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From Bangalore to Boston
The trend of bringing IT back in-house

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Introduction

The last two decades have seen a phenomenal rise in the outsourcing of Information Technology (IT) to external service providers. The driver for this trend has largely been economic, since outsourcers often offer more competitive price points for the same services at comparable service levels. Beyond cost savings, companies also use outsourcing to drive their IT strategy — the choice of focusing on core, strategic competencies and relying on a network of external service providers to perform less strategic functions. In recent years we have witnessed a small but growing reversal of this trend where companies that have previously outsourced functions are bringing them back in-house. This trend is generally referred to as "insourcing".

A full 48% of respondents in Deloitte's 2012 Global Outsourcing and Insourcing Survey[1] (The Survey) reported that they have terminated an outsourcing agreement early for cause or convenience. More importantly, 34% of those who terminated a contract for cause or convenience chose to bring the work back in-house. While the large majority of clients chose to move to a different service provider, it is worth noting that insourcing has become a viable option, particularly in the event that an outsourcing transaction did not meet expectations. In this paper we examine the insourcing trend, its drivers and discuss the opportunities and challenges associated with insourcing.

1 An executive summary of survey results is available at http://www.deloitte.com/view/en_US/us/Services/additional-services/Service-Delivery-Transformation/c78f7ebb3c356310VgnVCM2000001b56f00aRCRD.htm

Insourcing drivers

Improve customer service: Based on the results of The Survey, the single biggest driver for insourcing was the need to improve customer service and customer experience. This is particularly relevant when customer facing functions are outsourced and moved to offshore locations. Voice-based functions, such as call centers, come under direct scrutiny due to issues such as language, accent and contextual familiarity of the call center representatives. Such scrutiny can often lead to real or perceived concerns about the quality of service. These concerns are less severe for transaction-based processes and back office related IT processes/functions that don't directly touch the end customer. In The Survey, 100% of respondents who brought work back in-house indicated that improving customer service was a driver in their decision.

Improve controls: 77% of The Survey respondents indicated that a key factor for insourcing was to improve control on the functions that were previously outsourced. It is not uncommon for organizations to feel uncomfortable with a perceived loss of control when functions are decoupled from traditional IT organizations or moved to an output or performance based model. Organizations can overreach in their effort to outsource and include functions in the outsourcing scope that should, perhaps, be left in-house. IT Architecture, for example, is at the heart of an organization's IT policy and contributes to the organization's IT Strategy and roadmap. Outsourcing such a function can result in a perceived loss of control over the technology direction.

Other examples could be functional requirement definition, code development for critical systems, policy and procedures management and User Acceptance Testing (UAT). Depending on the client industry, regulatory constraints could also result in a need to improve internal control over certain processes or functions. As indicated earlier, much of the outsourced work is done in offshore locations. In some cases, recent regulations have mandated that certain types of data and certain functions be performed within the country where the organization's customers are located. The Health Insurance Portability and Accountability Act (HIPAA) is one such example. Other companies find compliance with certain standards, such as Payment Card Industry (PCI) data security standards to retard their ability to maintain successful outsourcing relationships.

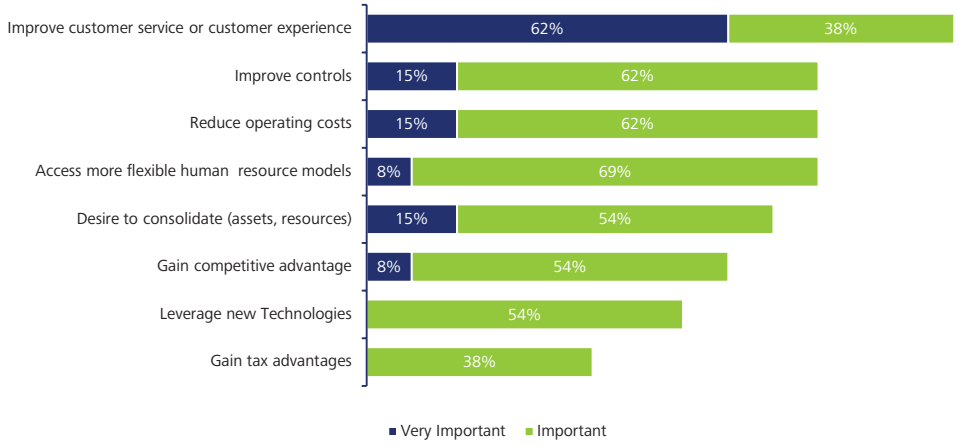
Cost reduction: It may seem counter-intuitive that 77% of respondents mentioned cost reduction as a driver for insourcing. After all, cost reduction can often be the main driver to outsource work. However, in some cases organizations may not be able to realize projected economic gains from their outsourcing program. This could be due to several factors, including:

- The need for additional internal quality control due to poor quality from the outsourcer
- An increase in true price of service delivery through scope "creep" and excessive change orders

Thus, when combined with some of the other factors mentioned above, if economic gains are less than expected, an organization may choose to bring some or all of the previously outsourced work back in-house.

Insourcing drivers (cont.)

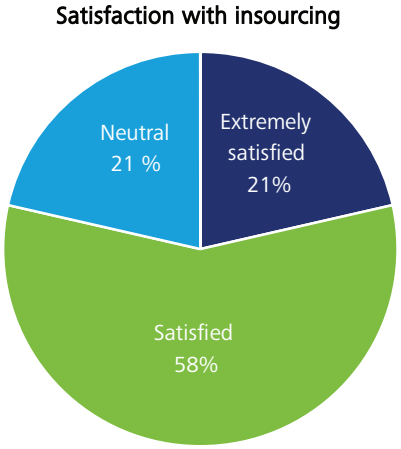
Figure 1: Drivers of insourcing in case of post contract termination — Deloitte's 2012 Global Outsourcing and Insourcing Survey



In addition to the three drivers discussed previously, other drivers can influence an insourcing decision. Notable among them is the desire to consolidate internal assets and resources, which can often reflect a shift in organizational philosophy from outsourcing to IT Shared Services (ITSS). Outsourcing decisions can be taken by individual business units or functions operating within silos or without a broader cross functional or enterprise perspective. In such cases, it may become apparent that from an integrated organizational view, it may be better to leverage certain assets or resources across various business units rather than outsourcing some functions or processes. IT testing is one example of where this can occur. A particular business unit may have outsourced its testing function as it did not have the scale economies to house such a function internally, but when combined with the testing requirements of other business units the organization may choose to build a Testing Center of Excellence (TCOE) to cater to such needs across all units.

In The Survey, 79% of respondents indicated that they were either satisfied or very satisfied with their insourcing program. In fact, none of The Survey respondents felt that the insourcing program was dissatisfactory.

Figure 2: Insourcing satisfaction post deal termination



There could be many reasons for the overwhelming satisfaction with insourcing. We surmise that given the organizational and financial costs of insourcing, an outsourcing deal may likely be in a state of serious disrepair to even contemplate insourcing. As such, The Survey respondents who insourced a deal after early termination for cause or convenience may have been pre-disposed to see the outcome of the insourcing as positive.

Challenges of moving to an insourced model

Although given the right situation the call to insource can be very compelling, there can also be several substantial challenges, including:

Sub-optimal knowledge transfer: In many outsourcing contracts, clients include a provision that allows them to hire the in-scope staff from the outsourcer particularly in the event that the outsourcing contract has been terminated for cause. Such a provision can greatly ease the reverse transition of the work back in-house. However, in the absence of such a provision, it may be difficult for the client organization to ramp up the required staff in order to be able to bring the work back in-house. It is this challenge that often precludes any insourcing movement, even if there are other compelling motives to do so.

The need to build internal capabilities: Particularly in cases where work has been outsourced for a significant period of time, the client organization no longer retains the capability to manage that work internally. Such capability includes service delivery management, tools & methodologies and technology. While knowledge transfer can be enabled through the transfer of in-scope staff, developing other capabilities, such as delivery management and technology can be a significant challenge.

Potential cost increase: It was discussed earlier that in some cases, projected economic gains from an outsourcing program may not be realized. However, in most cases outsourcing results in some level of cost efficiency. Thus, bringing work back in-house may result in a cost increase, at least in the initial years, as the client organization should make investments to make itself capable of managing the work.

Figure 3 outlines more information on whether a particular situation calls for insourcing or re-tendering. However, it is important to note that the first step of determining whether your outsourcing arrangement should be insourced or re-tendered is a thorough business case that takes into account the full set of costs associated with the change.

Figure 3: Considerations for Insourcing vs. Re-tendering

Considerations	Insource	Re-tender
Strategic nature of the outsourced work	• Outsourced work is a strategic differentiator for client • Vendor is causing a direct reputational risk to client	• Outsourced work is a commodity that is not providing a strategic advantage
Contract terms	• Have ability to solicit vendor employees • Low termination fees • Robust transition support clause • Ability to reduce the services gradually as work transitions • Favorable intellectual property (IP) clause	• High termination fees • Inability to reduce costs during transition • IP clause makes knowledge transfer difficult • Minimal contractual transition support
Supplier leverage	• Ability to influence vendor behavior during insourcing transition	• Transactional relationship; minimal leverage
Organizational readiness	• Resources exist or can be quickly procured to assume insourced functions	• Long resource procurement time and/or high specialty resources needed
Institutional knowledge	• Robust current state documentation, processes, procedures, job aids, and metrics	• Long resource procurement time and/or high specialty resources needed
Infrastructure	• Physical infrastructure for insourced functions exists or can be built quickly and cost effectively	• Supplier infrastructure footprint or cost structure hard to duplicate
Business case	• Given positions for other considerations, ROI in relation to re-tendering	• Given positions for other considerations, ROI in relation to insourcing

Selecting the right insourced organizational model

Once a decision has been made to insource an outsourced function, the right organizational model needs be to chosen to help ensure that the function can be successfully integrated back into the core business.

Figure 4 illustrates that the choice of the right model can depend largely on the driver behind the insourcing movement, as well as specific organizational characteristics and limitations.

Figure 4: Insourced organizational models

Insourcing Model	Description	Pros	Cons
Center of Excellence	• Each process is delivered by a "best in class" internal organization • Differ from Service Centers in that COEs tend to involve more knowledge-based work	• Retention of talent • Greater competitive advantage • Greater control over key processes	• Lower cost efficiency
Service Center	• Stand-alone (physically or organizationally) center that is developed, measured and governed to execute selected processes. • Service centers are generally used for transactional processes rather than knowledge-based processes	• Greater control over key processes • High cost efficiency • Better management of regulatory compliance	• Lower cost efficiency (although superior to COE)
Offshore Captive	• Captives are wholly owned Service Centers established in low-cost, offshore locations (typically outside of North America) with the intention of combining the performance, cost, labor pool benefits of offshore outsourcing while retaining operational control in-house	• Highest level of cost efficiency • High degree of scalability	• Data and IP protection issues • Limited control on regulatory compliance • Requires more coordination within the organization

Conclusion

Though insourcing is a small trend as compared to the global outsourcing juggernaut, given the maturity of the outsourcing industry we are seeing more and more clients wrestling with the question of whether an outsourcing deal that is not meeting expectations should be re-tendered or insourced.

Most clients still prefer to fix broken deals by either renegotiating with the incumbent provider or re-tendering the work. However, insourcing is also being considered a viable option when the business case and business drivers make sense.

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