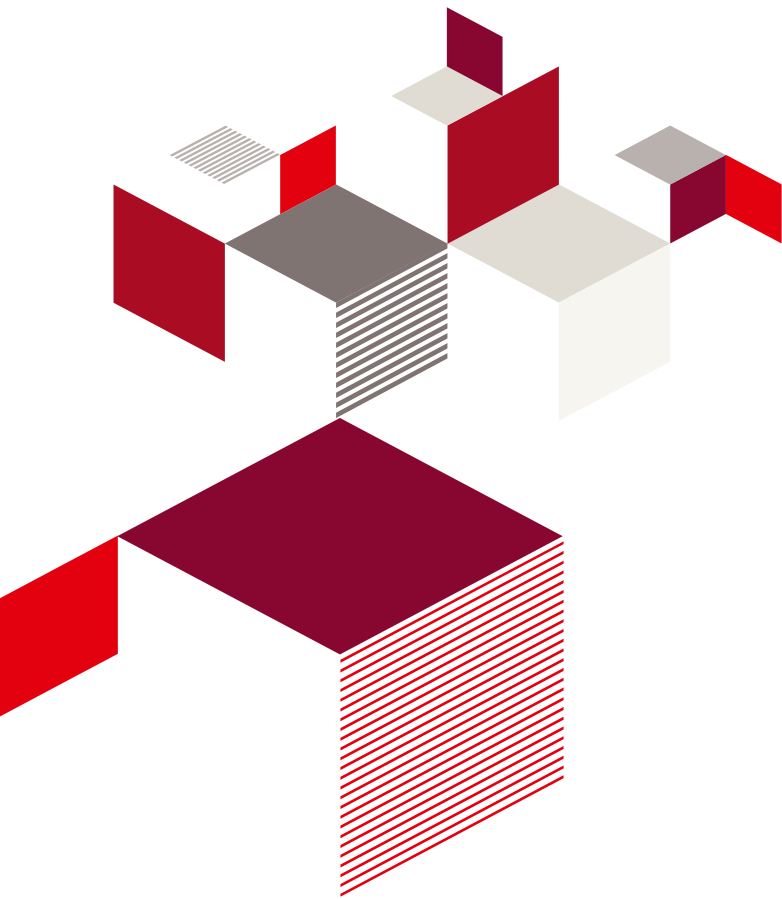




Insourcing –  
The end of the classic  
outsourcing deal

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# Executive Summary

Since IT outsourcing became a profitable business domain for the IT service industry, service providers tried to find ways to ensure long term profitability of their multi-year deals. In most cases growth was the answer. Clients on the other side had a hard time to manage unexpected demand shifts and increased resource consumptions in the context of rather inflexible sourcing contracts.

When the financial crisis hit the market in 2008 the trend towards consolidation and industrialization on the provider side accelerated. Today we are facing a service market that is not comparable to the one before 2008. New offerings are labelled “cloud services” (for infrastructures) and “as a service” (for software) and extend, if not replace, traditional sourcing models, that themselves gained a lot in terms of maturity and attractiveness.

But what to do with the existing large outsourcing deals that cover many different service types under one umbrella? These legacy deals are perceived to be “toxic” for both clients and providers because of their constraints (lack of vision/governance/shared vision, predictable bills). BearingPoint guided several clients and providers in their transformation of legacy deals and developed a structured transformation approach. In this approach turning from outsourcing to insourcing plays an important role, especially when combined with internal knowledge (know how, skills & expertise) with “as a service” and “cloud sourcing” of commodity services.

In our experience a legacy deal transformation, based on insourcing of core functions as key design element, can lead to significant performance improvements and a major mitigation of legacy deal risks.

## Definitions:

- *“IT outsourcing”*: contracting out of a business process to a third-party
- *“Insourcing”*: using an organization's own personnel or other resources to accomplish a task
- *“Cloud sourcing”*: an arrangement in which a company pays a cloud provider to carry out services that could be provided in-house. Although cloud sourcing is similar to outsourcing, the cost for cloud services is usually based on a per-use utility model instead of an annual or monthly contract.
- *“As a service”*: collective term said to stand for a number of things including “X as a service” (XaaS), “anything as a service” or “everything as a service.” The acronym refers to an increasing number of services that are delivered over the Internet rather than provided locally or on-site. Xara's is the essence of cloud computing.

## The situation in the sourcing market has changed significantly on both provider (sell) and client (buy) side.

### **The sourcing market has become increasingly attractive since the financial crisis 2008.**

The sourcing market has gone through a significant change since the 2008 financial crisis. Standardized market offerings have seen a huge rise in attractiveness, as is prominently shown in the increase in cloud-type services. Particularly for commodity services such as E-mail, collaboration, or (high-) computing power, such offerings are high on the agenda for all major providers and across industries. For example, in 2012 “SHELL” outsourced many of its hosting activities to Amazon; the multinational banking group “BBVA”, moved 10,000 employees in more than 26 countries to Google Apps.

The shift of IT services to external offshore sourcing models has been mainly driven by economical calculations, as per-unit prices for labour were (and are) significantly more competitive in such a setup compared to any other. While in the past this approach was often sufficient for being competitive, this will not be true in the future. Recent trends have shown that more and more companies realize that blindly outsourcing IT services is not the most efficient approach (but could be time consuming although Time To Market – TTM – is needed), but service packages should be evaluated individually to find the right sourcing mix. This is due to a variety of factors such as productivity differences, recent market changes, strategic value of some services. Considering such factors have led companies like General Motors or Daimler to bring back in-house large parts of IT service delivery. Santander and General Motors and Procter and Gamble brought back offshored work from India to onshore, and Sainsburys terminated an outsourcing contract with Accenture after 5 years of service.

Another trend we have witnessed in the last years is a shift from large outsourcing deals to a number of smaller individual transactions. This leads to a smaller average deal size, which is supported by the ISG Outsourcing Index that shows a decline in average contract value of outsourcing deals in the recent past.<sup>1</sup>

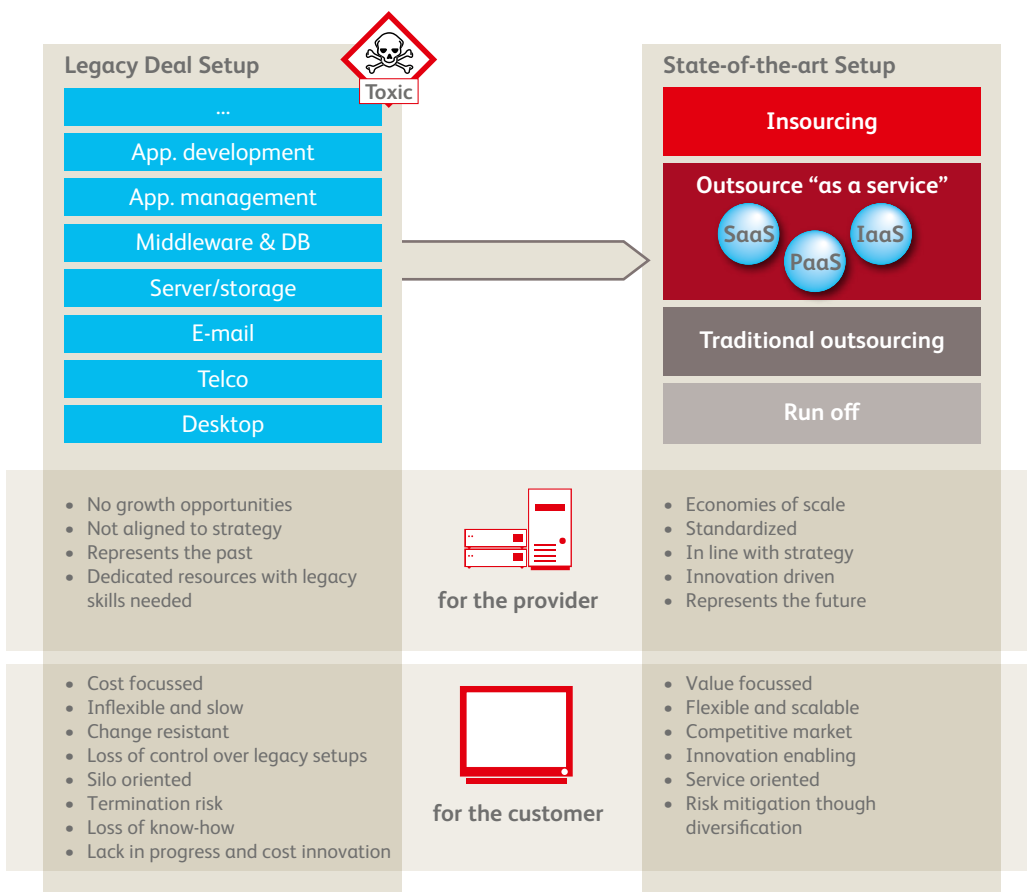
### **Companies and providers’ sourcing maturity increased**

With man-years of experience of outsourcing, transactions have become more mature and professional than ever. Many major corporations have already lost a lot of money with bad outsourcing deals or know of peers who have. It has become a commonly agreed necessity to either have a strong internal sourcing organisation or rely on external sourcing advisors to successfully deal with such large transactions. CIOs and their teams becomes a ‘solution architect’, designing solutions based on internal and external sourcing (people, applications, suppliers and infrastructures, in/near/off-shore).

Highly complex, yet attractive pricing models, such as “as a service” pricing, are more prominent on the market. Cloud delivery models for commodity services (e.g. E-mail, collaboration) provide much higher potential economies of scale and predictable bills. This changes the outsourcing game significantly as studies show that cloud based services will take over a significant portion of the currently outsourced business. Another indicator for the advance of such services is the fact that it is high on the agenda of

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<sup>1</sup> 1Q14 Outsourcing Index shows that the Trailing 12 Months 2Q13 – 2Q14 is the lowest since 2009



all major providers, which becomes evident looking at the huge industry-wide investments into infrastructure for the delivery of cloud services. Such pricing models (per user, per usage), however, require an advanced provisioning process/organisation and an integrated performance management.

While a few years ago, an established multi-provider management gave corporations a competitive edge; this is now a standard setup in most industries. For the successful integration of various different sourcing models, multi-provider management is a prerequisite. We are therefore witnessing an increased use of a mix of in-house and outsourcing delivery models. Clients, more than ever, need to have an in-depth understanding of sourcing as a core discipline or they are highly dependent on external sourcing advisors to manage the sourcing transaction risk and to ensure positive business cases. It remains to say that the degree of sourcing maturity is industry – as well as firm – specific and therefore there are still large corporations out there that have insufficient in-house sourcing capabilities.

## The new market situation is attractive for leveraging new sourcing models

The combination of a shift in market offerings and an increased sourcing maturity leads to an interesting improvement potential in transforming existing large outsourcing deals. In order to benefit from this potential an evaluation of all options is advised. We generally differentiate three approaches:

### 1. Renegotiate

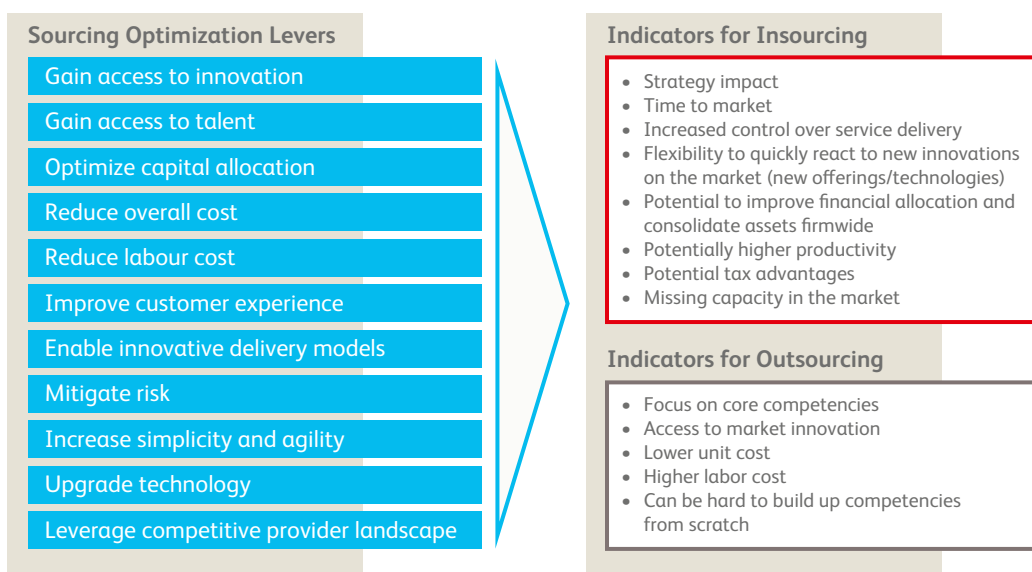
Renegotiation is the prolongation of an existing outsourcing deal with the same provider and largely the same services. In such a setup, it often proves difficult to modernize the deal regarding contract setup and service packaging. Nevertheless, studies have shown that 85 out of 100 outsourcing deals are given to the same provider upon renewal. While in some cases this may be the right thing to do because of sharing a long term vision, allowing both entities to transform each other securely, in most cases this means ignoring a significant savings potential, avoiding new suppliers or more effective COTS (Commercial Off the Shelf).

### 2. Insource

Insourcing means going back to internal delivery of once externally provisioned services. Often confused, insourcing does not automatically mean a local service delivery, as insourcing can be done in an off- or near shore location too. Insourcing has only lately come to the public attention as General Motors in 2012 announced to insource a comprehensive part of their IT services. Other companies have followed, such as the Swiss BCV who insourced their core banking operations. In France, for example Bouygues Telecom created in the late 2000's a near shore development department in Nantes so as to insource main competences and knowledge around its core IT systems such as its core network provisioning, SOA/BPM tools.

### 3. Retender (Xaas or traditional outsourcing)

As an alternative to renegotiation, retendering services allows to repackage them and optimize by using alternative delivery models such as cloud sourcing. Retendering and transitioning is always accompanied by a larger up-front investment to fund the whole process. It also requires planning ahead considering the most likely longer time required for evaluation and transition (mainly of acquired knowledge).

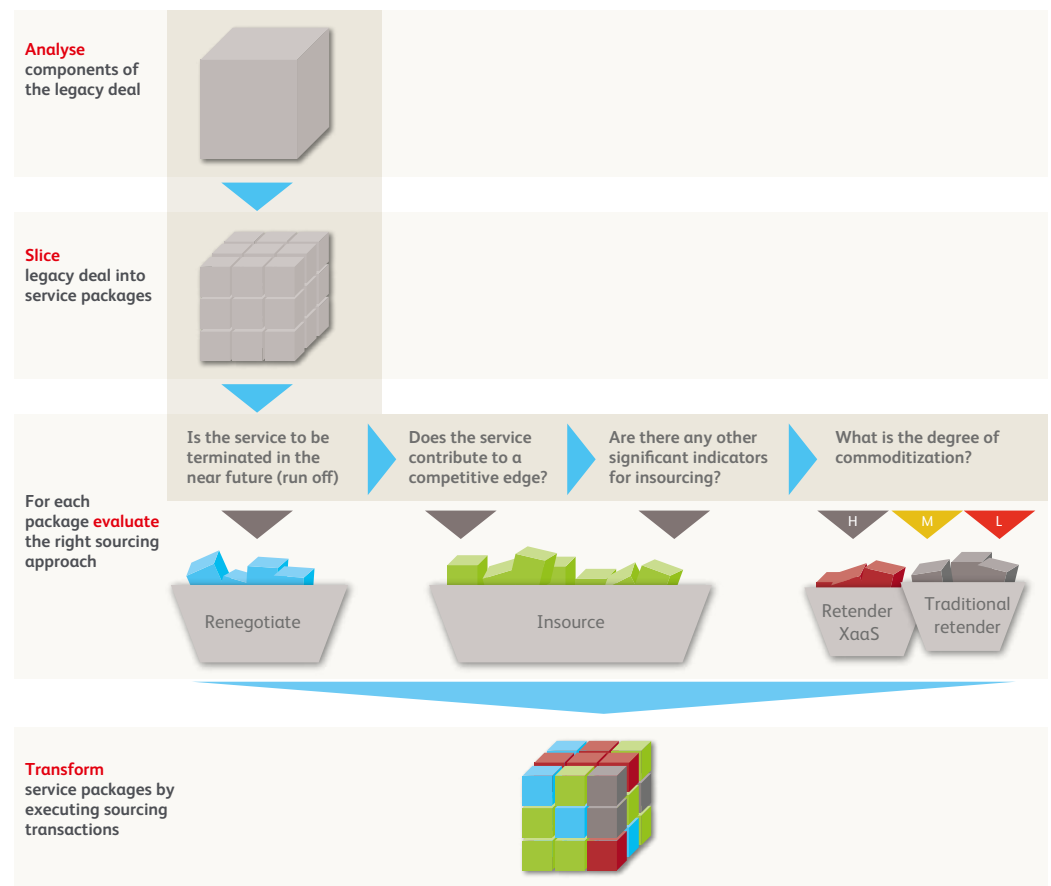


In a large outsourcing setup it is unlikely for all service packages to fall into the same category. Therefore, we suggest an individual analysis and approach based on service packages. This approach of slicing the existing deal into service packages and deciding the right way of sourcing for each package individually and in correlation to the other packages is sometimes referred to as “right sourcing”.

## BearingPoint suggests dividing the legacy deal into service packages and deciding the “right sourcing” approach individually.

Large outsourcing deals contain various different services with different properties and options. The maturity and granularity of today’s service offerings allows companies to optimize such deals by allowing different sourcing models. With the rise of cloud services, covering a large part of the IT service portfolio, it has become necessary for every large corporation to consider this option for their IT commodity services.

**FIGURE 1: DECISION TREE FOR “RIGHT SOURCING”**





Latest 1, better 2 years, before the expiration of an outsourcing deal, or any time in the event of pain points, it is advised to analyse the market for potential optimizations. Big outsourcing deals have to be evaluated on a service package level to which the whole deal has to be broken down. Similar services are then bundled and sourced together to achieve optimal efficiency.

For large deals, we recommend a combination of the 3 approaches in most cases:

**1. Renegotiate remaining part of old contract, switch pricing models (“run off”)**

In contrast to the common practise it is often not optimal to renegotiate the existing deal with the same provider. However, in case of “run off” services, which are planned to be downsized or terminated it is usually advisable to renegotiate and agree on a different pricing model. An example for such a service is the operations of a dying content management platform. Such “run off” services can often be quite expensive, especially if very specific legacy skill sets are needed for the delivery. Common laws of demand and supply typically increase the cost for not commonly available skills. In renegotiation scenarios it is worthwhile to consider a new pricing model, which also gives you the advantage of being able to benchmark the pricing to the current market conditions.

**2. Insource services with a strategic impact**

Non-commodity services that directly or indirectly drive a competitive advantage on the market should be considered for insourcing. This means that the service delivery capabilities will be built up within the organization either through trying to bring the existing provider team on board or by building up the capabilities from the market. Many cases of failed outsourcing were caused by mistakenly giving up a crucial part of competencies to the provider. A costly mistake! If such cases are identified and approached early, business risk can be mitigated.

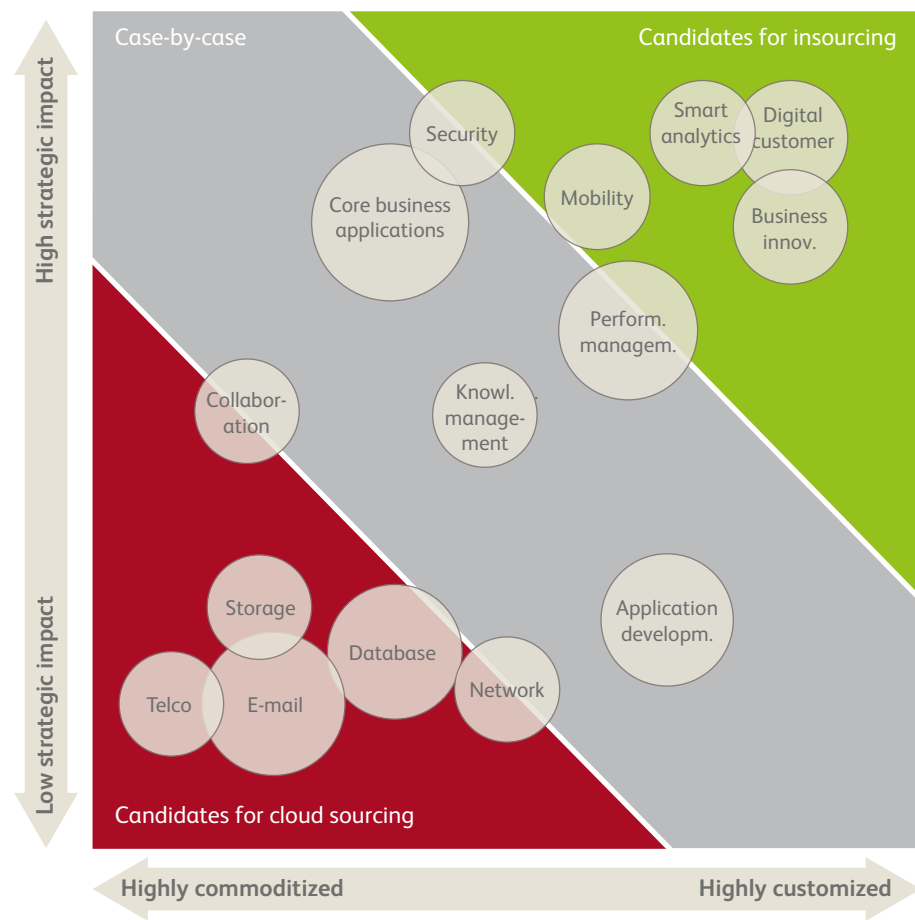
Insourcing of services often significantly improves alignment with business demand and enhances control over services, as well as the flexibility to react to new trends in technology.

**Retender commodity services to new contract or new provider**

For service packages under a growing concern a new retendering process is usually the preferred way forward. Instead of renegotiating services, it is often advantageous to retender. This approach provides a much higher flexibility to repackage services and include new sourcing models such as cloud-based services. Decisions that have to be discussed in this case are many. Can the services be sourced out of a cloud? Do we need a private cloud or can we join a trusted or even public cloud? What is the pricing impact?

When this “right sourcing” approach is applied comprehensively – not only isolated per package but considering dependencies and synergies – this approach allows the implementation of a sourcing mix best tailored to the business needs and risks. Figure 2 shows common service packages evaluated on two of the major criteria for evaluating the validity of applying an insourcing or XaaS approach.

**FIGURE 2: OPTIMIZATION MATRIX FOR SERVICE PACKAGES**



Size of circles: Optimization potential in %

# Insourcing challenges and how to deal with them

## Rebuilding internal capabilities

A key challenge for insourcing is to rebuild internal capabilities. You can either reintegrate a part of the service provider organisation or build up capabilities from the market (hiring). Unfortunately insourcing is most attractive in core business areas or in non-commodity areas, which often coincides with especially scarce capabilities in the human resource market. However, newly insourced setups are highly attractive for experienced and highly skilled IT experts. Considerations on how to build internal capabilities have to be a crucial factor in any insourcing discussion.

## Productivity factor

Productivity factors can render insourcing economically more attractive than outsourcing. Even though labour unit cost is likely to be higher in an insourcing setup, productivity factors have to be calculated in.

To be able to enter the core discussion on productivity you need to:

1. have a lean and effective performance management framework in place
2. focus on how to get better, instead of benchmarking with peers

Productivity is one of the key factors to be considered for insourcing. Our experience and market insights show that productivity in offshore facilities can be up to a factor 5 lower than onsite, that allows to consider any near shore configurations.

## Time factor

Experience shows that the transformation of an existing “large legacy deal” into a state-of-the-art setup typically takes 1-2 years. It is therefore crucial to start evaluating new sourcing options for such deals with enough lead-time before the lifecycle end of the deal. A tight time frame often inhibits the most efficient setup, as the required lapse time for retendering, transition to a new provider, or building in-house capabilities can be time consuming.

## Digitalization factor

Digitalization has increased interaction between companies and its clients as well as employees, therefore we have to challenge some old fashioned beliefs from the 2000's facing today's “Digital End User” driven market. So that, companies have to adapt themselves, to become agile, flexible, elastic, ... They have also to question themselves :

- What about the internal added value to maintain a core business system (often complex) when complex regulatory rules are to be implemented rapidly (core banking systems, payroll or HR systems ...)?
- What about the ability of an organization to learn, absorb/manage a (very) short life cycle development system, so as to be able answer a Time To Market (TTM) in e-commerce environment, when it becomes critical?
- What about new markets becoming more and more agile? Often driven by its end-users asking for services offered at work at least equal to those they have in the private sphere
- What about the ability of a supplier to provide and retain expert resources on critical knowledge (development of IOS/Android, Tuxedo, X25) while the buyer could be able to.

## Conclusion: Insourcing options are attractive, but often not considered

The evaluation of sourcing options has to be based on complex multidimensional criteria such as business and IT strategy, the current and anticipated future market offerings, internal sourcing maturity and cost cases.

The process of splitting a legacy deal and implement a “right-sourcing” approach for each package and its dependencies, is crucial for the future success of both IT and business organizations. Both major movements – insourcing and outsourcing – must be used in the present day. On the one hand, the company itself, leveraging its in/near/off-shore resources, should manage critical environments and ‘core business systems’. On the other hand, organisations and systems with no added value or necessitating elasticity (variable capacity to adapt busy periods) throughout the year can be easily outsourced and managed “as a service”.

Companies that are facing the transition of a legacy deal have to consider insourcing as an option for at least parts of the services. Particularly services having a direct impact on business strategy, its innovation, its core business, are often best delivered in-house. Even though there is common agreement on this point, we have witnessed only a small – even though growing – trend of bringing delivery back in-house. It is apparent that insourcing as an option is not consistently evaluated in sourcing decisions, which results in missed opportunities.

Only considering insourcing as an option in all critical sourcing decisions can allow companies to fully capitalize on the potential for an optimized strategy alignment. Failing to do so often means giving away a competitive edge all too easily.

It is easily understandable that “sourcing” is not as dualistic as it used to be. It has long become selective and as such of strategic importance for any CIO. It is already late to start adapting sourcing methods/contracts to the new market conditions. If not yet done, the time is now to get rid of your toxic legacy deals forever.

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## About BearingPoint

BearingPoint consultants understand that the world of business changes constantly and that the resulting complexities demand intelligent and adaptive solutions. Our clients, whether in commercial or financial industries or in government, experience real results when they work with us. We combine industry, operational and technology skills with relevant proprietary and other assets in order to tailor solutions for each client's individual challenges. This adaptive approach is at the heart of our culture and has led to long-standing relationships with many of the world's leading companies and organizations. Our 3350 people, together with our global consulting network serve clients in more than 70 countries and engage with them for measurable results and long-lasting success.

For more information, please visit: [www.bearingpoint.com](http://www.bearingpoint.com)

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