The Handbook of Global Outsourcing and Offshoring

3rd edition

Ilan Oshri, Julia Kotlarsky
and Leslie P. Willcocks

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The Definitive Guide to Strategy and Operations

3rd edition

Ilan Oshri
Professor of Technology and Globalisation, Loughborough University, UK

Julia Kotlarsky
Professor of Technology and Global Sourcing, Aston University, UK

Leslie P. Willcocks
Professor of Management, London School of Economics, London, UK

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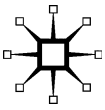

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Contents

List of Tables and Figures

Tables

Figures

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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 ninth 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.

Case Study Contributors

Erran Carmel is the Dean and Professor of Information Technology Department, Kogod School of Business at American University. Erran studies the globalisation of technology work. He has visited hundreds of firms in over 20 countries. He has published over 100 articles and 10 case studies. He recently completed his third book, which deals with how time zone separation impacts global coordination of work. His previous books are *Global Software Teams* and *Offshoring Information Technology*.

Rudy Hirschheim is the Ourso Family Distinguished Professor of Information Systems at Louisiana State University. He was previously a faculty member at the University of Houston, the London School of Economics (University of London) and Templeton College (University of Oxford). He has a PhD in Information Systems from the University of London. He was the Founding Editor of the John Wiley Series in Information Systems in 1985. He is Senior Editor for the journal *Information & Organization* and on the editorial boards of the journals *Information Systems Journal, Journal of Strategic Information Systems, Journal of Management Information Systems, Journal of Information Technology, Wirtschaftsinformatik/Business & Information Systems Engineering* and *Strategic Outsourcing*.

Evgeny Kaganer is an Assistant Professor at IESE Business School where he teaches MBA and executive courses in IT strategy and virtual enterprise. His research focuses on social and mobile technologies and their impact on individuals, organisations and business models. He has published in *MIT Sloan Management Review, Communications of the ACM, Journal of the AIS* and *European Journal of Information Systems*. His work on the use

of social and mobile technologies in business and education has also been cited in major media outlets, such as the *Financial Times, Business Week* and *San Francisco Chronicle*, among others.

Rajiv Kishore is an Associate Professor in the School of Management at the State University of New York at Buffalo. His interests are in improving organisational and IT performance through the effective management of global outsourcing projects, new forms of IT outsourcing including crowdsourcing, technology and innovation management, and strategic IT management. His papers have been published in *MIS Quarterly, Journal of Management Information Systems, IEEE Transactions on Engineering Management, Communications of the ACM, Decision Support Systems* and *Information & Management*, among others. Rajiv has consulted with a number of large companies, some of which include BellSouth, Blue Cross Blue Shield of Minnesota, IBM and Pioneer Standard Electronics.

Onook Oh is a Visiting Assistant Professor in the University of Colorado Denver Business School. He was a research associate at the Center for Collaboration Science in the University of Nebraska Omaha and an Assistant Professor of the Warwick Business School. He is interested in theorising the information systems infrastructure, its techno-social impacts on our everyday lives and technology-mediated collective sense-making under crisis situations. He is a recipient of multiple NSF-funded projects with these research topics. He published his researches in *MIS Quarterly, Communications of the AIS, AIS Transactions on Human–Computer Interaction* and *Information Systems Management,* among others.

Ken Schulz is Vice President of Corporate Marketing, Pactera Technology International Ltd. Ken has 20 years of experience in the IT industry, including 12 years in outsourcing services. Before joining Pactera in 2006, Ken worked at HP for ten years where as Engineering Manager he was tasked with increasing IT capabilities and capacity by establishing offshore software engineering resources in India. Prior to joining HP, Ken was Management Consultant on IT strategy and applications for Fortune 500 clients at PriceWaterhouseCoopers. Ken holds an MBA from the University of California at Berkeley and a Bachelor's Degree in Information Systems from Cal Poly at San Luis Obispo.

Sandra Sieber is a Professor and Chair of the Department of Information Systems at IESE Business School. She is also the Academic Director of the IESE Global Executive MBA. She has worked extensively on the impact of information and communication technologies on organisational and individual work practices, being especially interested in the most recent developments due to the impact of social media on organisations. Sieber has published scholarly and general articles in national and international journals, magazines and newspapers and has contributed to several books.

Mark Skilton has over 30 years of experience in a wide variety of customer-facing and provider solutions strategies, consulting to board level in operating model transformations and value creation, including big data, social media and digital infrastructure transformation. Mark has held International Standards Body Chair positions with the Open Group and is currently a member of the ISO JC38 distributed computing standards for cloud computing. He has graduated from Sheffield and Cambridge Universities and Warwick Business School. Currently, he is holding part-time position as Professor of Practice in Information Systems Management at Warwick Business School.

Introduction

The global IT outsourcing (ITO) market has increased each year since 1989, when global ITO was only a US$10 billion market. On conservative estimates, by the end of 2014 it exceeded US$700 billion. On some estimates, the market will see a 4.8% compound annual growth through to the end of 2018 as more is outsourced and new service lines and delivery locations are added. Looking at the global business process outsourcing (BPO) and IT services market by region, in 2013 North America was 42% of the market, Europe, Middle East and Africa (EMEA) 34%, Japan 10%, the rest of Asia Pacific 9% and Latin America 5%. However, for the first time, in 2014 growth in outsourcing services in Europe exceeded growth in the USA. Offshoring and offshore outsourcing are certainly expanding. By 2015, over 125 offshore locations have been providing ITO and BPO services for more than five years and are seeking to mature their service capabilities. Furthermore, today clients are facing a large variety of alternatives to choose from when making sourcing decisions, which means that they need to take into account a number of considerations to be able to make the right decision. Therefore, it has become increasingly important to understand the phenomenon, not least as a basis for suggesting what directions it will take, its impacts, how it has been conducted and how its management can be better facilitated.

These points are particularly pertinent because recent evidence has suggested that a number of offshore outsourcing relationships and offshoring projects have failed to live up to some of their promises. The reasons for this are many, ranging from poor quality delivered by suppliers to rising management costs that result in frustration and disappointment. Collaboration between remote sites and the ability to share and transfer

knowledge between dispersed teams have also been mentioned as imperative to successful offshore outsourcing projects. In addition, our own research highlights certain capabilities that suppliers and clients should develop, the governing structures that they need to put in place and the bonding activities that they need to promote and make time for. Although offshore outsourcing brings its own distinctive issues, it is the case that the principles for running any ITO or BPO venture also apply to offshoring and offshore outsourcing arrangements. However, offshoring is increasingly part of most deals of any significant size, so it becomes necessary to see and manage outsourcing within a global context.

The main objectives of this book

This book offers a broad perspective on various issues relating to the sourcing of IT-enabled business processes and services in a national and global context. Its key objectives are to:

- Assess the impacts of global sourcing on business
- Assess the risks and benefits for firms engaging in sourcing activities
- Devise a plan to outsource a process or service from a client viewpoint
- Devise a plan to offer services from a supplier viewpoint
- Ensure sustainability over the life cycle of an outsourcing relationship
- Raise awareness to recent developments in the global sourcing arena such as captive strategies and innovation potential.

This book therefore examines both the client's and the supplier's involvement in sourcing relationships by emphasising not only the capabilities that each side should develop prior to entering a relationship but also the potentials that they should develop as a result of their interactions with each other.

Key definition: Sourcing

The field of sourcing is replete with jargon and acronyms. For example, the terms *bestshoring* and *rightshoring* have become recent buzzwords, widely used by managers but poorly defined by the professional press and academic publications. Even more worrisome is the inaccurate use of the terms *outsourcing* and *offshoring* by both managers and academics. Although these terms and others are defined in Chapter 1, we offer this

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

Clearly, almost all firms are engaged in some way in sourcing activities, and each of them has developed a sourcing arrangement that suits its particular needs.

The structure of the book

The book is organised into 12 chapters in three key parts. Chapters 1 to 4 are about *making a sourcing decision,* Chapters 5 to 7 about *building sourcing competencies* and Chapters 8 to 12 about *managing sourcing relationships*. Some chapters can be read as a stand-alone body of knowledge (e.g., Chapters 1, 11 and 12), while others are more connected with other chapters.

Chapter 1 provides a historical perspective on outsourcing and offshoring, the marketplace and the incentives for firms from around the globe to tap into sourcing opportunities. Chapter 2 focuses on sourcing models for client firms and how to make sourcing decisions. Special attention is given to sourcing models based on Internet delivery of products or services that are becoming increasingly popular, such as cloud services and crowdsourcing. It also examines the sourcing arrangements available according to the nature of work outsourced. Chapter 3 considers geographical location in sourcing decisions and the factors that both client and supplier companies should consider when deciding on where a particular activity should be located. Chapter 4 continues the examination of country attractiveness, however, by focusing on the characteristics of Western countries. This chapter also discusses backsourcing of IT and business processes.

Chapter 5, which begins Part II, provides an overview of the supplier's landscape by examining supplier configurations, including multisourcing, and the role of intermediaries. It also discusses the core capabilities suppliers should develop to maintain their competitive position and to ensure their ability to provide quality services to their clients. Chapter 6 considers

the supplier selection strategy from a client's viewpoint. This includes the evaluation of vendors, the outsourcing arrangements, the retained organisation capabilities and legal issues. Chapter 7 examines the notions of expertise and knowledge in sourcing relationships from both the supplier and client perspectives and discusses issues related to the knowledge transfer process.

Chapter 8, which begins Part III, considers the outsourcing life cycle and its key activities from a client's perspective. It also provides an overview of key transition issues. Chapter 9 addresses the key challenges that both client and suppliers face regarding governance of outsourcing relationships. Chapter 10 focuses on the management of globally distributed teams from a sourcing relationship perspective. Chapter 11 explores the role that captive centres play in a firm's global sourcing strategy and, consequently, the strategies a firm can pursue regarding its captive centre. It also discusses Shared Services Centres that present another form of insourcing or captive solution. Finally, Chapter 12 discusses one of the emerging topics in outsourcing – the potential to achieve innovation through outsourcing engagements – and provides a practical framework consisting of six steps to help client companies to incorporate innovation in their outsourcing strategy.

part I

Making a Sourcing Decision

chapter 1

Overview of the Global Sourcing Marketplace

With the advent of globalisation and heightened levels of competition, many organisations are having considerable difficulties in 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 semiglobalisation, of corporate strategy. Moreover, with developments in information and communication technologies (ICT), firms do not have 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. Therefore, this chapter focuses on:

- The key terminologies used in the sourcing literature
- The background of 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 could be physically located anywhere. It encompasses various insourcing (keeping work in-house) and outsourcing arrangements such as offshore outsourcing, captive offshoring, nearshoring and onshoring.

- *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 refer to 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*.

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

Global Sourcing Background

The global IT outsourcing (ITO) market has increased each year since 1989, when global ITO was only a US$10 billion market. On conservative estimates, by the end of 2013, the global outsourcing contract value for business and IT services was about US$648 billion (business process outsourcing (BPO) US$304 billion, ITO US$344 billion) and by the end of 2014 exceeded US$700 billion. On some estimates the market will see a 4.8% compound annual growth through to the end of 2018 as more is outsourced and new service lines and delivery locations are added (Bhimani and Willcocks, 2014).

Looking at the global BPO and IT services market by region, in 2013 North America was 42% of the market, Europe, Middle East and Africa (EMEA)

34%, Japan 10%, the rest of Asia Pacific 9% and Latin America 5%. However, for the first time, in 2014 growth in outsourcing services in Europe exceeded growth in the USA.

Not surprisingly, spending on IT consulting topped any other function outsourced by leading multinationals in Western economies when working with a third-party service provider. Figure 1.1 depicts the distribution of expenditures in 2014 by the leading 150 multinationals in the UK and the USA on various ITO and BPO functions when working with suppliers.

While outsourcing has accelerated, we have also seen growth in the area of shared services and captive centres. Figure 1.2 depicts the distribution of outsourcing expenditure on shared services per function in 2014.

The main driver for outsourcing is still cost reduction; however, we have witnessed growing attention by client firms to other objectives such as access to skills and flexibility in how human capital is utilised. Figure 1.3 offers an insight into the drivers for outsourcing in 2014.

While, during 2014, many wondered whether automation and backsourcing (also known as re-shoring) would see the erosion of offshore outsourcing, in practice offshore outsourcing has been growing worldwide. Within the overall outsourcing figures cited above, offshore outsourcing exceeded US$100 billion in revenues in 2013 and is estimated to grow at 8–12%

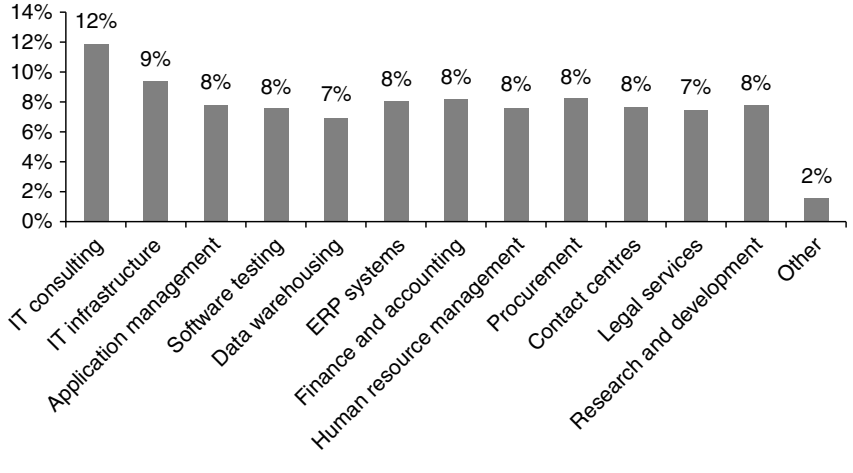

FIGURE 1.1 Distribution of outsourcing expenditures by ITO and BPO functions when working with suppliers

Source: Survey by Loughborough Centre for Global Sourcing and Service, 2014.

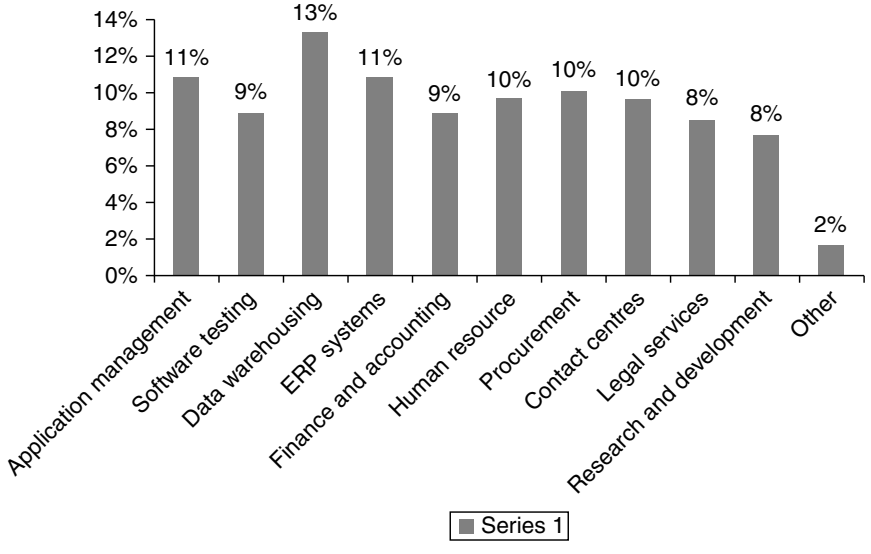

FIGURE 1.2 Distribution of outsourcing expenditures by ITO and BPO functions when working with shared service centres and captives
Source: Survey by Loughborough Centre for Global Sourcing and Service, 2014.

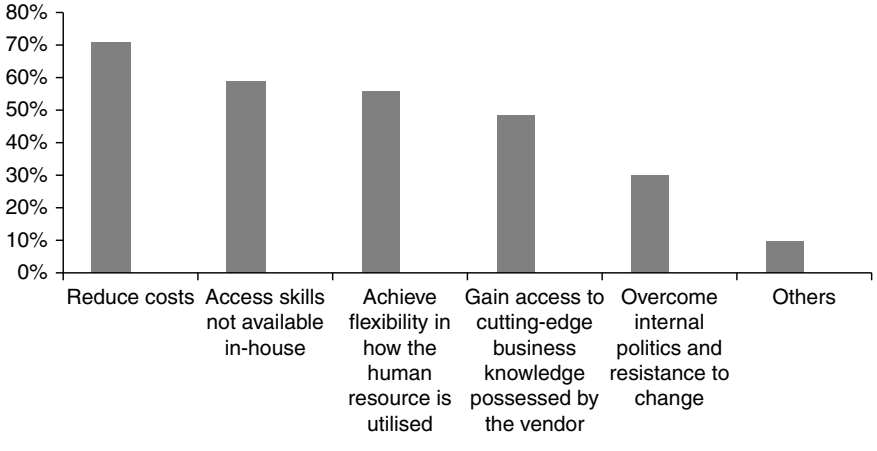

FIGURE 1.3 Main drivers of outsourcing
Source: Survey by Loughborough Centre for Global Sourcing and Service, 2014.

per year from 2013 to 2018 (Willcocks et al., 2015). This strategy has always appeared promising in terms of the reduction of costs as certain organisational activities would be 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 outsourcing, and for large multinationals, offshore outsourcing increasingly has to fit into 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 has appeared to be gaining momentum in Europe, where the UK is the lead consumer of such services. We cover offshore outsourcing in more details in Chapters 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 and have enabled the coordination of organisational activities at the global level. Other reasons are as follows: the supply of skilled yet low-cost labour in countries such as India and the Philippines and subsequently now over 125 further locations; investments in infrastructure; an improved business, economic and political climate in a number of developing countries; and the standardisation of 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. Jamaica constructed its Digiport, with a 20,000-telephone-line capacity and speeds of 1.5 Mbps. Furthermore, many countries have provided tax advantages to attract offshoring. For example, Bulgaria offers a 10% flat enterprise tax rate that is dropping to 0% in areas with high unemployment. In Jamaica the Digiport BPO free trade zones are tax free. South Africa offers government and provincial grants for job creation through attracting offshore work to the country and in 2014 made its immigration laws more supportive of the industry. Other countries like China, Morocco, Egypt and Kenya have invested heavily in business parks and in ways of supporting offshore industry growth. Chapter 3 deals with such issues in more detail.

Global sourcing may offer several benefits associated with the advantages of outsourcing in general. A company may 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 from outsourcing 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 on a relatively few knowledge-based core competencies where it can develop best-in-the-world capabilities (Quinn and Hilmer, 1994; Lacity and Willcocks, 2012). Concentration on a core business may allow a company to exploit distinctive competencies that will lead to a significant competitive advantage.

Another major benefit of outsourcing is that it can give the organisation access to the supplier's capabilities and innovative abilities, which may be expensive or impossible for the company to develop in-house (Quinn and Hilmer, 1994).

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, at a lower cost, in response to changing demand. In this way, outsourcing can provide greater flexibility (McCarthy and Anagnostou, 2003). Furthermore, outsourcing can decrease the product or process design cycle time if the client uses multiple best-in-class suppliers that work simultaneously on individual components of the system, as each supplier can contribute greater depth and sophisticated knowledge in specialised areas and thus offer higher quality inputs than any individual supplier or client can (Quinn and Hilmer, 1994). On this basis, having several offshore centres can provide around-the-clock workdays. In other words, development and production can take place constantly by exploiting the time difference between different countries.

While firms seek to reduce costs and access skills and ideas from outsourcing engagements, it is not always clear whether value is appropriated from such relationships. Oshri and Kotlarsky (2009) examined value in outsourcing to conclude that the vast majority of client firms

are in the dark when trying to measure and quantify the return on their outsourcing investments. In fact, less than half of the firms studied (43%) have attempted to calculate the financial impact of outsourcing to their bottom line, indicating that the financial benefits are difficult to quantify (51%). When asked about cutting back or bringing back operations in-house, executives sited 'unclear value for money' as the main driver (see Figure 1.4).

Adopting sourcing strategies poses several other disadvantages. Loss of critical skills or overdependence on an outside organisation for carrying out important business functions may evolve into significant threats to a company's well-being. Also, security and confidentiality of data can become major issues for many companies. Another major issue is losing control over the timing and quality of outputs since these will be undertaken by an outside supplier: the result may be a poorer quality of the final product or service, and this may sully a company's image.

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

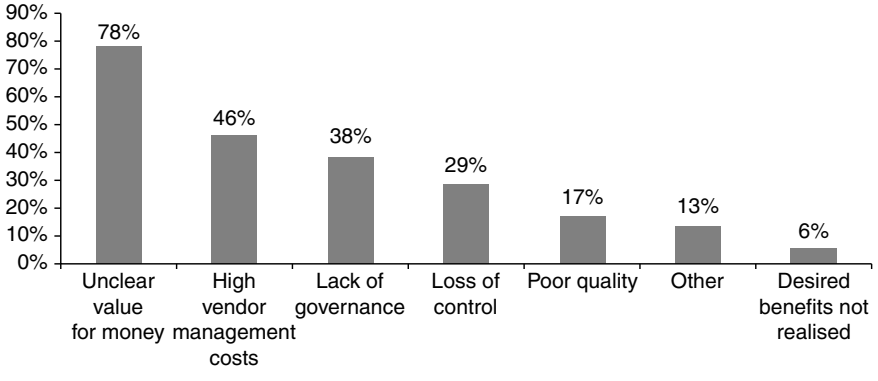

FIGURE 1.4 Main drivers for cutting back or bringing back outsourced services

Source: Oshri and Kotlarsky, 2009.

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 that would redesign and implement a new Customer Relationship Management (CRM) system for that would be the heart of its business. The system needed to be built around Chordiant Software and 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 that would be 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 for the CRM system.

EDS had been founded in 1962 by Henry Ross Perot, a former salesman from IBM who came up with the idea that besides delivering computer equipment, IBM should also deliver electronic data processing services to its customers. When IBM rejected the idea, Perot resigned and founded his own company, EDS. In 2008, Hewlett-Packard (HP) acquired EDS, which now delivered a broad range of infrastructure technology, applications and BPO services. In 2009, EDS changed its name to HP Enterprise Services.

The initial idea was that EDS would provide BSkyB with a technically advanced solution that would make a valuable contribution to BSkyB's drive to lead innovation in customer service

and maintain Sky Digital's industry-leading levels of customer retention. BSkyB's customers would be able to access account, billing and other information and services by phone, the Web or the television service itself.

On 30 November 2000, BSkyB and EDS signed a contract estimated at a value of £48 million. As there was uncertainty about the cost of this work (due to the uncertainty regarding the amount of work that needed to be done), BSkyB employed EDS on a time-and-materials basis. EDS stated that it would be able to go live in nine months and complete delivery in 18 months. However, just five months later, in March 2002, BSkyB terminated its relationship with EDS because, according to BSkyB, EDS did not fulfil 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 had 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.

Back in 2004, BSkyB initiated legal action against EDS, citing that EDS had not been honest during the competitive tender about its resources, technology and the methodology it planned to use in order to deliver the system within the defined time frame and within budget. BSkyB claimed that it would have probably chosen PricewaterhouseCoopers for the work if EDS had not given a false sales pitch in which it overestimated its capabilities. EDS, for its part, claimed that the most critical element in this project was that BSkyB did not specify the project properly and that it did not know exactly what BSkyB wanted or needed. In October 2007, the trial started at the High Court in London and was concluded in July 2008. On 26 January 2010, 18 months after the end of the trial, the High Court ruled on the dispute between BSkyB and EDS (now part of HP). It found that EDS had been deceitful when it claimed that it had carried out an accurate analysis of the time needed to complete the delivery and go live and when it

claimed that it was able to deliver the system within the agreed-to schedule. According to the Court, the CRM manager for EDS had known that it was not possible to finish the project according to schedule and that there had not been 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. In addition, the Court stated that the responsibilities for deceitful misrepresentations that were not described in the contract were not accurately excluded by the same contract.

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

Additional outsourcing risks are associated with organisational changes. For example, outsourcing is usually followed by changes in organisational structure with redundancies and layoffs. Research and experience indicate that outsourcing effectively signals to employees their employer's intention to initiate a change that may involve deskilling and redundancies (Kakabadse and Kakabadse, 2000). Such initiatives can generate internal fears and employee resistance.

Moreover, as Hendry (1995) highlights, outsourcing can be associated with problems related to the company's ability to learn because it can increase insecurity among the workforce and decrease its motivation, reducing employees' willingness to question and experiment. There are fears as well that interactions among skilled people in different functional activities, which often lead to unexpected new insights or solutions, will become less likely (Quinn and Hilmer, 1994).

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 Future of Outsourcing and Offshoring

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

Trend 1: Spending will continue to rise in all global sourcing markets, but BPO will overtake ITO

We have already seen how, following the long-term growth trend, ITO and BPO expenditure is set to rise continually in the 2012–2018 period. The interesting feature is that BPO is and will grow at a faster rate than ITO, with BPO expenditures rising across the board in areas such as the human resources function, procurement, back-office administration, call