Prudential Financial in 2021. We expect this trend to continue in the coming years as global enterprise continues to invest in moving its IT assets onto the Cloud.[12]

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[11] https://www.computerweekly.com/news/252503713/IT-and-business-services-spending-bounces-to-new-heights

[12] https://economictimes.indiatimes.com/tech/ites/it-cos-to-see-double-digit-growth-on-mega-deal-wins/articleshow/79946407.cms?from=mdr

Trend 3: Digital Resonance Will Become an Important Component of the Service Location Decision

The key factors that traditionally helped executives reach a decision about the location of their services were financial attractiveness, skills availability, and business environment. A.T. Kearny, a leading advisory firm for outsourcing services recently introduced an extension to this framework that considers the digital resonance of a country as part of the offshoring decision. Digital resonance, representing the digital proficiency of a country, is emerging as a key factor with automation and cybersecurity becoming more important in outsourcing decisions. As the outsourcing sector is being transformed by technology, it only makes sense to factor in the digital skills of the labour force, legal and cybersecurity protections, investment in digital start-ups, and digital outputs. In 2021, India and China retained their first and second positions in the A.T. Kearny Global Services Location Index with digital resonance factored in. However, countries that have invested heavily in digital skills and resources have climbed up the index, including the USA and the UK, whose digital resonance is more advanced than that of China and India. In the near future, we expect that countries with strong digital resonance will become more attractive for outsourcing services than those who have built their reputation on low costs. Among the countries already making significant advances are Germany, Portugal, and Japan.

Trend 4: China's Investment in ITO and BPO Services Is Still Signalling Promise

China continues to invest in ICT, with investment reaching 711 billion USD in 2021, a 9.3% increase from 2020. China's spending on digital transformation is forecast to hit 1.5 trillion USD by 2024, with a 17% year-by-year rate of growth. The digital economy in China accounts for about 70% of Gross Domestic Product (GDP) and continues to be boosted by new infrastructure and dual circulation. These advancements place China in a strong position to compete globally in the offshore services market. The promise is there, with the Chinese IT vendor landscape slowly changing and suppliers such as Lifewood finally creating a global footprint.