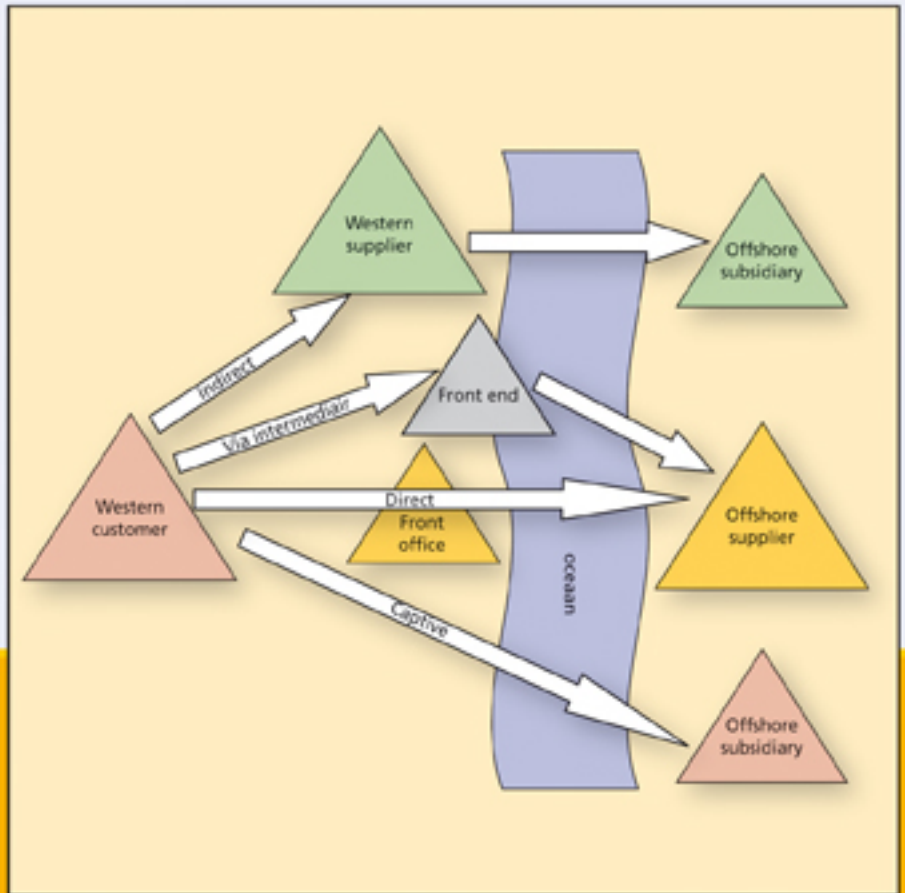


IT Outsourcing

An Introduction

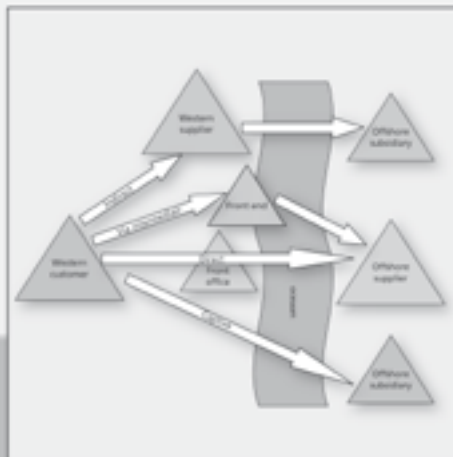


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IT Outsourcing

An Introduction

Guus Delen (editor)



Colophon

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Authors:	Dr Anja Dekhuijzen (DLA Piper) Dr Guus Delen (Hogeschool van Amsterdam, VKA) Dr Diana Hoogeveen (VKA) Mr Louis Jonker (Van Doorne advocaten) Mr Polo van der Putt (Lovells) Dr ing. Sicco-jan van der Meulen (Quint Wellington Redwood) Kees van Oosterhout (Hogeschool van Amsterdam) Mr Bart Straathof (Atos Origin) Dr Frank Winnubst (Atos Origin)
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Foreword by Daan Rijsenbrij

The main purpose of Platform Outsourcing Nederland, PON for short, is to bring about greater transparency with regard to outsourcing, offshoring, and the creation of Shared Services Centres.

A good outsourcing deal means that all parties involved, meaning the customers, the providers, the consultancy agencies and the lawyers, all reach, execute, and conclude an agreement together. It is important that these four essential groups communicate amongst each other when increased transparency through shared knowledge and standardisation are at hand. However, PON has included a fifth group consisting of the knowledge institutes, universities, and the HVEs (Higher Vocational Education) for the sake of 'accuracy'.

It is up to the knowledge institutes to convert the practical experiences into useable theories by applying scientific research. Yet, it is also the responsibility of these knowledge institutes to carry out these theories together with the practical experiences through education.

The PON aims not only for transparency, but also for professionalism. Seminars and conferences are organised with this in mind, but a variety of work groups also write reports and books. Recently, PON decided to start providing official training. The first course was entitled 'The Basics of Outsourcing'. Specialists from the PON membership with solid practical experience taught this course and Dr. Guus Delen coordinated it. This course provided a clear insight into the most important issues regarding outsourcing and we focused our attention on law and the personal and financial issues. The first course was so successful that PON decided to continue this course and to outsource it to the University of Amsterdam. A thorough course should always be accompanied by a clearly written handbook, which documents the essence of the topic. The book is the result of that effort. This book also serves as a very suitable refresher course for those who have already achieved an advanced level of outsourcing.

PON, in conjunction with the knowledge institutes, has meanwhile developed a broader range of courses. These consist of a minor insourcing at the University of Amsterdam and a Master's insourcing at the University of Utrecht. If you have an interest in any of these educational courses, send an e-mail to info@platformoutsourcing.nl.

In the event your institute or company is not yet a member of the PON, become a member now and help us make outsourcing, offshoring, and shared service centres a fully developed discipline. You can reach PON through this website: www.platformoutsourcing.nl.

Prof. dr. Daan Rijsenbrij
Zeist, October 2007
Chairman for Platform Outsourcing Nederland

Foreword by Emilie Randoe

The subject of sourcing has kept many Boardroom minds busy for years. Those, whose portfolio has included this subject at any given point in time, know that the question as to whether or not sourcing is a viable option is not an easy one to answer. First, many different variants exist in sourcing ranging from outtasking to outsourcing demand management. The supplier can be located not only in the Netherlands, but in Eastern Europe or Asia as well, and there are quite some legal complexities and emotional issues that also play a role here, as moving from one employer to another is often quite stressful for the employees involved.

Fortunately, there is good news for all those doubters in management; you now have this book. It explains all of the aspects involved in outsourcing in a clear and concise language.

The book is the product of the ‘Basics of Sourcing’ course, initiated in 2006 – 2007 by Guus Delen, the sourcing lecturer for the Institute for Computer Science at the University of Amsterdam, which is under the auspices of Platform Outsourcing Nederland (PON). The course was organised to provide managers with the latest knowledge and insights in the field of IT sourcing. We praise Delen for getting all of the lectures to incorporate their individual contributions to the course into a chapter of this book.

As director of the Institute for Computer Science at the University of Amsterdam, I am proud of this publication. It is also the fruit of the sourcing lectureship, and that alone provides a prime example of the necessity for lecturers at colleges.

I wish you much reading pleasure and wisdom when taking your decisions.

Emilie Randoe
Amsterdam, October 2007
Director of the Institute for Computer Science
University of Amsterdam

The authors

This book was written by experts from the trade and industry, who taught the first ‘Basics of Sourcing’ course in the spring of 2007. A short profile of each author is included below.

Anja Dekhuijzen



Anja Dekhuijzen is an IT and outsourcing partner at DLA Piper. DLA Piper is the largest law practice in the world, with both solid domestic and international TMC businesses. Anja specialises in advising clients in the field of outsourcing company processes, information technology, and the legal right aspects of software packages, E-commerce, and IT contracts. In doing so, she focuses on consulting larger clients in the IT sector, including the financial, insurance, and publishing worlds. In the European Chambers, Anja received a recommendation as a ‘leading individual’ (“Anja Dekhuijzen is a specialist in outsourcing”) and in the Legal 500 for 2007, (“Partner Anja Dekhuijzen has niche experience in the IT outsourcing field”). Anja also received a recommendation in the Chambers Global 2008: “Clients are full of praise for her entrepreneurial approach, which shows ‘she always has the business in mind’.” Anja frequently publishes articles about secondment and IT licences, and lectures regularly at conferences both in the Netherlands and abroad for the International Technology Law Association (Itechlaw) and AIJA.

Anja teaches IT law at the Grotius Academy. She is the co-author of two books about IT law relating to the issues of the millennium (1998) and e-commerce (2001). She has also written several articles on the risk factors of outsourcing and liabilities because of failed automation contracts.

Guus Delen



Guus Delen (1951) completed his studies for theoretical physics in 1975 at the University of Utrecht. He then remained employed at Capgemini software for 21 years and gathered experience on all aspects of system development: from information planning to the acceptance test. Delen published these experiences whilst serving as editor in chief of the SDM (System Development Methodology) series. He was also the internal auditor at Capgemini in charge of protecting the interests of all their projects. Delen worked for KPMG Consulting from 1996 to 2002, where he developed and supervised the development of IT outsourcing projects and provided extensive consulting services to clients striving for professionalism within their IT organisations.

As of 2003, Guus Delen is a partner at Verdonck, Klooster & Associates, where he now leads the Sourcing-consulting department. He consults clients who are looking to outsource their IT management and/or system development programs, and lately, this has come to include advice on offshore outsourcing. He also spent a week in India in 2005 to get a hands-on look at the offshore IT industry. That same year, Mr Delen graduated from the University of Amsterdam (UvA) with his dissertation entitled ‘*Decision and Control Factors for IT sourcing*’. Based on his ten years of consulting experience at KPMG and VKA, he created a system to monitor sourcing factors, which

enables one to make the right sourcing decisions and to base the entire sourcing process on this system. Since 2006, Dr Delen is part-time associate professor at the Amsterdam school of IT, which is a collaboration effort of the UvA and the HvA (University of Applied Sciences).

Diana Hoogeveen



Diana Hoogeveen (1970) studied administrative computer science at the Erasmus University in Rotterdam. She works as a senior consultant at VKA. Diana advises organisations on questions with regard to sourcing and on all kinds of economic and strategic questions involving IT investments. She graduated Erasmus University *cum laude* in 1997 with a dissertation entitled '*The long and winding road from IT investments to business performance*'. She developed the FIRM method with this dissertation, a method by which one can map out both the added value of IT and the factors that influence the actual realisation of this added value in an organisation. These different factors are clearly identified to enable implementation by management. Diana has advised several organisations on how to attain more added value from their total IT portfolio. She has also developed business cases for large-scale investment proposals.

Diana published a book on outsourcing in 1994 with Kluwer, a publisher specialising in business science. She has accompanied several government organisations through their decision taking process with regard to sourcing issues and the implementation of demand management.

Louis Jonker



Louis Jonker graduated from the University of Amsterdam (UvA) with a degree in Dutch law and a particular emphasis on intellectual copyright and new media. On completing his study in 2001, Louis went to work for IT specialist Oosterbaan & Van Eeghen, where he furthered his specialisation of IT related issues. In 2006, Louis joined the Van Doorne IT practice group. Louis provides legal advice for agreements regarding software licences and related services, and has specific experience consulting for multinationals listed on the stock market regarding their collaboration agreements worldwide. His activities also focus on consulting on a wide variety of outsourcing projects and in particular regarding the contractual aspects of these projects.

Louis is a member of the Dutch Association for Information Technology and Law (NVvIR). He was also actively involved with organising the biannual convention for the Federation of Computer Law Associations (IFCLA) held in Amsterdam in 2006.

Sicco-Jan van der Meulen



Sicco-Jan van der Meulen (1968) works at Quint Wellington Redwood presently, where he holds a position as Senior Consultant for outsourcing and production organisations. Van der Meulen focuses on complex assignments of a strong international nature and/or on sourcing in combination with merger and acquisition projects. Prior to starting employment at Quint Wellington Redwood, Van der Meulen worked at EDS in a variety of Delivery Executive functions. In doing so, he spearheaded key accounts in the Netherlands, Germany, and England, which also included managing the acquisition by

EDS of the Towers Perrin administration EMEA services. Van der Meulen started his career as an independent advisor. He ran projects in the field of organisational diversification in the Netherlands and Indonesia over a period of eight years, primarily in the energy sector. Van der Meulen graduated from the Radboud University in Nijmegen while attaining his Master's degree in business science. He is married, has two children and lives in Zwolle.

Kees van Oosterhout



After attaining his Bachelor's degree at the College of Education and having spent two years teaching at a special education school for children with (serious) learning problems, Kees van Oosterhout made the transition to ICT. In his 18 years of employment at Volmac/CapGemini, he evolved from a programmer to a program and change manager. After a short intermezzo as a partner with The Vision Web, he and two colleagues initiated Vigor Transitions, a network company primarily oriented towards creating agile organisations.

Kees van Oosterhout's expertise lies in the area of competence development, organisational change, and in providing training courses in these fields. One of Kees' main spearheads is the 'Valuation of Prior Learning' (VPL). Together with the ROC Nova College, Kees is one of the founders of the EVC Centre for Professional Education (www.evccentrumberoepsonderwijs.nl). Kees was appointed as a member of the VPL Special Interest Group for the VPL Centre of the HvA, and as a VPL project manager at the Institute of Computer Science. His involvement with Sourcing comes from a wide range of experiences with sourcing projects and by providing support to all parties willing to participate from within their individual core competences.

Polo van der Putt



Polo van der Putt (1972) studied law in Amsterdam. He started his career in 1996 as a lawyer for Lovells Advocaten, one of the largest lawyer firms in the world. As of 2009 he is partner at Vondst Advocaten. Polo van der Putt focuses on commercial law and on the IT market. He specialises in outsourcing and provides services to both clients and suppliers. He has been involved in a number of noteworthy BPOs in the financial market. He spends the majority of his time drafting and negotiating outsourcing, services, distribution, licensing, and other similar commercial contracts, which also includes supporting clients involved in disputes. Polo also provides advice regarding issues of privacy. Yet another segment of his business consists of e-commerce. Polo represents a number of European companies providing internet-betting services wanting to enter the Dutch market.

Polo published a book in 1996 on the subject of software distribution. He is the president of the Netherlands Association of Computer Lawyers (VIRA) and president of Platform Outsourcing Nederland (PON). Polo regularly gives presentations on a variety of juridical subjects.

Bart Straathof

Bart Straathof (1957) has been working in the IT and Telecommunication sectors for more than 25 years now. After completing his study of Higher Computer Science at the Higher Technical School in The Hague, he performed several functions in system and application programming, system and application management, and numerous management functions in both the telecom and IT industries. The (international) organisations where Bart worked provide air transport, financial support, public utilities, and IT services. The functions he performed were part of either client or supplier organisations.

Therefore Bart has experience as being both a client of an IT service company, or a supplier of IT services. He has worked together with many (international) service providers in his management functions.

These service providers took on the role of either a 'customer' or 'outsourcing partner'. He has managed a number of outsourcing projects from the get-go (from the proposed decision to outsourcing), to the actual execution on the client side and with that, also set up service/contract management departments to manage the contracted service providers.

He has worked at Atos Origin for a number of years now, where he provides interim management and program management assignments, intended (primarily) for (possible) outsourcing projects. He has been actively involved since day one with the team in charge of providing sourcing education at PON.

Frank Winnubst

Drs. F.T.W. (Frank) Winnubst (1957) graduated cum laude in Sociology from the University of Groningen in 1985. He studied the sociology of knowledge, philosophy, and took courses at the Science Studies Centre in Bath (UK) and the École Nationale Supérieure des Mines in Paris (France). He worked as the HR manager for corporate ISA at Philips in Eindhoven for five years and was director of the Joint Medical Store in Kampala (Uganda), a non-profit wholesaler in medicine and medical products. Afterwards, he became an independent consultant for Philips Communication & Processing Services and the Danish

Red Cross. At the end of the 1990s, he was a consultant to the Ethiopian Red Cross in Addis Ababa. After his excursions to Africa, Frank returned to his previous job at Philips and delved into the HR aspects of IT outsourcing, with particular emphasis on labour issues. He has worked at Atos Origin in the Netherlands since the late 1990s, and as the HR Director for outsourcing, is responsible for the transfer of employees related to sourcing projects. His work activities at Atos Origin are not limited only to the Netherlands, though his focus does lie there.

In his free time, Frank teaches sociology at the Gerlach Institute for Adult Education; for recreation, he rides his racing bike.

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1 Introduction

1.1 The target group

This book was written for students in their third year and up. It is intended for use in courses on Computer Science, Business Administration, Law, and Human Resource Management. This book can also be used as a best practice book for employees of organisations involved in IT outsourcing; these could be outsourcers, advisors, or IT service providers. We assume knowledge of the best practices for information management as established by the ITIL.

1.2 Reading guide

The book begins with general topics, such as the definitions of the various forms of sourcing and the sourcing lifecycle in chapter 2. We divided the remainder of the book along two lines: on the one hand is the sourcing lifecycle, dedicating a chapter for every phase of this issue, and on the other hand, the various disciplines involved in the sourcing process. Sourcing is primarily a multidisciplinary profession, whereby HR, managerial, and legal expertise are just as important and indispensable as the information management expertise. We mapped out the sourcing lifecycle in the matrix below in relation to several of the vertically listed disciplines. Table 1.1 indicates the sections where we discuss these combinations.

Table 1.1 Book layout

Phase/aspect	Decision taking	Supplier selection	Transition	Services	Contract termination
Managerial	3.1	4.1		6.1	Chapter 7
HR			5.1		Chapter 7
Legal		4.2/4.3	5.2		Chapter 7
Practice case	3.2	4.4	5.3	6.2	Chapter 7

Keep in mind that the boundaries are not as precise as table 1 might indicate. For instance, the legal work begins during the decision-taking process and is not limited to the drafting of a contract after the supplier has been selected. We placed all of this information in one location for readability purposes. This way every chapter remains independently readable. Furthermore, Atos Origin has made a real life practice case available to us that will accompany you throughout the book.

2 Framework

2.1 What is outsourcing?

The Platform Outsourcing Nederland (PON; 2006) defines outsourcing as follows:

The transfer of services, where if applicable, the accompanying employees and resources are transferred to a specialised service provider and consequently 2. the rendering back of those processes by that provider as services for the duration of the contract at an agreed-upon level of quality and a financial compensation structure.

This definition of outsourcing is applicable in a broad sense and applies not only to IT services, but also to management, catering, and cleaning services.

2.1.1 Forms of outsourcing

There are several forms of outsourcing. We will mention the most feasible ones here.

Co-sourcing & joint venture

There are certain companies where both the service provider and the customer have a stake in the matter. The purpose of these companies is to provide services. These can be provided uniquely to a customer, or if possible, to several customers. We call this enterprise a joint venture. In co-sourcing, the customer and the service provider set up a joint venture for a specific outsourcing project.

Global outsourcing

To customers, global outsourcing means outsourcing to one or more service providers in several countries. To service providers, global outsourcing means providing services in several countries.

Offshore/Nearshore/Onshore outsourcing

Outsourcing cannot always take place in the Netherlands (onshore). Service providers who provide quality services at reasonable rates and match well with the outsourcer to boot are rare and not readily found. Hence, these need to be located abroad from time to time. For example, a Dutch company could find an excellent partner in Poland (nearshore). However, if one is seeking the cheapest provider, then one's attention must be turned to a different sector, namely Asia. We will discuss this further in section 2.2.

Outtasking

The customer can decide to have a certain service performed by someone else without transferring the accompanying resources and people.

Transformational outsourcing (Transitional sourcing)

With transformational outsourcing, the outsourcing takes place with a particular goal in mind. This is done to raise the quality and development of the services significantly.

Greenfield offering

Greenfield offering has many similarities in comparison to those of regular outsourcing, yet it has the unique distinction of not requiring a transition, as the services have no external source. The customer buys the services and the service provider already has the required employees and resources in-house. The services are requested for a certain period and this is documented in a contract. This contract is then executed for the agreed-upon price, after which either an extension or termination of the contract takes place.

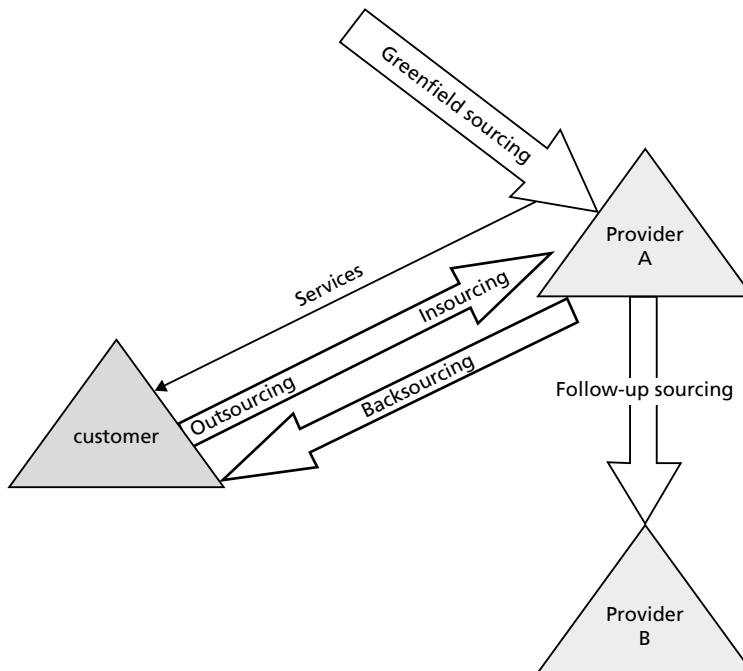


Figure 2.1 Different types of sourcing

As indicated in the above-mentioned definitions, a customer's contract can exist for a number of years. Once this contract expires, the customer can either extend it or request proposals from other suppliers with the hope that he might receive a better offer. In fact, through the public tender law of the European Union¹, the government requires this for the whole public sector. It could also mean that the current supplier (A) would have to transfer his services to another supplier (B). This creates a follow-up sourcing situation.

This situation distinguishes itself with two issues related to a first-time outsourcing: (1) provider B does not reciprocate with services to A, but to the organisation that outsourced to A at the time and (2) providers rarely transfer personnel and resources to one another, as they consider themselves competitors.

¹ Public authorities are obligated to make every contract of € 137,000 or more a public tender. They must post a request for a quotation on the EU website and every offer they receive from one of the EU countries must be taken into consideration. They are obliged to award the contract to the supplier whose proposal complies best with the initially established criteria, and the authorities must be able to justify this decision to the other suppliers.

We define follow-up sourcing as:

Follow-up sourcing is:

1. The transfer of certain services from one service provider to another and consequently;
2. The continuation of these services from that other supplier to the original supplier, based on the condition that those results are satisfactory.

Upon termination of the contract, a customer can also decide to return the services in-house. The original customer sees this as insourcing (and outsourcing for the supplier), but in order to avoid confusion surrounding a term such as ‘insourcing’, PON acknowledges Kern & Willcocks (1999), who call this *backsourcing*. The transfer of personnel or resources is usually no longer an issue when backsourcing. Besides, why should a rejected supplier relinquish materials, and what specialised personnel would feel challenged to return to fulfilling just a supporting role in an ‘ordinary’ organisation? If we were to abstract the term backsourcing from previous history, the situation where an organisation returns services that were always provided by an exterior party in-house could also be considered backsourcing. We can therefore define this backsourcing as:

Backsourcing (returning in-house) is:

1. The acquiring of company resources required to carry out certain company processes, which up until a certain point were supplied by an external party and;
2. The supplying of one’s own company processes as services to one’s own organisation.

At a higher level of abstraction, we could say that in the case of outsourcing and insourcing, the provider and the receiver of services are separated and wind up in separate organisations, as opposed to backsourcing, where they return to being together again in one organisation.

2.1.2 Shared Services

In larger companies, many of the advantages pursued by outsourcing can also be achieved without transferring something to an external party. By bringing together a number of departments that perform the same processes within an organisation, one can achieve an increased return to scale and save costs. This also applies to the back-office processes. We call this new type of department a Shared Service Centre (SSC). Strikwerda (2003) provides the following definition:

An SSC is the entity within the internal organisation of a company that is responsible for providing specific services to the operational entities of that company based on an agreed upon standard price.

When we put all of these aspects together, we arrive at the following definition for establishing an SSC:

The organisation of a Shared Service Centre is:

1. The transfer of certain company processes and accompanying resources to a newly initiated department (the SSC) within the organisation and consequently:
2. The return of those processes as services over an undetermined period from that SSC based on a results obligation.

One could consider establishing an SSC as outsourcing within one's own organisation, or *internal outsourcing*. Once the organisation also takes advantage of the opportunity to allow the SSC to operate according to the new regulations using the new resources, it can also achieve a quality check. The former departments then relinquish the personal and material resources, allowing for operations that are more selective: (1) allow the employees to apply for functions in the SSC and accept only those employees who qualify for the positions available and (2) only take over the resources that fit within the desired architecture. Once the SSC is operating properly, the organisation can either privatise it or sell it, if so desired. In the case of privatisation, the former parent company is usually required to purchase a certain volume of services for a number of years; while on the other hand, the SSC also provides services on the free market.

Example

A good example of this state of affairs is the Dutch Government Computer Centre (RCC), established in the 1960s as part of efforts by the Home Department, to manage computer centres for the central government. This RCC was privatised later on and after a number of mergers (Pink Elephant being one of them), grew to one of the top five IT service providers on the Dutch market under the name Getronics PinkRocade.

In essence, the final situation after privatisation of an SSC is one where it becomes identical to that of outsourcing. The SSC can also be sold directly to an external supplier. In the last two cases, the same result was achieved through one or two intermediate steps as is also possible with *outsourcing*. Another possibility is to position the SSC within a joint venture using a supplier. Outsourcing is almost achieved here as well, but a fallback option is retained in the event that expectations are not met. All these strategies do cost more time, but make the entire project and the process of change much more controllable, as opposed to one-step outsourcing. Moreover, shared services are just as old as large organisations; this was called *centralisation in earlier times*. A perfect example of an SSC before the term actually existed is the CommonAdministration Office (the Dutch GAK) of the industrial insurance boards for the social administration services that have been in existence since 1954.

SSC start-ups have increased enormously over the last years in the Netherlands, especially for the Information, Personal, and Financial (IPF) processes that support organisations. We can observe this tendency in both the business world and the government; Strikwerda (2003) names at least 100 cases.

Some examples are:

- The DTO (Defence Telematica Organisation)
- The HRM departments of the ministries all merged into one Shared Service Centre. (A cabinet decision made on 4 July 2003). This SSC is now called P-direct.

- The IPF-functions for all prisons and juvenile detention centres of the Dienst Justitiële Inrichtingen (the Dutch correctional system) in the cluster (region) of Utrecht joined forces. This started as a pilot in 2002, to be followed up by the other clusters later on).
- I-Bridge, Randstad's automation company.
- Achmea Active, Achmea's automation company.
- All 25 of the regional police force IT departments in the Netherlands, including those of the National Police Services Agency, merged into six regional centres under the ISC (Information Service Cooperation) of the police force. This operation took several years to complete and was finalised in 2003.
- The ISZF (ICT Collaboration of Southwest Friesland) established on 1 January 2004 by six Frisian communities in the Bolsward area.

2.2 Domains of IT sourcing

Up to this point, this chapter discussed the sourcing of processes in general. From here on we are going to focus on IT services (IT sourcing). We can identify the domains of IT sourcing by using the nine-field-model developed by Rick Maes (Maes, 1993), in which the dimension 'branch-specific' is illustrated horizontally against the 'IT-specific' knowledge, and the follow-up, *focus, organisation and execution, is illustrated vertically*. The result is figure 2.2; here we provide an indication as to which of the IT processes qualify for outsourcing.

The IT processes that qualify for sourcing are those that require a great deal of IT expertise yet require little branch expertise. These are the processes on the right hand of the illustration. Furthermore, considering the nature and frequency of operational processes, these will most likely develop into a commodity instead of a tactical or strategic process. Finally, the following colouring of the illustration occurs from bottom right to top left:

- Management of hardware and software (servers, workplaces, LAN WAN), has reached a high level of standardisation and has developed into a commodity. Offshoring starts to develop because of the ever-increasing competitiveness in price.
- Both the operational ITIL processes and the management of standard applications and/or packages take on commodity characteristics.
- A supplier can no longer offer a better rate than can the customer for the management of custom applications, as this pricing advantage is only obtainable by offshore sourcing.
- The market for strategic ITIL processes (Service Level Management and the like) is still developing. These processes are occasionally included in the outsourcing process, but the results are often less significant than when outsourcing operational processes.
- IT management and planning are rarely outsourced. Even though IT suppliers often talk about partnerships, it seems that the primary focus is on organising their own operational services in such a manner as to ensure that their costs are covered. Because of this, they barely get around to proactive strategic management, let alone IT strategy and planning on behalf of their clients.
- The operational processes of functional management are also outsourced occasionally, but due to a high percentage of branch expertise and the embedding of the company processes, we have a tendency to view this as Business Process Outsourcing rather than IT outsourcing. The bulk of the outsourced IT services and the most competitive pricing amongst providers are found in the three commodity domains, bottom right in figure 2.2.

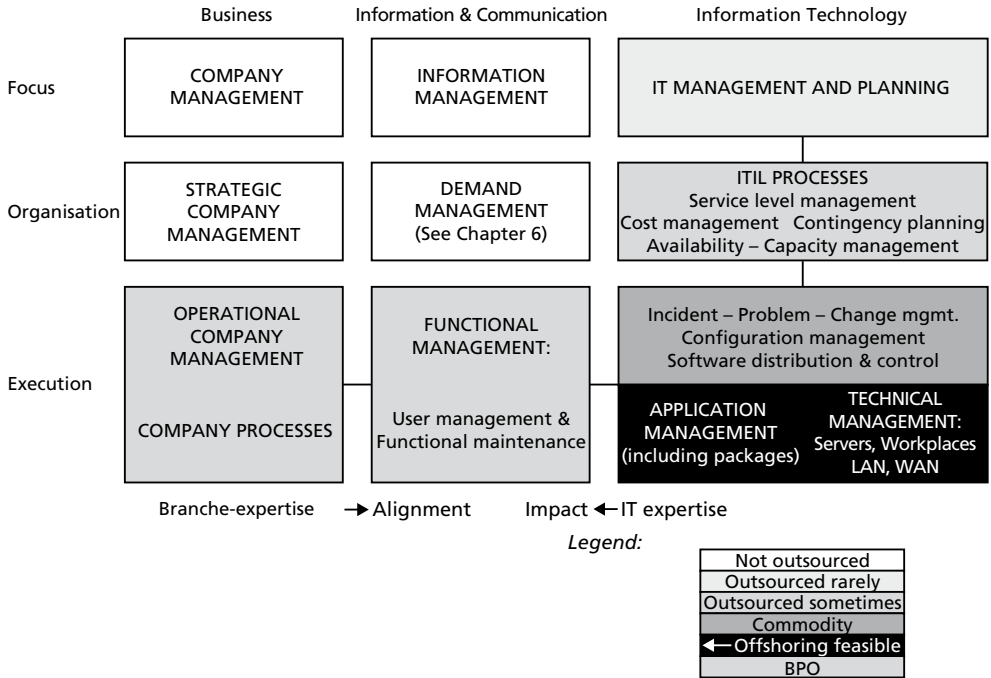


Figure 2.2 Domains of IT sourcing

2.3 The sourcing lifecycle

We can make the sourcing process more manageable by planning it in relation to several workweeks and clearly assigning responsibilities for every activity. The customer designs a plan for the entire cycle and builds his project based on that. The suppliers put their processes out to tender during the supplier selection phase. Once a supplier is selected, the customer and the selected supplier must organise their transition plans and design a mutual project for them to carry out. In order to have a frame of reference for this, a phasing model is required for this type of sourcing plan to provide an analogy of the software development models. After all, the development of the software only became manageable with the application of phasing models such as the (SDM) System Development Methodology. The definition of outsourcing in the previous section already provides a rough classification of two phases, namely the transfer of processes and the reciprocation of services.

PON elaborated on this classification in a sourcing lifecycle model consisting of five phases. Aside from phasing models familiar to us from literature, there are number of consulting organisations that have designed their own phasing models. Examples are models by Gartner, Equaterra (The Life Cycle Sourcing Framework™), the Quint Wellington Redwood model (the 7-phase model™), and the TPI model. An analysis of these commercial models gave no cause for any further modifications. Figure 2.3 illustrates the model designed by the PON taxonomy team.

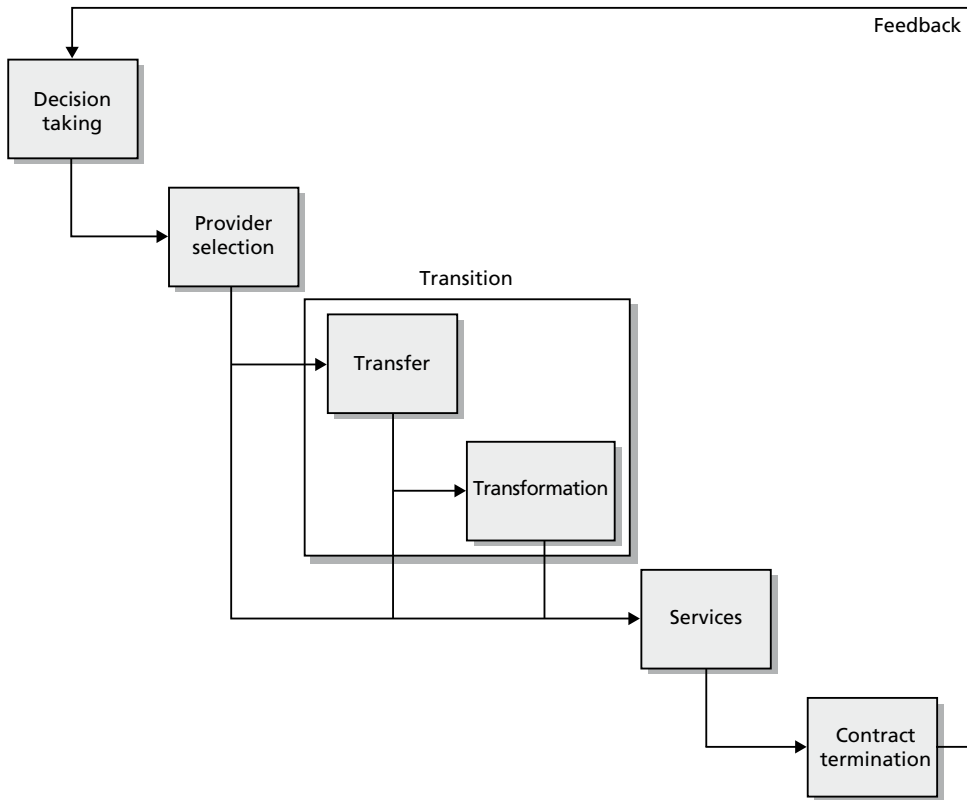


Figure 2.3 The PON sourcing lifecycle (PON, 2006)

Phase 1 Decision taking

Decisions with regard to outsourcing (IT) are not simple, as we must consider several factors. The most common are the reduction of costs and the improvement of quality. We call the strategy developed by the company to achieve the goals they set the *sourcing strategy*. In chapter 3, we describe how to develop a business case for outsourcing.

Phase 2 Selecting the provider

In the second phase, the customer makes a selection from a number of potential IT service providers. ISPL is a generally accepted method that can be used to support the selection process. ISPL enables organisations to make a selection of potential IT service providers based on facts and commercial insight. ISPL is a best practices library in the form of a framework from which a variety of segments can be utilised to achieve this. We describe this phase in more detail in chapter 4.

Phase 3 Transition

The transition is comprised of three subphases: unbundling, transferring and transforming.

Unbundling

This is the release and separation of personnel, hardware, software and the like, from the outsourcing organisation.

Transferring

This is the actual transfer of services to a service provider, whereby the accompanying resources and employees are transferred to that service provider. The transfer is usually organised as a joint project between the customer and the service provider.

Transforming

This is the transformation of services and the adjustment of the transferred organisation, services and IT resources, so this can fit within the service provider’s environment and capabilities. We can distinguish three levels in relation to the intensity of their impact:

1. As-is transformation: here the service provider continues to provide the existing processes and resources.
2. Integration: here the processes and tooling of the service provider’s organisation are implemented.
3. Transformation: here the intent is to significantly improve the quality and development of the services (*transformational outsourcing*).

Phase 4 Service provisioning

The service-provisioning phase is an ongoing process that could take years. In this phase, both parties manage services from their individual perspectives. We call management from the customer’s perspective ‘demand management’ as it bundles the demands of *all* the users. Management from the service provider’s perspective is comprised of the ‘delivery management’ of the individual services, and the ‘service management’ that bundles those services together. This creates just one channel through which to manage all agreements (see figure 2.4). We will discuss the demand management and service management issues further in chapter 6.

Phase 5 Contract termination

Contracts only last for a determined period. However, we can make yet another distinction on the subject of contract termination: either it can end once the determined period of the contract has expired or it can be terminated prematurely. The latter occurs when either of the parties breaks off the contract before the determined period expires. We will describe this phase further in chapter 7.

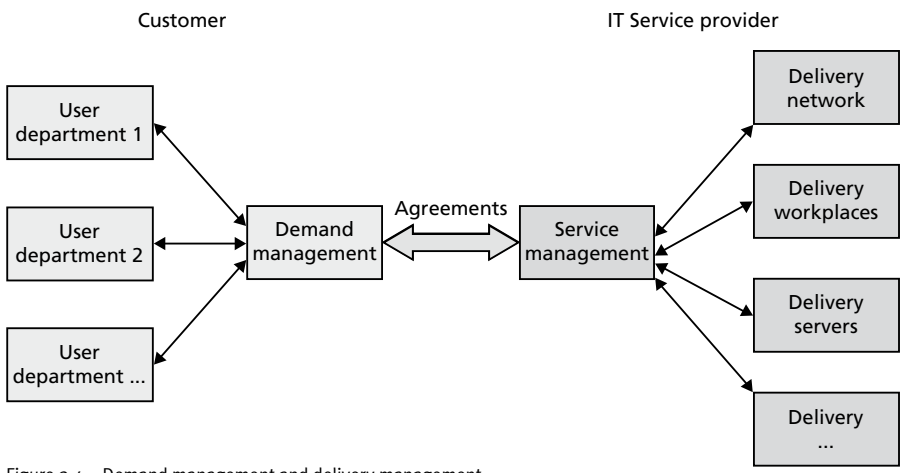


Figure 2.4 Demand management and delivery management

2.4 Success factors

2.4.1 Sourcing factors

Research has shown that the success or failure of IT sourcing is determined primarily by ten so-called *sourcing factors* (Delen, 2005). The role of these sourcing factors evolves during the sourcing process. During the decision taking process, they indicate whether the right decision is being taken and that is why they are called *decision factors*. Thus, the continuation of the sourcing process is justified when those factors are present, but at the same time we must also continue to manage those same factors during the process for continued success. Since the factors then take on another form and change their shape, we call them *control factors* at that stage of the process. In practice, the decision factors serve towards taking the right decision with regard to sourcing and one must manage these control factors in order to execute that decision properly. Every sourcing contract ends at one point or another and the customer must then consider whether to renew the contract, transfer it to another supplier, or return the services in-house (backsourcing). At that point, the factors take on the form of decision factors once again, only now in a different context. Depending on that context, they can then become either follow-up factors or backsourcing factors. Table 2.1 shows the course of all the sourcing factors during the lifecycle of a sourcing project.

We describe these factors further below:

DF1 A systematic approach of the sourcing process

A phasing model is necessary in order for the sourcing process to be manageable. This is done by analogy with the system development processes that only became manageable with the onset of the application of phasing models such as SDM. Every phase of the sourcing project must be planned ahead of time and that planning must then function as a management tool for the process. The PON sourcing lifecycle (see section 2.3) is a very useful model to demonstrate how this works.

Table 2.1 Generic sourcing factors and their role during the sourcing process

Sourcing decision: Decision factors	Sourcing process: Control factors	Follow-up sourcing	Backsourcing
DF1 systematic approach	CF1 systematic approach	FF1	BF1
DF2 business case outsourcing	CF2 business case outsourcing	FF2	BF2
DF3 business case insourcing	CF3 business case insourcing	FF3	---
DF4 ability to unbundle	CF41 transfer of personnel CF42 transfer of assets CF43 user support	FF42	BF41 BF42 Bf43
DF5 good governance	CF51 solid contract CF52 financial agreements CF53 performance mgmt.	FF51 FF52 FF53	---
DF6 sourcing knowledge	CF6 retaining knowledge	FF6	BF6

DF2 A positive business case for the customer

A business case is created when a customer identifies the advantages he wants to achieve and weighs these against the risks involved with outsourcing. The greatest risk is that the customer does not recognise a core competency² as such and outsources it accidentally. A business case is not only important when making a sourcing decision, but also becomes an important tool afterwards in keeping a handle on the ongoing sourcing process up and until the service provisioning phase.

DF3 A positive business case for the insourcer

Sustainable sourcing is only possible when both parties (the customer and the client) can benefit from the sourcing – that is, when a win-win situation is present. The business case for back-sourcing is almost identical to the business case for outsourcing:

- The acquired processes must in fact be a core *competency* for the client.
- Due to the specific knowledge and technology of the client, he can offer the outsourcer significant advantages.
- Due to the scale of the providers operations, he can offer *efficiency advantages* to the outsourcer.

DF4 The ability to unbundle processes

In order to transfer processes and the accompanying resources to another organisation, they must first be unbundled from their organisation. Unbundling is particularly applicable when the outsourcer does not want to outsource everything, but wants to retain the option of outsourcing only those IT processes that make up the best possible scenario for a business case. As a frame of reference for this unbundling process, an enterprise architecture on all of the process layers right up to the IT components is indispensable.

DF5 Good governance

An outsourcer can only outsource his IT processes if he is sufficiently capable of managing the provider to whom those processes are being transferred. The level of governance required for this depends entirely on the extent of the outsourcing. A lower maturity level will suffice when outsourcing operational IT processes such as network or server management, in comparison to what is required when outsourcing entire IT departments and the strategic management thereof.

DF6 Sourcing knowledge

Both the client and outsourcer should have IT sourcing experience. However, this experience is not always distributed evenly. Organisations outsourcing for the first time obviously have no experience with this, whilst IT service providers survive purely on insourcing and do have a lot of experience in this field. This is why outsourcers rely heavily on external knowledge for their first contracts. They should be able to gather that knowledge from their candidate supplier, but outsourcing is not the same as insourcing and that IT provider will always look out for himself first. Hence, the outsourcer is better served by involving an independent sourcing advisor who has dealt with these types of projects before.

² A core competency is a set of skills and technologies that provides a significant advantage over the competitor, cannot be imitated and is expandable to other markets (Hamel & Prahalad, 1990).

CF41 Careful transfer of personnel

The first sourcing project usually involves the transfer of people. Because IT services require so much knowledge, these personnel are crucial for the success of IT sourcing, as they are the principle media of knowledge transfer. During the transfer, ample attention is required regarding the retention of knowledge, communication, bridging cultural gaps, dealing with resistance, and the Works Council.

CF42 Transfer of assets

The material assets of the company that can be transferred with IT sourcing are the hardware (WAN, LAN, servers, PCs), the software (system software, applications), licences, and sometimes the offices of an IT department. By transferring these assets to an external service provider, the outsourcer enables standardisation and integration within his IT infrastructure, producing efficiency advantages for the supplier's operations.

On the other hand, moving assets to a different environment where they must fit in with a different IT architecture also involves quite a bit of risk, not to mention the fact that transferred resources must be transferred all over again every time one switches suppliers. This is why the customer often keeps these assets in-house.

CF43 User support

Because of outsourcing, the distance between the users and the IT service provider grows further apart. Priorities that were self-evident to their own IT departments before, or when necessary, were enforced by the users themselves, now make way for formal agreements as dictated in the Service Level Agreement. That is why it is essential that the users have thorough knowledge of the processes and the critical dependencies of the IT services within their organisation and that the outsourcer involves them when setting up the SLA. Naturally, everything has its price and individual users must understand that they are getting exactly what their organisation is paying for. What works well here is to give the users a dose of reality by charging them directly for the costs they are incurring in return for the requested services. In short, the main issue here is the ability to manage these expectations properly.

CF51 A solid contract

A sourcing contract must provide both security and flexibility. The contract is valid for the duration of the sourcing agreement and, ideally, it should remain on the shelf for that period. If all goes well, the contract should never have to come off the shelf again to be 'revisited'. Consider it similar to the 'marriage vows' that normally remain tucked away in the bedside table but contain certain rules of the game that both parties can fall back on if problems arise or circumstances change drastically. In the event these problems do occur, what is most important is preventing them from rapidly escalating into legal procedures. It makes sense to include procedures in the contract for mediation or arbitration by trusted independent experts in case negotiations do break down. After all, both parties depend heavily on each other and need to get on with their work quickly. Neither of the parties will benefit from a long, drawn-out legal process with expensive lawyers and bad publicity, as such legal proceedings could take years before judgement is pronounced.

CF52 financial agreements

There is a big difference between purchasing products and taking on a sourcing relationship. When purchasing products, the idea is to acquire the products at the lowest possible rate for as long as quality is fixed. With outsourcing, there is long-term interdependency. When a supplier cannot cover his costs, he is often forced to limit his investments, and that means his services will suffer. He might start putting all his efforts into identifying additional sources of income. What ensues is that additional charges are billed for everything not specifically mentioned in the SLA and the contract. Such situations can easily arise when cost savings is the only motivation for outsourcing.

A transparent cost price calculation is of great importance for good sourcing relations. The best way to accomplish this is to apply the Activity-Based Costing (ABC) (Kaplan & Bruns, 1987) principle for IT services.

CF53 Performance management

Already the first thesis on sourcing De Looff (1996), stated, that *'outsourcing is justified only when the demands of the activities can be specified ahead of time and the performance of these demands can be measured and enforced'*. This indicates an important control factor, namely the ability to specify, measure, and manage the performance of the IT service provider. The term *performance management* usually summarises this complexity of tasks.

CF6 Retaining knowledge

Up until their first migration to clients, an organisation actually has the knowledge to provide IT services on their own. Moreover, during the selection of the supplier and the migration process the outsourcer acquires the knowledge that is required to manage the supplier. After that, it is important to retain both these forms of knowledge for the duration of the contract management phase. Once an outsourcer loses so much knowledge that he is not capable of starting IT services from scratch again on his own, he loses the option for back-sourcing, or stated otherwise, he cannot turn back the hands of time on the outsourcing project. If on top of this, he also loses the knowledge and ability to manage a different supplier, he loses the follow-up sourcing option and definitely becomes dependent on just that one supplier.

2.4.2 Weighing factors

Not all sourcing factors are equally important. According to Delen (2005), we can ascertain the following weighing factors. The results from that research also revealed that all of the criteria for the most important sourcing factors must be satisfied at every stage of the sourcing cycle before one can move on to the next phase. Therefore, all of the criteria for the most important decision factors must be satisfied in phase 1, the *sourcing decision*, before one can proceed to phase 2, the *supplier selection*.

Decision score and control score

Likewise, after the *supplier selection* phase, the most important control factors must be satisfied before one can move on to the transition and *service(s)* phases. Table 2.2 provides an indication of how strong or weak these individual factors really are. This also helps to create a quantitative picture as to what degree the criteria are satisfied for the entire package of relevant decision and control factors. When all of the decision and control factors are relevant (as worked out in

Table 2.2 Classification of decision factors and control factors

Category	Weighting factor	Decision factors	Control factors
Very strong factors: Non-compliance always leads to failure	5	DF2 business case for outsourcing	CF2 business case for outsourcing CF41 transfer of personnel
Strong factors: Non-compliance leads to partial success at best	3	DF3 business case for insourcing DF5 good governance	CF3 business case for insourcing CF51 solid contract CF52 financial agreements CF53 performance mgmt.
Average factors: Non-compliance leads to failure most of the time, but sometimes to success	1	DF1 systematic approach DF4 the ability to unbundle DF6 sourcing knowledge	CF1 systematic approach CF43 user support CF6 retention of knowledge
Weak factors: no evidence of a relationship between the factors for failure and success	0	-----	CF42 transfer of assets
Maximum score		$5 + 2 \times 3 + 3 \times 1 = 14$	$2 \times 5 + 4 \times 3 + 3 \times 1 = 25$

table 2.2), one can attain a maximum of 14 decision points and 25 control points. The Decision score (Dsc) is now defined as the number of decision points that one can attain from the factors satisfied by the criteria (Dact), divided by the maximum number of decision points that one can attain from all of the relevant factors (Dmax) from that sourcing project expressed in percentages. In the same way, the Control score (Csc) is defined as $Cact/Cmax \times 100\%$. When comparing these scores with actual situations, the results indicated that successful sourcing projects attained scores of 85% or more. The partially successful cases showed scores between 50 and 85%; all of the cases where one of the scores fell below 50%, failed.

The Sourcing Factors Monitor (SFM)

By combining all of the results attained up to the present time, it is possible to work out a generic plan to monitor the sourcing factors over the entire course of the sourcing cycle; the so-called *sourcing factors monitor*. This monitoring can be considered as a kind of ‘early warning system’ that recognises bottlenecks at an early stage, so that timely adjustments can be made to the sourcing process. The natural moments for determining the scores are at the beginning and end of each phase of the sourcing cycle.

2.5 Onshore and offshore sourcing

At the start of the 21th century, we thought that offshore outsourcing was still a thing of the future in the Netherlands. However, the huge € 1.8 billion ABN-AMRO outsourcing project that went to IBM, Accenture, Infosys, Tata, and Patni in 2005 suddenly attracted a lot of attention to this phenomenon. The latter three suppliers are located in India; Accenture also supplies its share from India. Shortly after the announcement of the agreement, IBM grabbed the headlines again by announcing that their helpdesk service would be transferred from Holland to South Africa. Let us look at how all of this became possible.

2.5.1 The Indians are coming

India's capital are its 1.2 billion inhabitants. The population has a growth percentage rate of 2.5% a year, which equals an addition of 30 million inhabitants every year. India will soon surpass China with largest population in the world. The supply on the job market far outweighs the demand, the cost of living is low, and we consider it a low-wage country. These points are exactly what makes India very competitive with the western world. So far India has not really distinguished itself from other countries in the third world, but all educated Indians speak English and India traditionally has a tremendous amount of very highly educated and ambitious people. That is why aside from such labour intensive industries such as the metal and textile industry they have also developed a branch for knowledge workers. That development began during the last century with Business Process Outsourcing. In India, this means 'simple administrative work' and can be something as simple as retyping salary checks. A large part of the application conversion for the year 2000 wound up in India on the coattails of this development. Many of the application portfolios stayed in India for maintenance after the conversion was completed, and from that, the application development industry was born.

Service in remote management of IT infrastructures is something that only started developing over the last few years. This created the IT sourcing industry paradox where offshore developed in the exact opposite way that onshore did. As we've just seen, the sequence in India ran from 'BPO' via applications to infrastructure management, while the classic development of onshore outsourcing started with network and server management (the largest commodity), and only progressed to application management and BPO later on (Delen, 2006).

The Indian IT industry is concentrated in 'electronic cities' close to several cities that have large universities in southern India (Bangalore, Hyderabad, Chennai, and Mumbai). Because of this, the knowledge infrastructure has not only become the determining, but also limiting factor as well. Presently, at least 250,000 computer scientists graduate from the universities every year, but that is barely enough to meet the demand. According to NASSCOM (National Association of Software and Service Companies; the Indian branch association) numbers, the offshore industry employed 1.3 million Indians at the start of 2006, of which 878,000 in IT outsourcing. The growth percentage has been fluctuating around 30% since the end of the previous century and last year, another 240,000 employees came on-board. Naturally, the question is: how long can this growth continue? Optimists, especially Indians, think that the trend will continue for another five years. Critics, (especially westerners) are quick to point out that salary and rates are on the rise in India. The latter is certainly true for project managers, who already cost € 150 an hour. On the other hand, a programmer at € 15 an hour still represents only 25% of the similar average wage in the Netherlands (NRC, 2005). This is how the offshore branch in India has grown into a mega industry with annual revenues of over 36 billion dollars, giving India a 70% global market share of offshore services.

Meanwhile, the largest companies have an average of 20,000 to 100,000 employees on the payroll. They have expanded to branch offices throughout the world and continue to grow by hiring large numbers of graduates and orchestrating corporate take-overs and mergers, our shore included. Table 2.3 provides the revenue and employee numbers for the 'big seven' IT companies in India. Table 2.4 provides a comparison to 2.3, using a number of large western companies. Nonetheless, India is so huge that the offshore industry has barely affected the rest of the country.

The offshore industry with its 36 billion provides no more than 4.8% of the gross national product in India. The internet penetration is a mere 1.5% and the average village has only one mobile satellite telephone available (to be rented from the village chief).

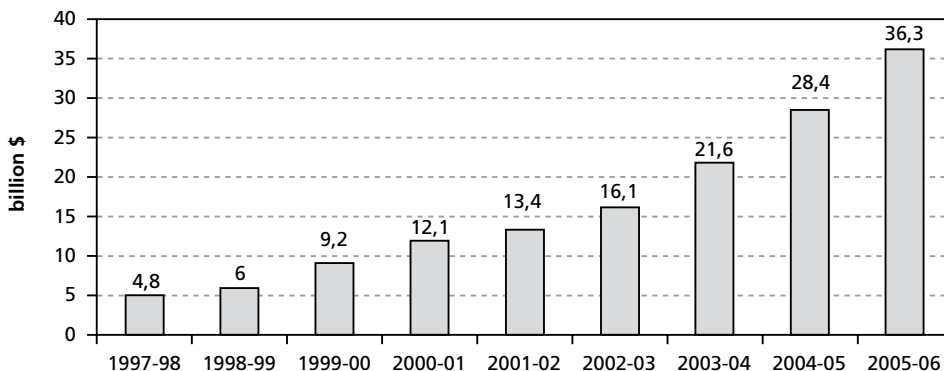


Figure 2.5 Growth numbers for the Indian offshore industry, including IT enabled BPO³ (NASSCOM, 2005)

2.5.2 The offshore outsourcing business case

Together with the stormy development of offshore sourcing come the horror stories as we remember them from the time when onshore sourcing was up and coming. The cause behind poorly prepared business cases today often lies with a gross underestimation of the effort required from management. To make this more tangible, we will delve into a business case for offshore outsourcing.

Just as any other business case, the offshore outsourcing business case is nothing more than the balancing of costs and benefits. If the benefits exceed the costs, the business case is positive and otherwise it is negative.

The benefits of offshore outsourcing

Offshore outsourcing provides a lot of advantages, both material (cost savings) and immaterial (global presence). The important issue here for multinationals, is the round the clock service. The latter is possible by forwarding through the different time zones, for instance, on our day in the Netherlands or South Africa to our evening in the US or Brazil, in our night to Singapore and then on to India. This could be useful when monitoring networks or extending support desk hours.

The costs of offshore outsourcing

In the classic economic theory, (*efficient market hypothesis*: Adam Smith, 1776), the idea was that products and services were always delivered by the lowest-priced supplier. If that hypothesis were still true today, we would have to offshore just about everything, as IT labour is much cheaper now in the third world. Some companies actually seem to believe this, but the efficient market hypothesis has long been adjusted by the *cost of transaction theory* by Coase (1937).

³ The Indian fiscal year runs from 1 April to 31 March.

Table 2.3 Revenue and number of employees of the largest Indian IT companies 2004 – 2005

Company	Revenue 2005-2006 (\$ million)	Global employees 2007
Infosys	3.451	66.150
Tata C Services	2.860	100.000
Wipro	3.320	50.000
Satyam	1.260	30.000
Cognizant	886	27.000
HCL	763	33.000
Patni	450	30.000

Table 2.4 Revenue of large western IT service companies

Company	Revenue 2005 (\$ million)	Employees 2007	In India (2007)
IBM	91.134	329.000	53.000
Accenture	15.550	140.000	35.000
Capgemini	8.940	70.000	12.000
Atos Origin	5.000	47.000	2.000

This theory recognises that there definitely are costs involved in transactions between demanders and suppliers of products or services. The same applies to IT outsourcing. Nowadays, the transaction costs for onshore outsourcing have become relatively predictable. For the most part, these costs fluctuate around 8% of the contract value (Barthelémy, 2001). However, in an underdeveloped industry such as offshore sourcing, these are not only higher but more difficult to predict as well. According to Davison, (2003), transaction costs vary between 12% and 52% of the contract value. This enormous spread leads one to conclude that offshoring was still a matter of trial and error and that a best practice has not yet been developed. This is why it is important to analyse further where the differences originate.

Transaction costs for services rendered can be divided up into the costs for the development of a relation with a service provider and the costs for the managing the provider's services. Finding a suitable supplier abroad is already more complicated than finding the right partner domestically, and then there are a number of additional cost items: (1) the termination of employment costs, (2) the transfer of knowledge costs, and (3) the management costs after closing the deal, which remain high due to the difference in culture. Let's look into each of these points:

1. Termination of employment costs

The offshore outsourcing business case only works if cheap offshore personnel replace highly paid onshore personnel. This means that the existing employment contracts will have to be bought out according to local legislation.

2. Transfer of knowledge

Applications (typical in offshore sourcing) require quite a bit of knowledge, especially when their legacy is poorly documented. Seeing as little or no personnel are acquired offshore, the explicit transfer of the required knowledge is even more critical. This requires an investment far greater than those required for onshore sourcing. Moreover, language barriers and cultural differences must be bridged here.