

“In the near future, with structural risks that

Negative articles are outpacing the positive.

- 30 percent more anti-outsourcing articles (55) than pro-outsourcing (42) ones were published in 2004.¹
 - For the first time, the number of anti-outsourcing articles has surpassed the number of pro-outsourcing articles in the six sampled publications.
- In a 2004 LexisNexis® search, occurrences of 13 stock phrases² denoting negative outsourcing sentiment exceeded all such occurrences in the last five years combined.

Calling a Change in
the Outsourcing Market
Faced with unflexibility,
rigidity, organizations are
insourcing activities to
regain control, negatively
impacting the market

Companies Are Concerned About Intellectual Property and Confidentiality Risks, Loss of Institutional Knowledge, and Loss of Control Over Outsourced Functions.

Outsourcing increases the risks of intellectual property violation and loss of confidentiality.

- 26 percent of the participants view intellectual property and confidentiality issues as leading risks of outsourcing.
 - Outsourcing IT infrastructure such as IT Systems Administration allows vendors to access confidential business information.
 - *“It’s important to keep intellectual capital close to the chest.”*
- 10 percent of the participants experienced confidentiality and intellectual property rights violations.
 - One participant discovered its vendor selling its proprietary software to other clients.
 - However this is a tough risk to mitigate: *“This is very troubling, and I have to constantly keep a watch on my vendors.”*

The risk of losing institutional knowledge is greater when outsourcing “thought leadership” functions and can be partially mitigated by outsourcing only commodity processes.

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Outsourcing Often Reduces Organizations' Responsiveness to Market Changes and Poses Internal Political, Organizational, and Cultural Challenges.

Multi-year contracts result in a loss of flexibility to react to market changes, hurting companies' competitiveness.

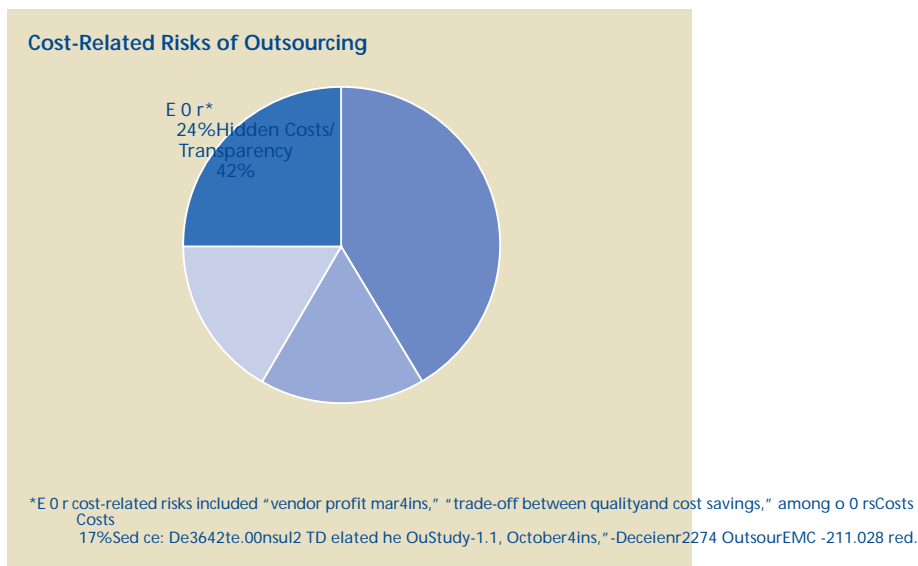
- 1 in 6 participants are concerned about the loss of flexibility to react to changes in the market (e.g., competitive, regulatory), as a result of being locked into multi-year deals.
 - Vendors push for long-term deals to recoup initial investments and make profits. When pressed to shorten deals, they provide shorter term deals, even though

Outsourcing, Which Originated as a Popular Cost-Saving Strategy During a Recessionary Economic Environment, Is Still Dominantly Driven by Cost-Related Objectives and the Perception that Organizations Benefit from Vendors' Economies of Scale.

Real-World Experience Suggest That the Potential for Cost Savings Has Been Overstated.

Organizations are becoming aware of cost-related risks. • 52 percent of participants ranked cost-related issues as the main risks of outsourcing.

- 42 percent of the cost-related risks correspond to hidden costs and/or transparency.
 - “Vendors give clients better deals until years three or four;



Participants Recognize the Need for Improvement in Decision-Making, but Attempts to Standardize the Business Case, Improve Due Diligence, and Increase Transparency Often Are Not Used for New Contracts or Are Too Late for Existing Contracts.

Vendor Complacency, Employee Turnover, Unsatisfactory Delivery Resources,



Services Outsourcing Has Evolved from Product Sourcing, but Fundamental Differences Have Been Overlooked and Are Coming to the Fore.

Measuring quality is standardized in product sourcing,
yet it is tricky in services outsourcing.

While 30 Percent of the Participants Have Encountered Normal Outsourcing Growing Pains, 70 Percent Have Had Significant Negative Experiences and Are Outsourcing with Increasing Caution and in a Conservative Manner.

However, Outsourcing Will Remain a Useful Solution Within the Conservative Context of These Five Models.

Centralized Sites Outsource

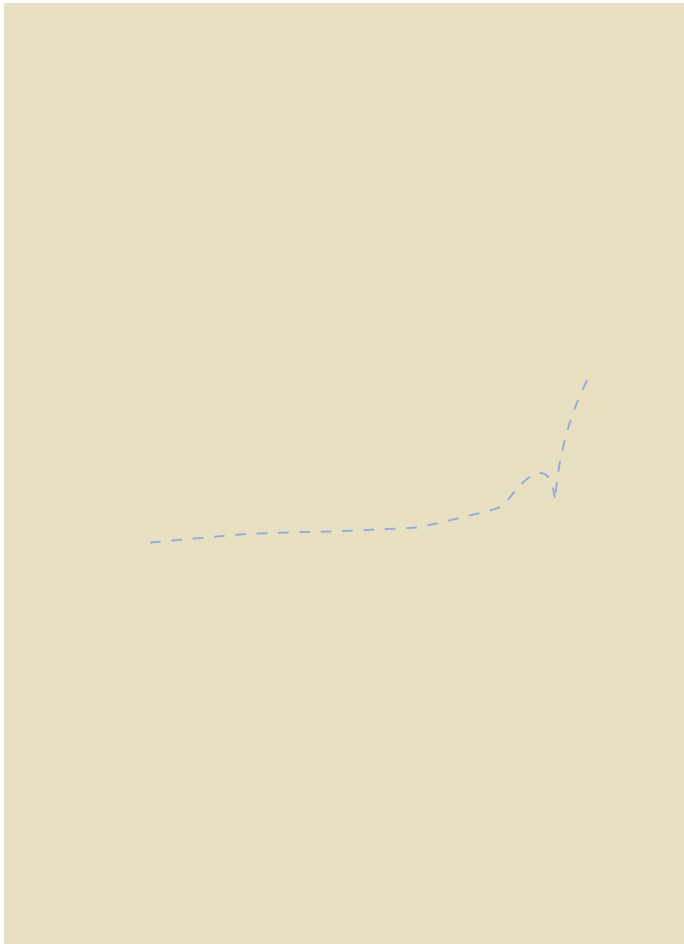
- Initially, organizations pursued processes that have become targeted for strategic and more differentiated standards (e.g., allowing the hosting and maintenance of servers internally and to gain detailed management insights into processes and costs).
 - Companies will outsource these types of functions to vendors that specialize in these areas. These vendors have the potential to manage and run these functions.
- Increased management insight into the functions enables organizations to spread the operational and financial risk for functions that they are less able to perform in-house, providing insurance-like protection rather than sharing them with the vendor.

Shifting Fixed Costs to Variable Costs

- Organizations employ vendors to transform a function and to run it for a short-term period.
- Transformations are often more easily achieved externally than internally; thus, the benefits outweigh short-term outsourcing costs.
- This model is relevant especially for companies in volatile/ fast-moving industries, where rapid changes and adjustments are required.



Appendix: Literature Sentiment Index



¹ Publications included *The Economist*, *The Wall Street*

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