Outsourcing Amid Complexity

Contents

Preface

This publication presents Deloitte's perspectives on designing, implementing, and managing outsourcing[1] initiatives in ways that recognize and address the many risks involved in outsourcing while securing the anticipated benefits. The approach presented here builds upon experiences from more than 1,200 global engagements of Deloitte Outsourcing Advisory Services (OAS) and Finance & Operations Risk Transformation Services practices and on the findings of two Deloitte OAS Surveys: "Deloitte Global Outsourcing and Insourcing Survey"[2] and "Outsourcing Vendor Management Program Office (VMPO): Art, science, and the power of perseverance."[3] This paper also incorporates insights gained from Enterprise Risk Services and Governance, Risk and Compliance practices, which focuses on assisting organizations in managing the risks associated with third-party relationships.

Please refer to the additional reference section of this document for recommended readings in other Deloitte outsourcing and risk management publications.

Open communication is one key to the success of any major enterprise initiative, including outsourcing. We therefore encourage you to share this paper with board members and senior executives in your organization who oversee, manage, or participate in outsourcing decisions and initiatives. The resulting discussion can promote awareness of the risks and success factors associated with your organization's new or ongoing outsourcing efforts and help you chart a path to successful initiatives.

Executive summary

Outsourcing has become a standard worldwide business practice and management imperative, as indicated by the majority of the respondents in Deloitte's Outsourcing Advisory Services (OAS) Survey. However, new risks and challenges continually arise from the growing complexity of service providers, geographies, technologies, and engagement models, as well as from escalating expectations, integration issues, governance requirements, and external oversight. If the risks and challenges are not clearly understood and systematically addressed, organizations may face unnecessary exposures, fail to realize outsourcing objectives, and loss of substantial investments of time and money.

This paper discusses risks and challenges at each key phase of the outsourcing lifecycle. A lifecycle approach to outsourcing enables organizations to significantly improve their prospects of achieving outsourcing goals. With this approach and a thorough understanding of service requirements and constraints and of the risk/benefit trade-offs of sourcing options, organizations can make well-informed outsourcing decisions and better manage ongoing relationships.

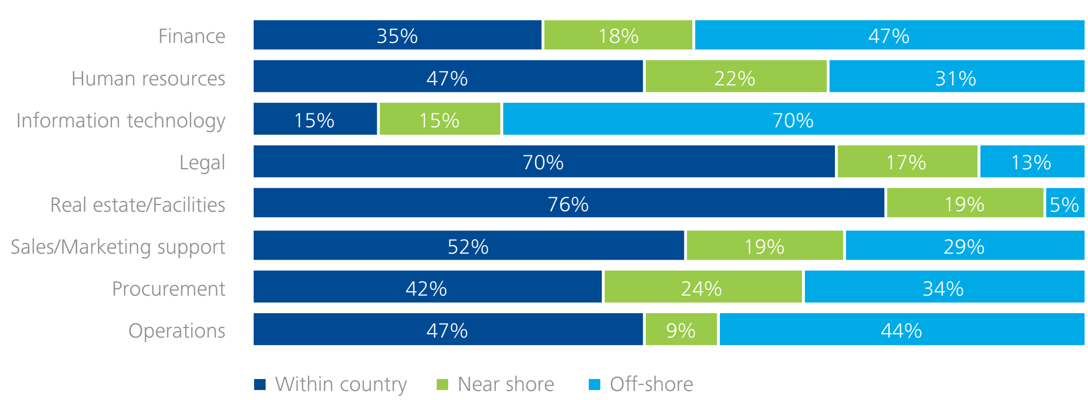
Based on Deloitte's engagement experience, most outsourcing failures stem from inadequate risk identification and mitigation early in the lifecycle. Organizations should consider testing their risk awareness early in the process to enhance decision making and proactively address gaps that may hinder implementation and value realization of the outsourcing initiative.

Outsourcing trends and risk implications

Outsourcing has become an integral component of many Global 1000 companies' operating models. However, while these organizations have gained experience with outsourcing, they also face the following key issues:

- **Increasing complexity and higher demands:** A broad range of emerging service providers, engagement models, technologies, and delivery locations are presenting new and significant trade-offs and interdependencies. At the same time, organizations are extending outsourcing to a broader set of business processes (beyond IT services and back-office functions) and stakeholders are demanding higher value (beyond labor-cost arbitrage).
- **Global delivery models:** More organizations are adopting a global delivery model for their outsourced services. Deloitte's OAS Survey found that more than half of the respondents plan to offshore or nearshore the majority of their outsourced functions, such as finance, human resources (HR), information technology (IT), procurement, and operations (see Figure 1). This trend is driven by demands for integrated global delivery solutions that fit specific requirements for regulatory compliance, talent, cost, proximity, language proficiency, tax efficiency, sustainability, and business continuity. While the benefits of "right-shoring" can be substantial, if not properly designed and managed, a global delivery footprint can lead to significant geopolitical, foreign exchange, inflation, and reputational risk.
- **Governance, alignment, and control issues:** Many organizations are using a portfolio of vendors and a hybrid operating model that combines internal shared services, outsourcing, and cloud-based solutions. This trend compounds the challenges associated with vendor governance and service integration. In addition, many organizations aim to foster healthy competition among internal and outsourced service providers, leading to processes with elements delivered by multiple parties. Such environments may lack a single point of control and accountability. A fragmented multi-vendor environment and the absence of an effective service integrator can undermine alignment, generate inefficiencies, erode cost savings, create control issues, and hinder innovation.
- **Increasing regulatory and compliance risks:** Regulatory developments are increasing the liability exposure that organizations may face in outsourcing. Senior management and the board may be held accountable for noncompliance associated with third-party operations. For example, the U.S. Office of the

Figure 1: Target location model for planned outsourcing initiatives



Comptroller of the Currency (OCC) has emphasized controls used by financial services organizations to manage risks associated with outsourcing, and the Consumer Financial Protection Bureau (CFPB) has investigated inappropriate marketing tactics of organizations and outsourcing partners. Australia introduced regulatory requirements under Prudential Standard CPS 231 for banks and the insurance sector. Similar requirements have been issued in Belgium by that nation's Banking, Finance and Insurance Commission (CBFA) and in France under Regulation 97-02, and in many other countries worldwide. Regulatory agencies in other countries and regions also extend their purview to service providers.

- **Unsatisfactory service and failed initiatives:** Apart from complexities and risks, improperly planned and managed initiatives typically fail to deliver the anticipated benefits. In Deloitte's OAS Survey, 48 percent of respondents had terminated an outsourcing contract in the past, primarily due to concerns with service quality (see Figure 2). Additionally, a total of 24 percent indicated a less than satisfactory rating for their most recent outsourcing initiative (see Figure 3), and many respondents reported lower-than-expected cost savings (see Figure 4).
- Addressing these issues calls for an approach to outsourcing that recognizes and manages risk at the global enterprise level. This approach should — also at a global level — help align business objectives and internal and external resources, implement sound governance and controls, and address all relevant regulatory and compliance matters. This approach to outsourcing characterizes the Risk Intelligent Enterprise™, which exemplifies Deloitte's cross-functional, enterprise-wide approach to risk. Consistent with this approach, a critical first step to consider in any outsourcing initiative is to identify key risks at each phase of the outsourcing lifecycle. The next step is to measure, track, and manage all risks associated with specific outsourcing strategies and across the organization's outsourcing activities.

Figure 2: Ability to meet cost reduction

Q. Have you ever terminated an outsourcing contract for cause or convenience?

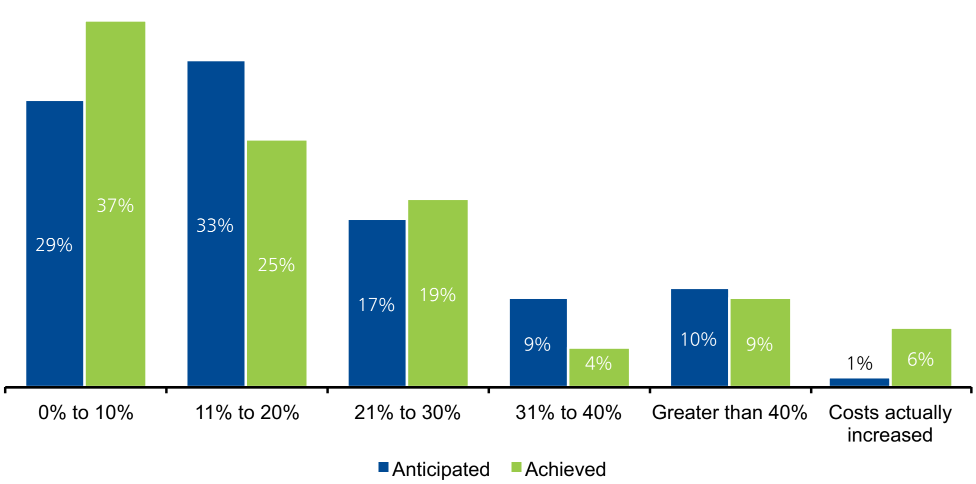
52% | Yes
48% | No

Figure 3: Outsourcing contract

Q. How satisfied are you with the outcome of your most recent outsourcing initiative?

7% | Extremely satisfied
69% | Satisfied
16% | Neutral
8% | Dissatisfied

Figure 4: Ability to meet cost reduction



Risks at each phase of the outsourcing lifecycle

Deloitte's OAS methodology defines five phases of the outsourcing lifecycle (see Figure 5), which move an organization through the design, execution, and management of an outsourcing initiative. Each phase addresses unique challenges and risks while fulfilling business objectives and risk management needs.

Figure 5

Outsourcing lifecycle

Phase 1: Define strategy and operating model	Phase 2: Develop solution and request for proposal	Phase 3: Evaluate deal and manage transaction	Phase 4: Execute transition and transformation	Phase 5: Manage ongoing operations

As noted, outsourcing initiatives often fail to meet expectations due to inadequate risk identification and mitigation early in the lifecycle. Many organizations, therefore, maximize the value of these initiatives by developing a risk management plan in the first phase to identify, evaluate, and prioritize risks and mitigation strategies, and then implementing those strategies. In the following pages, we examine key risks at each phase of the lifecycle and as well as strategies to help make each phase a success.

Outsourcing lifecycle

Phase 1: Define strategy and operating model	Phase 2: Develop solution and request for proposal	Phase 3: Evaluate deal and manage transaction	Phase 4: Execute transition and transformation	Phase 5: Manage ongoing operations

Phase 1: Define strategy and operating model

In this phase, the organization develops and prioritizes outsourcing objectives, defines the target operating model, and formulates a roadmap for the initiative. In the process, the organization develops outsourcing strategies and operating models and identifies and addresses risks.

It's essential to address risks before a strategy has been selected, and to identify risks for all viable service delivery options when defining the outsourcing strategy. For example, a major natural resources organization committed significant resources upfront to develop risk mitigation strategies to manage service delivery and transition issues before engaging vendors and internal stakeholders in the sourcing process. This enabled the company to effectively complete a complex global transition program that impacted more than 1,200 functional roles in 14 months.

An organization can build risk identification, evaluation, and response planning directly into the strategy and the operating model in Phase 1. Doing so can help ensure that risks associated with key strategy and design issues as well as mitigation strategies (see Figure 6) are considered upfront for each sourcing scenario — a far more cost effective approach than trying to retrofit risk strategies after a sourcing option is undertaken.

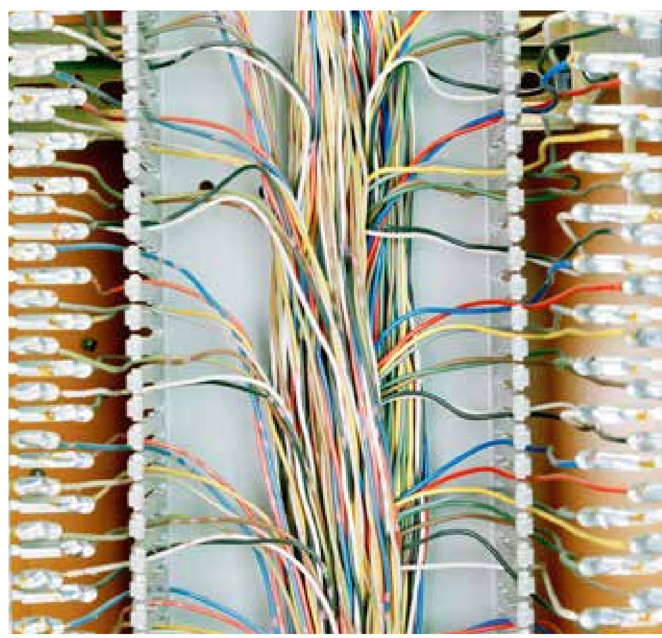


Figure 6: Risk considerations and mitigation strategies

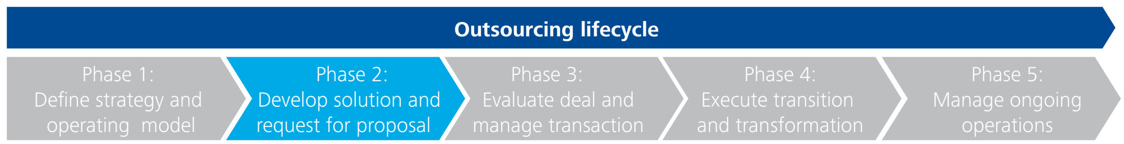
Risk considerations	Related mitigation strategies
Are the outsourcing objectives aligned with the overall business strategy and the target operating model?	Clear alignment between outsourcing objectives and the overall business strategy ensures development of a viable target operating model. Misalignment or gaps may lead to poor business performance when the operating model proves inadequate to support the business strategy or becomes unresponsive to changing needs.
Are scope, requirements, and constraints fully understood?	A holistic scope assessment assists organizations to achieve economies of scale. These are particularly important when outsourcing encompasses multiple business units, processes, and geographies. An integrated service delivery model should be both comprehensive in scope and flexible enough to support current and future service delivery needs.
What are business case drivers?	A solid business case starts with a current state assessment of financial, operational, and organizational needs to provide a baseline for evaluating sourcing scenarios. This provides valuable insight into the total cost of each sourcing scenario and the trade-offs of any scenario as compared with the baseline.
How much change will the new operating model entail? Does the organization have the plans, tools, systems, processes, and resources to cost effectively manage the changes without disrupting operations?	Underestimating the changes involved in outsourcing may impact service delivery and delay full realization of the benefits of outsourcing. Change management programs identify and mitigate capability and communication gaps and include planning and implementation activities that determine the pace and success of an outsourcing initiative.
What are the technology risks and the options to reduce them?	The outsourcing value proposition rests on the notion that outsourcers optimize their processes and use of technology. Organizations can therefore properly view outsourcing as an opportunity that goes beyond a simple “lift and shift” of existing operations and processes. Outsourcing can and should be transformational, generating upstream and downstream improvements through process enhancements, re-engineering, and application of advanced technologies.
What are the regulatory reporting and monitoring requirements, and how will they be addressed?	While some industries are more regulated than others, most organizations face some internal or external oversight requirements. Regulatory requirements can preclude participation in certain business activities, and failure to meet requirements can carry significant financial penalties. An organization must understand all relevant regulatory requirements and work with service providers to ensure that compliance is integrated into outsourced processes and operations at each phase of the lifecycle.

Risk considerations and mitigation strategies

Results of this first phase may include the following:

- Clear, prioritized outsourcing objectives
- Cohesive, enterprise-level operating model
- Specific scope, requirements, and constraints for the overall solution
- Business case analyses that include costs and impacts of risk mitigation plans
- Change management program that addresses the risks and requirements associated with organizational changes around the outsourcing initiative
- Iterative process to revalidate the strategy and operating model in light of changing needs

This first phase produces an overall plan that identifies the steps required to implement an outsourcing strategy and the investments required to achieve the goals of the initiative.



Phase 2: Develop solution and request for proposal

During this phase, outsourcing goals are translated into a solution or set of solution scenarios, and a request for proposals (RFP) process is developed for potential vendors. This phase focuses on developing solution requirements, vendor evaluation criteria, and RFP details in order to communicate the outsourcing objectives, scope, requirements, and constraints to potential vendors.

The RFP presents an opportunity to mitigate risk by reducing uncertainty about operating environments and clarifying mutual expectations. Toward that end, the RFP should document expectations, including which services an outsourcer is to provide and how they will be provided, including vendor personnel qualifications, security processes, and performance metrics, and which related services will remain in-house.

RFP development and response evaluation should include stakeholders and representatives from the relevant functions across the organization. These individuals must be given clearly defined roles and responsibilities, and possess the experience and expertise required to evaluate the vendors. Failure to engage the right resources in this phase can result in an unclear or incomplete RFP and faulty vendor proposals or unrealistic pricing.

To mitigate the risks associated with RFP development, organizations should develop a comprehensive RFP template that has been vetted by relevant stakeholders, including legal and procurement professionals. At a minimum, the RFP template should include:

- Background information that articulates the objective and scope of the outsourcing initiative, including in-scope and out-of-scope business units, functions, processes, and activities
- Operating environment information that fully describes the "as is" situation with respect to systems and activity volume
- Instructions on completing the RFP, including organization of responses, pricing template, vendor qualifications template, and stated evaluation criteria, in order to draw forth consistent, comparable information from each respondent
- Constraints such as regulatory requirements and existing contracts with other third parties
- Service Level Agreement Framework, including performance metrics, target service level, service level reporting, incentives for performance, and penalties for nonperformance
- Other requirements such as change management, disaster recovery, protection of intellectual property, rights regarding audits and site visits, asset ownership and management, and termination rights

This phase calls for an understanding of the linkage between outsourcing objectives and performance indicators. This includes defining Service Level Agreement (SLA) provisions as well as Key Performance Indicators (KPIs) to be documented in vendor contracts, along with incentives and penalties to motivate vendor performance. Articulating the required services and performance expectations during RFP development will position an organization to assess, build, and enhance the vendor management framework and processes.

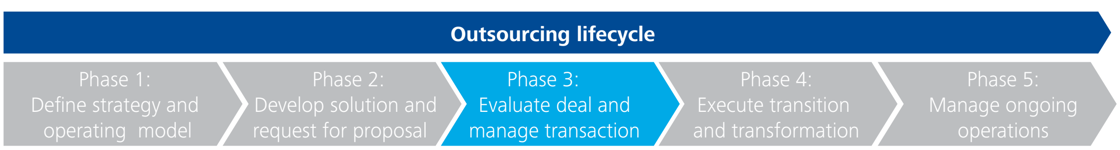
Risk factors to consider in this phase may include:

- Location risks, including risks of service concentration, as well as resourcing, country risk, and geopolitical considerations
- Staff recruitment, retention, performance improvement, and termination processes
- Governance processes and risk-reporting and risk-escalation capabilities, as well as risk response and business continuity and recovery planning
- Processes to monitor and report contract performance, including service levels and KPIs
- Potential for increased service costs, operational bottlenecks, and lost business due to inappropriate performance metrics or the absence of a vendor management framework

- Ability to scale and support new services based on market conditions and organizational needs
- Ability to manage regulatory compliance and reporting requirements
- Ability to evaluate, adopt, and implement new enabling technologies

This phase presents the opportunity to begin building a rigorous RFP evaluation process, which includes predefined evaluation criteria assessed by subject matter experts and key stakeholders. The evaluation process needs to extend beyond a "checklist" and allow for vendors who propose innovative alternative approaches.

Evaluations also need to extend beyond vendor capabilities under normal conditions to consider potential performance under stress or in crisis situations. For example, what are the vendors' capabilities for monitoring and managing risks proactively to prevent downtime, service deterioration, security breaches, and financial, reputational, and other losses, and to recover from natural or man-made disaster? Broad assessment of the vendors' capabilities under such conditions against those of your organization will give you a clear picture of their preparedness and resilience.



Phase 3: Evaluate deal and manage transaction

In this phase, the organization engages stakeholder groups to evaluate vendor proposals and choose a vendor based on predetermined criteria and weighting factors. This phase also focuses on transition planning and vendor governance model development — important factors in evaluating vendors.

Following solution development and proposal evaluation the organization will narrow the field of potential vendors, complete negotiations, and generate a final, signed contract that clearly articulates expectations, pricing, terms, conditions, incentives, and penalties, and supports a successful service transition. This process often becomes complex as vendor proposals typically respond not only to stated requirements but often include alternative solutions which play to the vendor's strengths.

As the field narrows to the finalist, the chief risk is that of selecting a suboptimal solution. Therefore, as tempting as it may be to fast-track the selection process, the urge should be resisted. Creative solutions may be overlooked. Also, be aware that stakeholders may skew the decision process, resulting in a delivery model that falls short of meeting all outsourcing goals, or that puts the entire business at risk.

An organization can help to mitigate the risks of this phase by employing an RFP evaluation process which includes predefined criteria and weighting factors identified by all stakeholders as essential to success. By aligning evaluation criteria with prioritized outsourcing objectives, the organization can recognize and manage the risks and craft a deal that meets all stakeholders' reasonable expectations. It is also essential to consider the full range of risks presented by vendors at this stage (see Figure 7).

In addition, it is sometimes prudent to conduct onsite, pre-contract visits to the service locations once finalists have been selected. These visits are often part of due diligence in vendor selection (as distinct from inspections undertaken to check progress on remediating activities required as a result of service breaches). Organizations often utilize third parties to conduct due diligence visits (and inspections) and factor the results into their risk mitigation plans. Those results can impact contract negotiations when visits identify risks that may require mitigation activities that generate additional costs.

In addition, reference checks to validate the vendor's track record, capabilities, values, reputation, and financial stability are essential to risk mitigation at this point. These checks are conducted among the vendors' clients to verify vendor qualifications claims and assess clients' experiences with the vendor.

This phase should also include preparation of a negotiating strategy that plays to the organization's strengths and

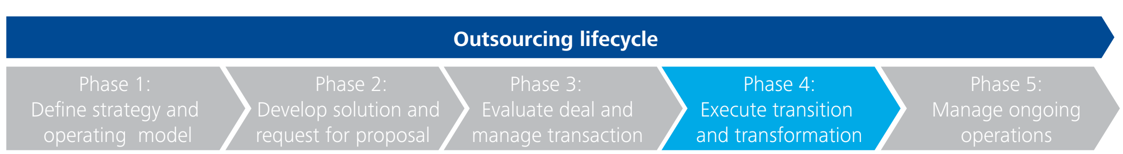
Figure 7: Potential risks related to vendors in outsourcing

Risk areas	Specific potential risks
Strategic risk	Vendor activities are inconsistent with the organization's strategic goals and business objectives, which may lead to financial, reputational, or other losses.
Reputational risk	Vendor or vendor activities pose the risk of negative public opinion due to poor customer service, fraud, or other factors, resulting in financial or reputational loss.
Compliance/Legal risk	Vendor fails to comply with all applicable laws, industry-related regulations and standards, or internal policies, or fails to provide adequate governance and oversight, placing the organization at risk of regulatory or legal action.
Transactional/Operational risk	Vendor competency and experience are inadequate to provide the required services at the expected levels and consistent with service level reporting requirements.
Credit risk	Vendor's inability to maintain good credit to support ongoing operations may result in financial loss and inability to support ongoing operations.
Financial stability risk	Vendor's ability to generate profits and to maintain adequate capital may be inadequate to support ongoing operations.
Data integrity risk	Vendor processes and technology are not aligned with the organization's operating and reporting needs, potentially resulting in business interruptions or adverse impact on service quality.
Confidentiality of information risk	Vendor lacks the necessary infrastructure, policies, or procedures to protect information and intellectual property from unauthorized access, modification, destruction, disclosure or misuse, potentially resulting in financial and reputational loss or legal or regulatory action.
Data/Security risk	Vendor lacks a tested plan to recover and resume critical business processes after an unplanned service interruption, potentially impacting service delivery and the viability of the outsourcing arrangement.
Contractual risk	Vendor is unable or unwilling to enforce terms and conditions of the outsourcing contract, creating barriers to meeting business needs and to fostering a true partnership.

precludes a long and costly process. As you develop your negotiating position, you can benefit by:

- Assembling an experienced team with clearly defined roles responsibilities, and communication protocols
- Identifying key issues that may bog down the process, and ways to address those issues
- Creating a competitive atmosphere by communicating, if true, that the organization is negotiating with two service providers

It is equally important in this phase to identify and understand the risks associated with the transition to the new service delivery model, as well as the organization's readiness for the transition. Transition requirements and options for addressing constraints are critical to establishing realistic timelines, cost estimates, and resource allocations. Proper planning and management will control transition risks and costs, and set the foundation for a productive post-transition relationship.



Phase 4: Execute transition and transformation

In this phase, the organization designs and executes a transition plan that ensures orderly migration of service delivery to the vendor, while maintaining performance of the processes that the organization retains.

The plan should detail all steps, handoffs, responsibilities, and accountabilities required to migrate designated operational and reporting responsibilities from the current "as is" service delivery model to the target model. Lack of a formal transition plan undermines knowledge transfer, change management, and problem resolution — all critical to an orderly transition. The effectiveness of the migration is directly related the scope, detail, realism, and practicality of the transition plan. A useful plan integrates the organization's and the vendor's workstreams, activities, resource allocations, milestones, and deliverables.

To coordinate the transition, an effective plan will:

- Focus on the "steady state" agreed upon in the vendor contract
- Address both the organization's and the vendor's transition activities, schedule, and resources through a single project management methodology and project management office
- Provide stakeholders with visibility into and responsibility and accountability for specific tasks
- Facilitate the necessary integration of functional teams within both organizations

Transition planning extends beyond assigning individuals to specific tasks. It includes identifying the required support throughout the process and establishing a robust Transition Management Office (TMO) to lead and govern the transition to steady state. As part of the overall Vendor Management Program Office (discussed in Phase 5), the TMO works closely with the vendor's transition management team to jointly coordinate all activities and resources (see Figure 8), and provide guidance regarding:

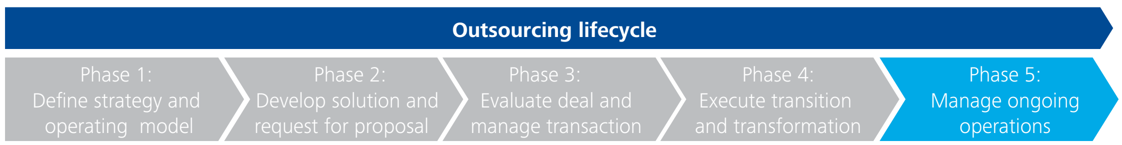
- Quality criteria for deliverables
- Knowledge transfer
- Issues and risk escalation and management
- Joint problem-resolution teams
- Transition communications
- Transition cost management
- Readiness criteria for "go-live"

During this phase, the organization and vendor should jointly plan and conduct Post Contract Verification (PCV) to validate and refresh the critical solution assumptions. The PCV scope should cover the following areas:

- **Functional** — Process and work instruction documentation, full time equivalent (FTE) breakdown, locations, transaction volume, performance metrics, training needs, role and shift requirements, service delivery costs, business continuity requirements, and third-party contracts
- **Human Resource (HR)** — Applicable HR policies and regulations, change management and communication requirements, and talent acquisition and retention expectations
- **Technology and connectivity** — In-scope IT infrastructure, systems, applications, licenses, tools, and ownership as well as connectivity and user-access requirements
- **Security and compliance** — Data security and privacy policies and regulations, infrastructure and personnel security standards, and internal and external compliance and audit requirements
- **Governance** — Governance model and VMPO structure, and key governance processes and controls

A rigorous PVC effort in this phase helps set the right expectations and tone for management of the relationship going forward.

Figure 8: Transition management office responsibilities



Phase 5: Manage ongoing operations

The “steady state” following the transition is not the final end state. Managing the ongoing operations and risks requires focusing not only on current business objectives but also on continually transforming processes to take advantage of new opportunities and innovations. Toward those ends, in this phase the organization institutionalizes a structured, responsive joint governance model and a robust VMPO to align priorities, resolve issues, track, manage, and report risks, improve performance, and drive value creation beyond service delivery (see Figure 9). A strong VMPO constitutes a structured, formalized, highly skilled team whose purpose is to bring process discipline to strategic outsourcing programs.

A VMPO with appropriate resources, tools, and funding — and a governance model that identifies and manages risks — represents a sound investment. In this context, effective governance is based on a structure that integrates management of multiple service providers and implements controls for changes, approvals, and reporting mechanisms

Figure 9: Core functions of Vendor Management Program Office (VMPO)

Contract management	Multiservice provider integration
Issue and dispute management	Transition and transformation PMO and oversight
Service performance management	Document management
Governance	Service request management
Financial and commercial management	Risk management and third-party compliance

for issue escalation and resolution. (For more information on the VMPO, visit Deloitte.com and access the document, “The Vendor Management Program Office (VMPO): Five Deadly Sins of Vendor Management.”)

In general, an effective governance model applicable to vendors in outsourcing relationships will:

- Define governance processes for ongoing service improvement, issue identification and resolution, and ongoing value creation
- Identify participants in governance and their respective roles and responsibilities throughout the organization and appropriate counterparts from all service providers
- Provide a tiered platform focusing on strategic, management, and operational issues

The VMPO should also focus on cost reduction, resource optimization, vendor performance and productivity improvement, and onsite inspections to verify SLA compliance, competence, and risk reduction. VMPO functions require adequate support and funding. Deloitte estimates that an organization can expect to spend between 1 percent and 7 percent of total outsource contract value to implement and operate a VMPO, with highly commoditized outsourced functions typically requiring funding at the lower end of that range.

Throughout this phase, consider the motto “Trust, but verify,” and take steps to document and ascertain actual vendor performance and compliance in light of contract terms. Many organizations increasingly use independent external partners to assess the effectiveness of their vendor contract risk and compliance (CRC) programs, and to test adherence to contract terms by individual vendors. Such external partners can provide expertise, experience, methods, access, and objectivity unavailable within the organization itself. These assessments occur within a formal program of setting objectives and measures of success, monitoring performance and risk, and establishing ownership and accountability for both the organization and the vendor.

Other goals and functions of an assessment program include:

- Clarifying ongoing business objectives, risks, controls, and benefits for each business partner
- Creating a common understanding of compliance and noncompliance with contracts
- Validating the accuracy of information provided by business partners, especially in the areas of service level reporting and invoicing
- Performing risk assessments and control reviews of business partners, which are required for regulatory compliance in certain industries

While specific activities and work performed in reviews by external parties will vary, the intent is to fully realize the value of outsourcing arrangements while managing the risks and maintaining regulatory compliance.

In sum, it would be useful to review the points in the accompanying outsourcing checklist (see Figure 10) to identify potential risk management gaps and other needs within the outsourcing lifecycle before continuing a planned or ongoing outsourcing initiative.

Figure 10: Outsourcing checklist

Phase 1: Define strategy and operating model	1. Articulate and prioritize outsourcing objectives, and align them to overall business strategy and target operating model 2. Understand the scope, requirements, and constraints early in the process to support the outsourcing strategy and key design decisions 3. Build a solid business case to provide a baseline for evaluating potential sourcing scenarios
Phase 2: Develop solution and request for proposal	1. Invest sufficient time and resources to build a comprehensive RFP document and process 2. Engage stakeholders with deep subject matter expertise and process knowledge to develop and review the RFP document 3. Build a rigorous RFP evaluation process which includes predefined evaluation criteria
Phase 3: Evaluate deal and manage transaction	1. Engage a well-qualified stakeholder group to objectively evaluate the vendor proposals based on agreed-upon criteria and weighting 2. Conduct reference checks to validate each finalist’s track-record, service delivery capabilities, values, and reputation 3. Assess risks through onsite due diligence visits to the service locations once finalists have been selected 4. Mobilize an experienced negotiation team with clearly defined roles, authorities, communication protocols, and escalation mechanisms
Phase 4: Execute transition and transformation	1. Develop a detailed transition plan to migrate the service operations to the target operating model 2. Establish a robust TMO as a part of the overall VMPO to lead and govern the transition to steady state 3. Work jointly with the vendor to conduct PCV to validate and refresh the critical solution assumptions
Phase 5: Manage ongoing operations	1. Develop and institutionalize a structured, responsive governance model to continuously align interests and jointly manage risks, enhance performance, and maximize value creation beyond service delivery 2. Create a strong VMPO that brings process disciplines to strategic outsourcing programs to reduce cost, improve productivity and overall performance, preserve savings, and manage risks 3. Create assessment programs for setting measures of success, and monitoring performance and risk 4. Conduct audits and onsite inspections to verify performance and compliance with contract provisions

Final thoughts

While many organizations have improved their outsourcing planning and management capabilities, increasingly complex outsourcing options, value expectations, and service integration and regulatory issues present new risks and challenges. Moreover, an intensified emphasis on internal controls and on data security and privacy are increasing liability exposure associated with third-party noncompliance. These risks, if not managed effectively, can lead to value leakage and adversely impact an organization's financial performance, operating model integrity, and reputation.

Therefore, we encourage you to thoroughly assess your organization's outsourcing governance model, operational policies and procedures, and transition, and vendor management capabilities as the first step in planning your organization's next outsourcing initiative or improving current relationships. An approach similar to the one presented in this paper can assist your organization in reducing its exposure to risk in each phase of the outsourcing lifecycle and in fully realizing the value of outsourcing programs.

Contacts

Ajay Bolina
Principal
Outsourcing Advisory Services
Deloitte Consulting LLP
+1 973 602 5635
abolina@deloitte.com

Aida Demneri
Director
Risk Services
Deloitte Netherlands
+1 212 436 4244
ademneri@deloitte.nl

David Hodgson
Partner
Global Leader of Enterprise
Risk Services for Life
Sciences and Healthcare
Deloitte & Touche LLP
+1 973 602 6869
dhodgson@deloitte.com

J Marc Mancher
Principal
National Outsourcing
Advisory Services Leader
Deloitte Consulting LLP
+1 312 486 0244
jmancher@deloitte.com

Steve Revesz
Senior Manager
Contract Risk
and Compliance
Deloitte & Touche LLP
+1 408 704 2044
srevesz@deloitte.com

Henry Ristuccia
Global Leader
Governance, Risk and
Compliance
DTTL
+1 212 436 4244
hristuccia@deloitte.com

Rishi Wahi
Senior Manager
Outsourcing Advisory
Services
Deloitte Consulting LLP
+1 714 913 1131
rwahi@deloitte.com

Dave Zechnich
Partner
Global Contract Risk and
Compliance Leader
Deloitte & Touche LLP
+1 408 704 4560
dzechinch@deloitte.com

Additional reference

- Outsourcing Today and Tomorrow: Insights from Deloitte's Global Outsourcing and Insourcing Survey
- The Outsourcing Vendor Management Program Office (VMPO): Art, Science, and the Power of Perseverance
- The Vendor Management Program Office (VMPO): Five Deadly Sins of Vendor Management
- The New Reality for Managing Supplier Risk - It's Harder Than You Think
- Beyond the Contract: Driving Value from the Renegotiation Process
- Avoiding the Ditch: Making an Effective Transition to Outsourcing
- Risk Intelligent Enterprise Management: Running the Risk Intelligent Enterprise
- Shaping a Risk Intelligent Strategy: Confronting Assumptions to Find Risk and Opportunity

You can request access to these publications by contacting any of the Deloitte representatives on the previous page.

[1] Throughout this paper, the word "outsourcing" refers specifically to business process and information technology (IT) services outsourcing, and excludes manufacturing operations outsourcing. Please refer to the Appendix for additional definitions.

[2] The Deloitte Consulting LP's 2012 Global Outsourcing and Insourcing Survey (2012 OAS Survey) had 111 respondents with median revenue between $1 billion and $5 billion. The respondents represent 22 primary industries located in 23 different countries across every major geographic region.

[3] Deloitte Consulting LP's survey, Outsourcing Vendor Management Program Office (VMPO): Art, science, and the power of perseverance (April 2011), included 27 senior executives respondents from various mid-size and large companies in eight primary industries headquartered in eight counties across the Americas, Asia, and Europe. The average value of the outsourcing programs being managed was approximately U.S. $400 million, with a total contract term of 6.8 years.

Appendix: Basic definitions

Outsourcing: The term "outsourcing" refers to the process of entering into a contract with an external service provider (or "vendor") to perform specific functions or processes, usually on an ongoing basis for the life of the contract. Typically, the vendors perform back-office or infrastructure functions related to:

- Information Technology Outsourcing (ITO) — cloud computing, data center, IT infrastructure, application development, maintenance, and testing, production support, etc.
- Business Process Outsourcing (BPO) — call centers, human resources, finance and accounting, procurement and supply chain, mortgage processing services, etc.

Relative to ordinary suppliers, service providers act more as business partners, often providing essential services within or on behalf of your organization, such as data management or customer service. They are, in effect, an extension of your company, an arrangement sometimes referred to as the "extended enterprise."

Outsourcing services can be performed onshore (within country), nearshore, or offshore. Most outsourcing service providers use a hybrid model which includes onshore, nearshore, and offshore resources to drive deep client relationships as well as significant savings through labor arbitrage.

Onshore (within country): Service is generally performed in the same country as the service is received or in a country where labor rates are generally consistent with those where the service is received (e.g., U.S.-to-U.S., U.S.-to-UK, Sweden-to-UK, etc.).

Nearshore: Service is generally performed in another country near where the service is received (usually within or close to the same time zone) and where labor rates are generally lower than those where the service is received (e.g. Mexico-to-U.S., Eastern Europe-to-UK, etc.)

Offshore: Service is generally performed in another country where labor rates are typically significantly lower than those where the service is received and there may be a significant difference in time zone (e.g., India-to-U.S., Philippines-to-UK, etc.)