Deloitte.

# Outsourcing fails when no one connects the pieces

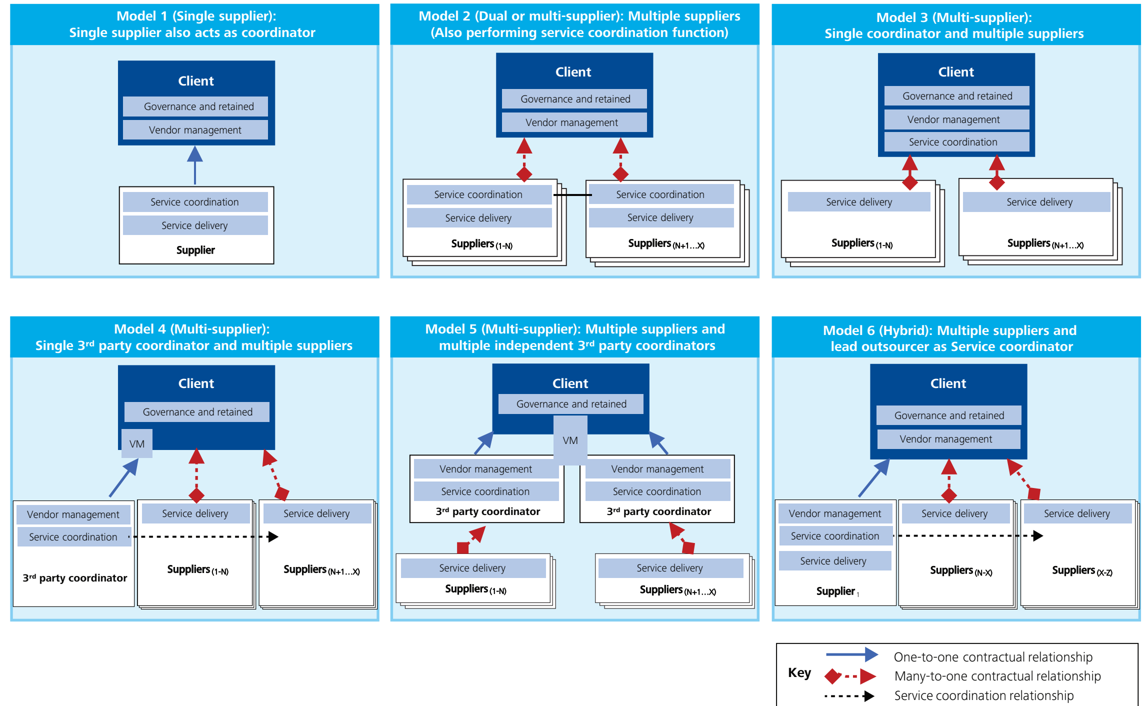
Since its emergence in the 1990s, outsourcing has become standard practice in nearly every major business function[1] and industry. The move to outsourcing is not slowing down and, according to Deloitte's 2012 Global Outsourcing and Insourcing Survey[2], every major business function is expected to increase its use of outsourcing in the future. This rapid growth does not mean that outsourcing is without drawbacks. In fact, 48% of the survey respondents report having terminated outsourcing contracts for reasons including poor service quality, lack of subject matter knowledge, unsuccessful transitions, and poor communication. While these problems may sound like they have a multitude of causes, many times they stem from a single issue: no one is linking the vendors to each other and to the internal client team.

To understand this issue, we need to consider the six fundamental outsourcing models that are leveraged across business functions and industries and understand how each model links vendors to each other and to the internal client team. Each model takes a different approach, and the choice of a model depends on the specific goals of an outsourcing initiative.

[1] Major business functions include IT, Operations, Finance, HR, Legal, Real Estate/Facilities, Procurement, and Sales/Marketing support
[2] "Outsourcing Today and Tomorrow: Insights from Deloitte's 2012 Global Outsourcing and Insourcing Survey"

As used in this document, "Deloitte" means Deloitte Consulting LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

## The models




### Model 1: The monolithic model — The original model

In this single vendor model all outsourcing work goes to a monolithic provider. The business manages the Governance, Retained Functions, and Vendor Management while the provider manages Service Coordination and Service Delivery. A contract exists between the business and the provider specifying the scope of services. The single provider may have different divisions within it doing the work, but all the work is done by the single provider and none is subcontracted out. The provider is responsible for managing all the interactions between its internal divisions.

This was the first outsourcing model to originate in the early 1990s and it is still used today. The advantage of this model is its simplicity since the business only needs to manage one other party. There are several downsides, including:

- If the business is outsourcing multiple functions it is unlikely that a single provider can provide leading service in each area;
- If the provider runs into difficulties (financial, regulatory, or technological) the business has no other providers in its stable available for immediate help; and
- Having only one provider removes a sense of competition between providers that can be a useful tool to optimize costs and maintain a high level of service.

### Model 2: Multiple vendors model — Second generation model

In this multiple vendor model the outsourcing work is distributed to two or more providers. The business manages the Governance, Retained Functions, and Vendor Management while the providers manage Service Coordination and Service Delivery independently. Since each provider manages Service Coordination within its own scope of work, no single party is responsible for overall Service Coordination. While a contract exists between the business and each provider, no contract exists between providers. Often, Operating Level Agreements (OLAs) exist between providers to establish some operating protocols for the areas in which they interact.

This model originated in the early 2000s; its advantage is that a business is able to get more leading services and innovation by hiring the leading providers for each area of work. Often a business can get a reduced price and better service compared to a single vendor model, as well. The downside is that the business now has to manage multiple vendors and relationships. As the number of additional providers increases, the number of interacting relationships increases geometrically and makes it increasingly difficult for the business to manage.

### Model 3: Multiple internally coordinated vendors model

This multivendor model is similar to Model 2 except that, here, the business manages Service Coordination globally; that is, the business now manages the seams of interaction between the business, service providers, and the Retained Functions. The business has contracts with each provider and can dictate what the suppliers do and manage how they interact.

This model was established in the mid-2000s to address weaknesses identified in Model 2; its advantage is that there is a process to determine the relationships and the responsibilities of the different parties. The downside is that the business generally does not have this function in place, and the skills and tools required to run the service coordination function typically require an investment.

**Responsibilities of key functions:**

**Governance:** Ensure that the outsourcing initiative is aligned to overall business strategy. Key tasks include establishing protocols, aligning internal and external stakeholders, and reviewing the external provider's performance.

**Retained functions:** Deliver the scope of services that are critical to retaining control, agility, cost effectiveness and service flexibility

**Vendor management:** Includes contract and financial management, management of vendor scope changes, day to day management and oversight, and monitoring and management of risks

**Service coordination:** Integrated coordination of the interaction of all internal and external service providers

**Service delivery:** Delivering the scope of services under the contract

### Model 4: Multiple externally coordinated vendors model

This model is the same as Model 3 except that an external group, like a consulting company or specialized provider, manages Service Coordination (and possibly Vendor Management), activities rather than the business. Its advantage, unlike Model 3, of this model is that the business does not have to establish the Service Coordination function. The downside is that the business has less control of that function.

Businesses often switch back and forth between models 3 and 4. Some businesses do not have the resources or sophistication to establish their own Service Coordination function and thus they have an external party establish it. Once it is well established the business may decide to take control and build their own service coordination function.

### Model 5: Prime sub relationship model

In this multivendor model, the outsourcing work goes to a "Prime" vendor, or multiple prime vendors who both delivers service and manages sub-contractors to perform additional work. The business just has a single contract with the prime vendor, who then contracts with multiple subcontractors. The business manages the Governance, Retained Functions, and elements of Vendor Management, while the prime(s) manages Vendor Management, as well as Service Coordination and Service Delivery for the subcontractors. Thus, the prime vendor can manage the interactions of the subcontractors.

This model was established in the mid-2000s and is frequently used by the government. The advantages are that it is a simpler model for the organization to manage while still receiving leading services in multiple areas. The downside is that many of the stakeholders may resist the organizational structure. For example, subcontractors typically prefer having a direct relationship with the business and thus do not want to cooperate with the prime, and often the procurement function within the business prefers to work directly with the subcontractors in order to manage services more tightly rather than is possible through an intermediary.

### Model 6: Largest provider coordination model

The final multivendor model is similar to Model 2 except that one of the providers — generally the largest one — is put in charge of Service Coordination for the others. The business manages Governance, the Retained Functions, and elements of Vendor Management, while the largest provider manages Service Coordination, Service Delivery, and those elements of Vendor Management not retained by the business. The business has contracts with each provider, and no contracts exist between the different suppliers.

This model also was established in the mid-2000s. The main advantage is that it is easy to implement. The downside is that, because there is not a contractual relationship between the suppliers and no OLAs, it is difficult to manage the interaction. Typically the managing provider will blame the others for any shortcomings, and providers will be reluctant to share information since they are competing against each other.

## Selecting an operating model — Strategic alignment

With an understanding of the outsourcing operating models, organizations can begin to think about which model provides the applicable level of vendor and business interaction and could be preferred for their initiative. The first step in the process is to conduct a strategic alignment exercise to identify the decision criteria and decide how they will be applied. Some common principles and applications include:

- Agility: How efficiently and easily can we change the supplier or modify the scope of work?
- Quality: How mature are our operating processes? What level of reliability do we require?
- Cost: How much are we willing to spend on the transition and ongoing management?
- Risk: Can the supplier do the job? What happens if the supplier goes out of business?
- Capabilities: How much work do we want to outsource? How will evolving technologies impact our need for outsourcing?
- Strategic alignment: Will this support the strategic direction of the organization? What are the regulatory and customer impacts of the decision?

After the principles are identified, the organization should evaluate how well each outsourcing model will meet the identified principles. Typically each principle is weighted based on its relative importance, and scorecards are used to rate them against each business model. Then a weighted factor analysis can be completed to select the highest scoring model. The business should confirm that the resulting decision makes sense; if it does not, the decision criteria should be revisited.

### Can I gift the risk?

While the choice of an outsourcing model can mitigate financial, operational, or regulatory risk, none of these outsourcing models will completely eliminate risk. Each model shifts risk differently between the parties and so a risk analysis needs to be completed to select the preferred model for a particular initiative.

| Sourcing guiding principles | Model 1: Single supplier and service coordination | Model 2: Multiple suppliers (also performing service coordination function) | Model 3: Single coordinator and multiple suppliers | Model 4: Single 3rd party coordinator and multiple suppliers | Model 5: Multiple suppliers and multiple independent 3rd party coordinators | Model 6: Multiple suppliers and lead outsourcer as service coordinator |
|---|---|---|---|---|---|---|
| | Single | Dual or multi-supplier | Multi-supplier | Multi-supplier | Multi-supplier | Multi-supplier (Hybrid) |
| Agility | Medium | Low to medium | High | Medium to high | Low | Medium |
| Quality | Medium to high | Low to medium | High | Medium to high | Medium to high | Medium |
| Overall cost | Low to medium | Low to medium | Medium | Medium to high | Low to medium | Medium |
| Overall risk | Medium | Low | Medium | High | Low | Medium |
| Capabilities | Low to medium | Medium | Medium to high | Medium to high | Medium | Medium |
| Strategic alignment | Medium | Medium | High | Medium to high | Low | Medium |
| **Overall benefit rating:** | Medium | Low to medium | Medium to high | Medium to high | Low to medium | Medium |

Once the executives have alignment on the appropriate outsourcing model to use, then operational teams can be engaged to start building and executing a plan. It is essential that alignment is reached before beginning operational work to determine that the appropriate model is chosen. When this step is skipped, the operational teams will too often try to optimize the outsourcing model based on cost or some other singular factor which will likely lead to poor results. By carefully evaluating this at a strategic level, organizations will know that they have carefully considered the required factors and be confident that they have the appropriate levels of vendor and business interaction; this greatly increases the chances of success for the initiative.

## Most common models — Migration to model 3 or 4

Over the last several years Deloitte has observed a trend that organizations are requesting leading services and increased innovation in multiple areas; this has led to organizations selecting multi-vendor models. Organizations have also realized the importance of Service Coordination functions and want to control and manage how the providers interact with each other and the business. This leaves Models 3 through 6 to choose from, but many organizations dislike the limitations of the prime / sub model (Model 5) or the managing provider model (Model 6). Thus, the decision often focuses on choosing between the Internally or Externally Coordinated models (Models 3 and 4). Between these two, the organization's size, sophistication, availability of necessary skills and tools, and budget frequently determine which model is selected. Of course, this is not always the case, and some organizations will find they do not have the scale or scope to require Service Coordination and will settle on Models 1 or 2, or they may find they need limited Service Coordination and settle on Models 5 or 6. Only a well-executed selection process can determine the optimal model.

## Conclusion

Outsourcing continues to offer the potential for significant value and benefits, and this value is only likely to be realized if the optimal outsourcing model is used. The six models leveraged in the market today provide companies with significant flexibility to receive appropriate levels of specialization of Vendor Management and Service Coordination activities for their business. A well-executed selection process will identify the model that most effectively addresses an organization's circumstances and places it on a path towards an effective outsourcing initiative, while a poor selection will likely lead to low service quality, uncoordinated communication, frustrated stakeholders, missed cost savings objectives, among other problems. The choice of an outsourcing operating model is not one to be taken lightly.

## Contacts


**Marc Mancher**
Principal
Deloitte Consulting LLP
+1 860 488 5071
jmancher@deloitte.com

**Ajay Bolina**
Principal
Deloitte Consulting LLP
+1 646 541 6712
abolina@deloitte.com

**John Tweardy**
Principal
Deloitte Consulting LLP
+1 303 641 7552
jtweardy@deloitte.com

**Douglas Plotkin**
Director
Deloitte Consulting LLP
+1 508 963 3648
dplotkin@deloitte.com

**Simon Tarsh**
Director
Deloitte Consulting LLP
+1 347 268 4376
starsh@deloitte.com

**Peter Lowes**
Principal
Deloitte Consulting LLP
+1 646 269 2067
plowes@deloitte.com



This publication contains general information only and is based on the experiences and research of Deloitte practitioners. Deloitte is not, by means of this publication, rendering business, financial, investment, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates, and related entities shall not be responsible for any loss sustained by any person who relies on this publication.

Copyright © 2013 Deloitte Development LLC, All rights reserved
Member of Deloitte Touche Tohmatsu Limited