Organizational Flexibility: The Strategic Differentiator of Global Sourcing Effectiveness

The 2011 Offshoring Research Network Corporate Client Survey Report

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Executive Summary

For Some Companies Organizational Flexibility Capabilities Are a Direct Outcome from Global Sourcing Practices

For the first time, the ORN Global Corporate Client Survey reveals a significant increase in the number of US companies reporting that their investment in and development of global sourcing capabilities has elevated their organizational flexibility capabilities. This finding reflects a significant development among leading-edge US companies that are seeking to successfully realign their structures and processes to compete for top-line growth in new economies.

Corporate Strategy that Guides Global Sourcing Becomes Key Success Criterion

Corporate-wide strategies that guide global sourcing decisions throughout the organization are increasingly critical to achieving a wider range of targeted results such as improved service quality, company growth, and process improvements.

Senior Functions Move Abroad as Competition for Talent Intensifies

US companies are transferring more of their professional functions abroad, especially in the areas of IT infrastructure, application development and maintenance (ADM), and innovation processes. Access to qualified personnel is among the top reasons, reflecting the ongoing dearth of the domestic talent pool. The competition to attract and retain talent is expected to become increasingly heated as more companies and service providers vie for the same local professionals to meet their US clients’ growing demand for more sophisticated service solutions.

US Companies Continue to Prefer Distant Geographic Locations Despite More Near-Shore Delivery Centers in Latin America

US companies continue to prefer basing their service operations in far-shore destinations such as India, China and the Philippines, especially in the IT infrastructure, ADM, contact centers and innovation services areas. Latin America is growing in popularity, especially among European companies, but US companies have yet to find operational or financial advantages in moving their well-established far-shore operations to near-shore locations.

Midsize Firms Present New Opportunities for Service Providers

While most large companies have adopted and are deploying global sourcing initiatives, only half of midsize organizations in the ORN sample have adopted global sourcing practices. Midsize companies therefore represent the next frontier in the implementation of global sourcing. For service providers, especially midsize ones, this means many more opportunities to develop value propositions that attract a new client base.

Preference for Outsourcing Business Services Accelerates Despite Superior Performance of Captive Centers

Captive centers consistently generate greater cost savings and operate more efficiently than outsourced centers.
Yet the 2011 Survey reveals a growing preference for delivery centers that are outsourced to service providers across the business services spectrum. This finding is consistent with the growing importance respondents place on other strategic drivers beyond cost that influence global sourcing decisions, among them company growth, innovation activities, and the new emphasis on organizational flexibility.

**Labor, Service Quality and Security Risks Remain Global Sourcing Concerns**

About 70 percent of companies that currently run operations in India noted labor risks. The primary risks identified by respondents considering offshoring options in the 2011 Survey were “service quality” and “data security.”

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**Looking Forward: Global Sourcing Activities Will Continue to Expand But at a Slower Overall Pace**

Looking ahead, companies with global sourcing experience expect to steadily grow their global sourcing operations, albeit at a slower pace than before. About half of the responding companies plan to expand their existing global sourcing operations over the next 18 to 36 months, while 70 percent of midsize companies plan to do so during that time. Growth in the functional areas of IT, finance and accounting is slowing among companies currently engaged in global sourcing, but 40 percent of companies expect to initiate new global sourcing activities, mainly in the areas of contact centers, application development and maintenance, as well as knowledge services.

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1 The survey asked respondents to provide their own descriptions of the risks associated with offshoring to countries under consideration. Labor risk combines comments such as risk of attrition, risk of wage inflation, language risk, and talent shortage risk.
The Offshoring Research Network

The Offshoring Research Network (ORN) led by Duke University is a global network of renowned research universities, top scholars, and practitioners that has become the most recognized international research network tracking the globalization of services. ORN has university partners in Australia, Belgium, Brazil, Denmark, Germany, France, Italy, Japan, South Korea, Netherlands, Spain, and the United Kingdom.

Duke ORN produces two key annual reports: the Global Corporate Client Survey report and the Global Service Provider Survey report. The ORN research reflected in these reports is distinctive because it both informs and is informed by managerial practice worldwide. The ORN’s database covers large multinational, midsize and small companies headquartered across the globe – including more than 620 service providers and 1,850 companies engaged in the global sourcing of business services. In addition, unlike other studies that monitor the global sourcing of business services, the ORN surveys have tracked the evolution of global service offshoring practices since 2005, both at the function and implementation level.

The ORN Global Corporate Client Survey covers all industries and functions, and it includes responses from companies that are already sourcing business services globally, those considering the practice, and those that have decided not to engage in global sourcing.

The annual Global Service Provider Survey tracks service offerings, contract and client relationships, and future growth strategies and investments. Combined, the Corporate Client and the Service Provider surveys offer the only comprehensive insight into the demand for and the supply of global sourcing of business services.

2011 Corporate Client Survey Profile

This report highlights the key findings from the ORN’s 2011 Global Corporate Client Survey. The ORN cumulative database covers large multinational, midsize and small companies headquartered across the globe. This survey report focuses on US companies.

The most recent Corporate Client Survey reflects data collected through May 23, 2011 from participating companies based mainly in the United States and Spain. The survey on other European companies, as well as Australian, Korean and Japanese companies is scheduled to be released in October 2011. The survey was conducted across a significant range of industries (Chart 1), allowing for observations of trends and any heterogeneity of offshoring. (While the survey covers the offshoring of a number of functions — contact centers, finance and accounting, human resources, legal services, procurement, and innovation work — it does not cover offshore outsourcing of manufacturing activities). Regarding the number of employees, the majority of participating companies in the 2009/2010 survey are either large or midsize companies (Chart 2).
Chart 1. 2011 ORN Corporate Client Survey Profile

Company by Industry

- Financial Services Industry: 28%
- Software and IT services: 12%
- Manufacturing: 11%
- Professional Services: 12%
- Healthcare and Pharma: 12%
- Telecommunications: 8%
- Retail and Consumer Goods: 7%
- Transportation and Logistics: 4%

Chart 2. 2011 ORN Corporate Client Survey Profile

Company by Size

- Small: <500 employees: 33%
- Midsize: 500-10,000 employees: 36%
- Large: >10,000 employees: 31%
Global Sourcing Leads to New Organizational Flexibility Capabilities and Potential Growth

As global competition for new revenue streams intensifies, future top-line growth for US and Western European companies increasingly lies in new economies like China, India and Brazil. Against this backdrop, leading-edge companies recognize that they must rethink their global organizational footprint, from a focus on vendor management to where to hire and locate staff. US companies that in recent years have diversified the scale and scope of their global sourcing operations, spanning call centers, knowledge processing, and research and development, appear to be reaping operational and financial returns. For the first time, the ORN Global Corporate Client Survey demonstrates a significant jump in the number of respondents for whom offshoring activities have led to improved organizational flexibility – from 48 percent in 2009/10 to 66 percent in 2011.

Companies with existing operations abroad most frequently cited “increase organizational flexibility” as one of the three most important drivers guiding their global sourcing initiatives. Even among those companies that did not report greater organizational flexibility as an important strategic driver, approximately 50 percent agreed that their offshoring effort has led to greater flexibility within their organization. Moreover, administrative functions were more frequently cited as driven by the need to “increase organizational flexibility” compared to functional areas such as innovation services.

Figure 1. Global Sourcing Leads to New Organizational Flexibility Capabilities
Figure 2. Administrative Functions More Frequently Cite “Increase Organizational Flexibility” as Most Important Driver Today Than Innovation Services
Companies with Increased Flexibility Are Better Positioned for Global Growth

Interestingly, compared to companies that did not report improved organizational flexibility in the 2011 Survey, US companies that did report improved flexibility have the following characteristics in common:

- They adopted a corporate-wide global sourcing strategy for guiding sourcing decisions at the business unit and function levels one year earlier, on average, than other companies.
- Their global sourcing operations are more dispersed geographically.
- The functional activities of their global sourcing operations are more diverse.
- They achieved higher levels of average cost improvement from their global sourcing operations.
- They are more likely to operate a “center of excellence,” also known as a global offshoring/outsourcing resource center.
- They are more likely to have avoided global sourcing “hot spots” as a location choice, opting instead for second-tier cities.

These results indicate that US companies with established global sourcing operations are successfully addressing key issues typically related to the globalization of services, among them coordination among operations in different locations and vendor management. And with greater organizational flexibility comes financial and competitive advantage: these US companies appear to have the foundation in place to manage dispersed resources around the world, thereby strengthening their position to compete in emerging economies.

Table 1. Companies With Increased Flexibility Are Better Positioned for Global Growth

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>No</th>
<th>T-test</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of years since corporate-wide strategy in place</strong></td>
<td>7</td>
<td>6</td>
<td>1.77</td>
</tr>
<tr>
<td><strong>Average number of global sourcing locations</strong></td>
<td>9</td>
<td>6</td>
<td>3.9</td>
</tr>
<tr>
<td><strong>Average number of functions offshore</strong></td>
<td>3.7</td>
<td>2.6</td>
<td>4.02</td>
</tr>
<tr>
<td><strong>Average cost improvement from last year</strong></td>
<td>23.5</td>
<td>17.8</td>
<td></td>
</tr>
<tr>
<td><strong>Percentage of Companies have center of excellence</strong></td>
<td>47</td>
<td>36</td>
<td>1.48</td>
</tr>
<tr>
<td><strong>Percent indicating &quot;Avoid Hotspot&quot; in location criteria</strong></td>
<td>27</td>
<td>10</td>
<td>19.02</td>
</tr>
</tbody>
</table>
Deeper Recognition of the Operational and Market Benefits that Global Sourcing Produces

Recognition among US companies that global sourcing should be integrated with their organization’s global growth strategy appears to be gaining traction. Of those US companies that are still only considering global sourcing options, 58 percent in the 2011 Survey indicated that achieving “increased organizational flexibility” was an “important” or “very important” driver for offshoring, compared with 43 percent in the previous year’s survey.

In addition to improved organizational flexibility, a series of other noteworthy organizational factors have gained importance among companies currently considering global sourcing activities. The 2011 Survey respondents identified the following strategic drivers:
- “Part of a larger global strategy” increased from 40 percent the previous year to 67 percent this year;
- “Exploit location specific advantage” jumped from 28 percent to 57 percent; and
- “Access to new market” rose from 24 percent to 48 percent.

In summary, the most recent ORN Global Corporate Client Survey findings suggest that the use of global sourcing as a business practice has allowed many US companies to enhance their organizational flexibility at a time when competition for top-line growth worldwide is intensifying. It appears that companies that have been sourcing their global operations abroad are therefore, also better positioned to compete than companies that have not.

Figure 3. Globalizing Companies Start to Consider Offshoring as They Seek Top-Line Growth

<table>
<thead>
<tr>
<th>Drivers for Companies Who Are Considering Offshoring by Survey Year</th>
<th>2011</th>
<th>2009/10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part of a larger global strategy</td>
<td>40%</td>
<td>67%</td>
</tr>
<tr>
<td>Growth strategy</td>
<td>49%</td>
<td>66%</td>
</tr>
<tr>
<td>Increase organizational flexibility</td>
<td>43%</td>
<td>58%</td>
</tr>
<tr>
<td>Exploit location-specific advantages</td>
<td>28%</td>
<td>57%</td>
</tr>
<tr>
<td>Business process redesign</td>
<td>24%</td>
<td>53%</td>
</tr>
<tr>
<td>Access to new markets</td>
<td>48%</td>
<td>47%</td>
</tr>
<tr>
<td>Increasing speed to market</td>
<td>36%</td>
<td>36%</td>
</tr>
<tr>
<td>Access to qualified personnel</td>
<td>44%</td>
<td>57%</td>
</tr>
<tr>
<td>Improved service levels</td>
<td>41%</td>
<td>40%</td>
</tr>
<tr>
<td>Domestic shortage of qualified personnel</td>
<td>23%</td>
<td>25%</td>
</tr>
</tbody>
</table>
Corporate Strategy Guiding Global Sourcing Is a Prerequisite for Global Sourcing Success

As US companies increase the scale and scope of their global sourcing activities, they are laying the foundation for achieving far-reaching organizational flexibility capabilities. With these capabilities they are in a position to redesign processes, which in turn lead to enhanced process efficiencies; improved service quality; new ways of integrating service providers in higher value activities that affect revenue growth; better access to new markets; and product and process innovations. To that end, companies have experimented with various strategic instruments and capabilities, among them the implementation strategies that guide global sourcing decisions throughout the organization.

Corporate Strategies Directly Linked to Improved Organizational Flexibility

Adoption of a corporate-wide strategy is much more common today. Across nearly all industries represented in the Corporate Client Survey, approximately 50 percent of companies with existing global sourcing operations have a corporate-wide strategy in place; 59 percent have a strategy at the business unit level. In addition, 48 percent of responding companies have implemented a function-level global sourcing strategy.

Application of the odd ratio analysis\(^2\) indicates that companies with a delivery model strategy\(^3\) are 2.8 times more likely to report having “improved organizational flexibility” compared with the firms that do not have delivery model strategies in place. Companies with a corporate-wide strategy guiding global sourcing practices are 1.7 times more likely to report having “improved organizational flexibility” compared to the ones that do not have a corporate strategy.

Industry Sectors Focus on Strategy, Core Competencies and Market Opportunities

The 2011 Survey revealed noteworthy developments by industry. Regarding corporate global sourcing strategies, the survey revealed the following:

- More than half of US companies in most industries have a corporate strategy in place, with the exception of the pharmaceutical and health care sector, where about 47 percent of companies have such a strategy;
- More than half of the companies in most industries have a function-level strategy. The exceptions are the financial services and the pharmaceutical and health care sector, in which about 41 percent and 35 percent of companies, respectively, have such a strategy.
- The financial services industry represents the highest percentage of companies – 58 percent – with a delivery model strategy. Next is the professional services industry with 55 percent, followed by the software sector at 50 percent. Only 14 percent of the retail and consumer goods sector have a delivery model strategy.

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\(^2\) The odds ratio is a measure describing the strength of association between two binary data values.

\(^3\) A delivery model strategy is a combination of geographically dispersed delivery centers consisting of captive and third party provider-run service centers to maximize flexibility amid contingencies such as currency fluctuations, infrastructure failures, etc.
What follows are a series of other industry-specific highlights:

**Financial Services Industry**

Within the financial services industry, 62 percent of companies reported higher organizational flexibility. In addition to labor costs, respondents from this sector most frequently selected “increase organizational flexibility” and “access to qualified personnel” as the drivers behind their current strategic decision-making.

More financial services companies achieved “better focus on core competence” – an increase from 44 percent last year to 61 this year; better access to new markets, up 4 percent to 25 percent; and a 14 percent increase in major product innovation.

IT is the most offshored function for this industry, and centers of excellence are also important: 70 percent of financial services companies have such a resource center in place, more than any other industry.

**Software**

Respondents from the software sector most frequently selected “firm growth” and “competitive pressure” as the most significant strategic drivers in today’s environment. Software companies’ focus on core competence jumped from 43 percent to 63 percent, and “better access to new markets” rose from 24 percent to 33 percent. IT is the most significant offshored function for the software industry.

**Telecommunications**

For more than half of the companies offshoring in this sector, “access to quality personnel” and “business process redesign” were the most important concerns. IT is this industry’s most critical function.

**Professional Services**

Besides labor cost, “business process redesign” was most frequently noted by professional services companies as the primary driver behind their strategic decision-making. Regarding the distribution of their offshoring functions, IT was most important.

**Retail and Consumer Goods**

At 67 percent, the retail and consumer goods industries represent the highest proportion of companies reporting greater organizational flexibility as a result of offshoring efforts. Procurement is the biggest offshoring function for this sector.

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**Table 2. Strategy Profile Varies by Sector**

<table>
<thead>
<tr>
<th>Percent with corporate strategy</th>
<th>Financial Services</th>
<th>Professional Services</th>
<th>Retail &amp; Consumer Goods</th>
<th>Software &amp; HiTech</th>
<th>Telecom</th>
</tr>
</thead>
<tbody>
<tr>
<td>55</td>
<td>53</td>
<td>57</td>
<td>62</td>
<td>52</td>
<td></td>
</tr>
<tr>
<td>Percent with functional level strategy</td>
<td>41</td>
<td>51</td>
<td>62</td>
<td>56</td>
<td>62</td>
</tr>
<tr>
<td>Percent with center of excellence</td>
<td>70</td>
<td>40</td>
<td>33</td>
<td>47</td>
<td>47</td>
</tr>
<tr>
<td>Percent with a delivery model strategy</td>
<td>58</td>
<td>55</td>
<td>14</td>
<td>50</td>
<td>44</td>
</tr>
</tbody>
</table>
More Functions Are Moving Abroad as Competition for Talent Intensifies

As US companies recognize that top-line growth requires capturing markets in new economies, sourcing a wider array of professional functions abroad appears to be considered more critical to success. This is consistent with companies experiencing internal resistance to long-term assignments abroad, especially in emerging economies. Nearly 50 percent of offshoring operations are focused on the areas of information technology (IT) infrastructure, application development and maintenance (ADM), and innovation services, according to the 2011 Survey (Chart 3). Respondents indicate that 54 percent of existing offshoring operations in IT, ADM, and innovation services are to be expanded in the next 18 to 36 months. Moreover, 51 percent of the companies surveyed indicated plans to open new offshoring operations during that time period.

Demand for Qualified Personnel, in Addition to Lower Labor Costs, Is Driving Decisions

In addition to labor costs, the two most important strategic drivers shaping global sourcing decisions for IT infrastructure and ADM are “access to qualified personnel” and the goal to “increase organizational flexibility.” For the global sourcing of innovation services, the most frequently selected drivers were “global growth strategy” and “access to qualified personnel.”

Clearly companies are moving their operations abroad not simply to save cost. On average, labor arbitrage generally dissipates over two to three years. US companies are seeking talent abroad in fields such as science and engineering and software programming for which the domestic talent pool is not deep or wide enough; among the reasons to help explain this shortage are a restrictive US immigration policy and a decentralized education system in which priorities placed on math and science curricula vary greatly across the country.

IT, ADM, and innovation services are all functions that require highly skilled personnel. According to the 2011 Survey, 43 percent of offshore operations in these three areas involve the entire function-related processes and responsibilities, up from 32 percent in the previous survey (see chart 4). Of these operations, 43 percent of IT, ADM, and innovation services operations are undertaking tasks that involve “creating new capabilities/competitive advantage”, and 64 percent of these operations involve complex “tasks that are assigned to multiple individuals or teams and are technically highly interdependent.”

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4 Innovation services include product design, research and development, and engineering services. Production design services include prototype design, systems design, and application development. Research and development services include research on new materials and processes, code development, and research and development of new technologies. Engineering services include design automation, tool design, simulating, drafting and modeling, engineering analysis (e.g., finite element analysis), embedded systems development, re-engineering, and technical publications.
Chart 3. About Half of the Offshoring Operations are in the Areas of IT, ADM and Innovation Services

Distribution of Functional Implementations

- IT Infrastructure: 20%
- Application Development and Maintenance: 15%
- Innovation Services: 10%
- Call Center: 7%
- Finance & Accounting: 5%
- Human Resources: 5%
- Knowledge/Analytical Services: 4%
- Legal Services: 2%
- Marketing & Sales: 2%
- Other services: 5%
- Supply Chain & Facilities: 10%

Chart 4. Global Sourcing Operations in the Area of IT, ADM, and Innovation Services Increasingly Involve Performing Entire Processes

Percent of (IT, ADM, and Innovation Services) Operations involve tasks by Type by survey year

<table>
<thead>
<tr>
<th>Year</th>
<th>Discrete Tasks</th>
<th>Entire Processes</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>57</td>
<td>43</td>
</tr>
<tr>
<td>2009</td>
<td>68</td>
<td>32</td>
</tr>
</tbody>
</table>
Figure 4. Demand for Qualified Personnel Is Second Most Important Strategic Driver for IT and ADM, in Addition to Lower Labor Costs.

Percent of Companies Indicating Three Most Important Drivers in 2011

- Labor cost savings
- Access to qualified personnel
- Increase organizational flexibility
- Other cost savings
- Business process redesign
- Part of a larger global strategy
- Competitive pressure
- Growth strategy
- Improved service levels
- Enhance capacity for innovation
- Accepted industry practice
- Exploit location-specific advantages
- Increasing speed to market
- Domestic shortage of qualified personnel
- Access to new markets

Figure 5. Global Sourcing Operations in the Area of IT, ADM, and Innovation Services Perform High Value-Added Tasks

Percent of respondents rating task characteristics in their IT, ADM, Innovation Services Operations

- Tasks require personnel with company-specific knowledge: 55%
- Tasks require extensive use of web-based collaborative technologies: 56%
- Tasks are assigned to multiple individuals or teams and are technically highly interdependent: 66%
- Tasks offer an opportunity to collaborate with local universities/research centers: 16%
- Tasks involve breakthrough process innovations: 30%
- Tasks involve the development of major product innovations: 31%
- Tasks involve creating new capabilities/competitive advantage: 45%
Growing “War for Talent” Among US Companies and Service Providers

With the demand for a highly qualified workforce comes increased competition to attract or retain talent. Among those US companies represented in the 2011 Survey that are currently considering global sourcing options, 47 percent indicated that they plan to offshore IT, 41 percent to source ADM, and 41 percent to locate innovation services abroad.

Not only is the demand for IT, ADM, and innovation services talent growing among US companies (about half in captive centers), local and international service providers also aspire to offer these services and are recruiting the requisite personnel. An increasing number of companies expect service providers to deliver transformational solutions in the areas of ADM, as well as innovation in the areas of product design, research and development, and engineering services. The ORN 2010 Service Provider Survey found that the headcount of large ADM services providers has increased a dramatic 410 percent on average from 2009 to 2010. When asked for their most important criteria in attracting new clients, service providers identified “the skill levels” and “training of the workforce.”

Figure 6. Increased Demand in the Area of IT, ADM, Innovation Services, and Analytical/Knowledge Services will Intensify Competition for a Highly Qualified Workforce

Percentage of Companies That Considering Offshoring By Function by Survey Year

- Call Center: 51% (2011), 47% (2009/10)
- IT Infrastructure: 25% (2011), 27% (2009/10)
- Innovation: 30% (2011), 41% (2009/10)
- Application Development & Maintenance: 29% (2011), 41% (2009/10)
- Finance & Accounting: 27% (2011), 48% (2009/10)
- Supply Chain & Facilities: 24% (2011), 25% (2009/10)
- Knowledge/Analytical Services: 16% (2011), 24% (2009/10)
- Legal Services: 4% (2011), 10% (2009/10)
- Human Resources: 14% (2011), 13% (2009/10)
- Marketing & Sales: 8% (2011), 10% (2009/10)
Figure 7. 2010 Survey Finds Huge Increase in the ADM Area for FTEs Employed by Large Providers

Changes in average number of FTEs per provider of top four function by provider size across years

<table>
<thead>
<tr>
<th>Function</th>
<th>Large Providers</th>
<th>Mid-size Providers</th>
<th>Small Providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADM</td>
<td>13749</td>
<td>980</td>
<td>70</td>
</tr>
<tr>
<td>IT Infrastructure</td>
<td>7284</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finance &amp; Accounting</td>
<td>1658</td>
<td>300</td>
<td>29</td>
</tr>
<tr>
<td>Contact Center</td>
<td>5875</td>
<td>741</td>
<td>29</td>
</tr>
<tr>
<td>ADM</td>
<td>2691</td>
<td>822</td>
<td>80</td>
</tr>
<tr>
<td>IT Infrastructure</td>
<td>3034</td>
<td>740</td>
<td>37</td>
</tr>
<tr>
<td>Finance &amp; Accounting</td>
<td>572</td>
<td>416</td>
<td>81</td>
</tr>
<tr>
<td>Contact Center</td>
<td>3229</td>
<td>642</td>
<td>68</td>
</tr>
</tbody>
</table>

*ADM = Application Development and Maintenance

Figure 8. Service Providers Identified “Skills and Training of the Workforce” as Most Important in Attracting Clients

Percentage of providers perceiving driver as "Important" or "Very Important"

<table>
<thead>
<tr>
<th>Driver</th>
<th>2010 Percentage</th>
<th>2009 Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skills and training of workforce</td>
<td>63%</td>
<td>56%</td>
</tr>
<tr>
<td>Depth of industry knowledge</td>
<td>46%</td>
<td>49%</td>
</tr>
<tr>
<td>Quality of customer service</td>
<td>46%</td>
<td>49%</td>
</tr>
<tr>
<td>Depth of process knowledge</td>
<td>46%</td>
<td>49%</td>
</tr>
<tr>
<td>Low cost of service delivery</td>
<td>36%</td>
<td>45%</td>
</tr>
<tr>
<td>Recommendations by other..</td>
<td>33%</td>
<td>25%</td>
</tr>
<tr>
<td>Customization of service delivery</td>
<td>27%</td>
<td>21%</td>
</tr>
<tr>
<td>Market reputation</td>
<td>26%</td>
<td>25%</td>
</tr>
<tr>
<td>Track record of management team</td>
<td>26%</td>
<td>25%</td>
</tr>
<tr>
<td>Time to complete project</td>
<td>21%</td>
<td>27%</td>
</tr>
<tr>
<td>Global presence</td>
<td>15%</td>
<td>13%</td>
</tr>
</tbody>
</table>
Continued Preference for Distant Locations despite Growing Availability of Delivery Centers in Latin America

The latest ORN Global Corporate Client Survey results suggest that US companies continue to prefer far-shore destinations – locations beyond nine time zones from the United States – especially in the areas of IT infrastructure, ADM, and innovation services.

The 2011 Survey showed that 76 percent of offshored IT operations are located nine time zones away, up from 70 percent in 2009. ADM services located in far-shore locations rose from 66 percent to 79 percent, while innovation services operations rose from 63 percent to 67 percent.

Despite the increasing availability of near-shore delivery centers such as Latin America, US companies appear not to have found ample justification to relocate their facilities closer to the United States. Many US companies established their IT operations, business process offshoring, and contact center facilities in India and other countries in Asia several or more years ago. Forty-three percent of US offshoring operations in IT, ADM, and innovation services are currently located in India. Another 12 percent of such operations are in Eastern Europe, and 10 percent are located in China.

Familiarity and Greater Operational Agility Help Explain Preference for India

Latin America, the only near-shore location for US companies with low-cost, qualified personnel, is steadily attracting new operations, yet its offshoring industry is still relatively small and new. India therefore is still by far the primary destination for US companies. An offshoring destination involving a wide range of cities for two decades, India boasts mature service providers, a significant presence in most industries, and a relatively large talent pool. India has in general proven most agile in delivering attractive value propositions for offshoring companies.

Figure 9. Continued US Company Preference for Distant Locations

* CC = Contact Center | Inno = Innovation | F&A = Finance & Accounting | IT = IT Infrastructure | Know = Knowledge Services | Soft = Software
Experience and familiarity also help explain why US companies continue to prefer far-shore locations. In other words, US companies have become adept and seasoned at managing the challenges that distant offshore operations can pose. Relocating involves potential disruption to their existing operations, along with significant costs and managerial effort. Therefore, unless US companies experience serious degradation of the value proposition for global sourcing in India, they can be expected to be disinclined to move their operations closer to home.

Nevertheless, there are signs that in some functional areas at least, US companies are slowly beginning to build a presence in Latin America. In finance and accounting, the percentage of operations located in Latin America increased from 10 percent in 2009 to 16 percent. ADM services are also growing in this region – from 7 percent to 12 percent – though at a much slower pace than in the regions that are nine time zones away.

**Geography and Language Give European Companies a Near-Shore Location Edge**

In contrast to US companies, time zone and location are not as much of an issue for European companies. The ORN 2010 Service Provider report noted that local and international providers have been aggressively establishing delivery centers in locations within five time zones from key clients in major Western European cities; these locations include Latin America, Eastern Europe, the Middle East and India. On the other hand, an analysis of New York City-based clients — representative of major North America cities — shows a continued dependence on delivery centers located more than five time zones away from clients (see Figure 11). The lack of English proficiency in some countries is also more of an issue for US companies than it is for more multilingual European companies. In contrast to Asian countries, a country like Brazil, for example, has a low proportion of English fluency and a tight supply of IT professionals such as software developers and computer programmers. On the other hand, in 2010 Argentina had a surplus of IT professionals, but they are unable to work in Brazil because of the country’s complex immigration policies. As a result, given the shortage of qualified, English-speaking service providers in parts of Latin America, most US companies still very much rely on far-shore locations like India and China for locating their global sourcing activities.
Figure 10. Service Providers Today Are Available Worldwide

Overall distribution of ORN service providers* by HQ location

*The distribution is based on service providers participating in ORN surveys and may not be representative of overall population.

Figure 11. Most US Companies Still Offshore Their Activities to Locations Beyond 5 Time Zones

Percent of offshoring implementations to location within 5 time zones

<table>
<thead>
<tr>
<th>Category</th>
<th>Non-US</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engineering Services</td>
<td>79%</td>
<td>8%</td>
</tr>
<tr>
<td>Product Design</td>
<td>75%</td>
<td>21%</td>
</tr>
<tr>
<td>Finance &amp; Accounting</td>
<td>74%</td>
<td>15%</td>
</tr>
<tr>
<td>Contact Center</td>
<td>70%</td>
<td>11%</td>
</tr>
<tr>
<td>ADM</td>
<td>67%</td>
<td>17%</td>
</tr>
<tr>
<td>IT Infrastructure</td>
<td>64%</td>
<td>9%</td>
</tr>
<tr>
<td>Marketing &amp; Sales</td>
<td>64%</td>
<td>17%</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>60%</td>
<td>25%</td>
</tr>
<tr>
<td>HR</td>
<td>60%</td>
<td>10%</td>
</tr>
<tr>
<td>Analytical/Knowledge-</td>
<td>57%</td>
<td>13%</td>
</tr>
<tr>
<td>Legal Service</td>
<td>56%</td>
<td>10%</td>
</tr>
</tbody>
</table>
Midsize Firms Look Abroad Opening New Opportunities for Service Providers

The value proposition of global sourcing is becoming increasingly attractive to midsize companies, consequently opening new business opportunities for local and international service providers.

Of the large companies participating in the 2011 Corporate Client Survey, nearly 80 percent were engaged in global sourcing, with plans to expand about 41 percent of current operations in the next 18 to 36 months. In contrast, among midsize companies, 58 percent are currently offshoring, while another 17 percent are considering such a move. In addition, midsize companies have plans to expand about 71 percent of current operations in the next 18 to 36 months.

Application Development and Maintenance Top Midsize Companies’ Sourcing Plans

Of the midsize companies with global sourcing operations in place, 38 percent plan to launch new sourcing operations in the area of application development and maintenance (ADM); 28 percent plan to introduce new IT operations; and 28 percent indicated plans to launch new knowledge services operations. For large companies with global sourcing operations in place, 34 percent plan to launch new operations in IT, 24 percent plan new knowledge services, and 23 percent plan to launch new ADM services.

Figure 12. Most Large Companies Already Have Global Sourcing Operations; Only 58 % of Midsize Companies Do

Offshoring status by company size in 2011
Among midsize companies that had not previously offshored and plan to begin global sourcing activities, nearly 50 percent identified ADM, and approximately 40 percent reported considering offshoring IT infrastructure. This finding is consistent with the anticipated growth on the service provider side: In the 2010 ORN Service Provider Survey, over 60 percent of service providers indicated plans to expand the scale of their IT infrastructure operation. The largest headcount growth has been recorded by larger providers’ ADM operations.

Midsize companies are more reluctant about moving business services offshore because they perceive themselves to lack the management capabilities, technical expertise, and sufficient transaction scale to assure the successful rollout of a global sourcing strategy. That concern and lack of experience, coupled with a growing interest to enter global sourcing, presents service providers with potentially valuable opportunities.

In the past, when midsize companies expanded IT operations, 59 percent of such implementations began with the outsourcing delivery model, according to previous ORN surveys. Also, 63 percent of the IT operations implementations involved only discrete tasks. Service providers planning to target midsize companies interested in offshoring ADM functions, or other activities will have to develop or tweak their value proposition to emphasize new levels close customer support are significantly different from traditional IT operations contracts.
A Good Fit: Midsize Providers and Midsize Companies New to Global Sourcing

In the 2011 Corporate Client Survey, midsize companies identified “increased scale of company to take advantage of offshoring” as the second most important factor that would influence them to consider offshoring. Compared to previous survey years, the 2011 Survey found a substantial increase in the proportion of respondents from companies not yet offshoring who reported they would begin to consider global sourcing strategies if there were “better resources for managing a remote location” and “better capabilities for implementing offshoring projects.” Data show that both local and US service providers are starting to recognize that by addressing these companies’ concerns and requirements, they are in a stronger position to grow their businesses with midsize clients.
Figure 16. Other Than Perceived Certainty in Savings, Midsize Companies Are Most Concerned They Lack the Scale to Take Advantage of Global Sourcing

Factors That Would Drive Non-Offshoring Companies to Offshore by Company Size

- Greater certainty in high achieved savings
- Better resources for managing a remote location
- Increased infrastructure stability
- Better capabilities for implementing offshoring
- Greater maturity in BPO
- Ability to better quantify risks
- Better fit with corporate culture
- Increased political stability
- Increased scale of company to take advantage
- Reduced political backlash in US
- Competitors offshoring

Figure 17. More Concerns About Adequate Resources and Capabilities to Manage Offshoring Operations in 2011 Survey

Factors That Would Drive Non-Offshoring Companies to Offshore by Survey Year

- Greater certainty in high achieved savings
- Increased scale of company to take advantage
- Better resources for managing a remote location
- Better capabilities for implementing offshoring
- Increased infrastructure stability
- Increased political stability
- Better fit with corporate culture
- Greater maturity in BPO
- Ability to better quantify risks
- Reduced political backlash in US
- Competitors offshoring
The 2010 Service Provider Survey results reveal that midsize providers have made the most significant improvement in their transition processes. The time required to achieve target service levels declined from an average of 6.3 months to 4.6 months over the past year. This phenomenon indicates that service providers are introducing training and development programs designed to increase staff understanding of client-specific needs, processes and capabilities. Midsize local and US service providers, in particular, are investing aggressively in establishing training centers for internal staff. According to the 2010 Service Provider Survey, training centers owned by midsize companies represent nearly half (48 percent) of all training centers, followed by small providers (27 percent) and large providers (25 percent). This suggests that it might be midsize service providers that can successfully sell their value proposition, alleviating midsize clients’ concerns about “not having resources, or capability, or the scale” to go offshore.

Figure 18. Midsize Providers Make Significant Improvements in Transition Processes as Indicated by Time Required to Achieve Target Service Levels

*Time taken to achieve target service levels (months)*

- Small: 2009 (4.4), 2010 (4.0)
- Mid-size: 2009 (6.3), 2010 (4.6)
- Large: 2009 (5.1), 2010 (5.4)
Figure 19. Midsize Providers are Making Aggressive Investments in Establishing Training Centers for Internal Staff

*Percent of providers owning training center for employees*

- Small: 27%
- Large: 25%
- Midsize: 48%
Services Outsourcing Is Increasing Despite the Better Cost Performance of Captive Centers

Data from the most recent ORN Corporate Client Survey show that sourcing to a third party as opposed to operating a captive location has become more popular over time. Since 2007, according to ORN surveys, two out of three newly launched operations were outsourced to a service provider. Interestingly, however, the most recent survey also revealed findings about captive operations that seemingly contradict the growing preference for outsourcing operations:

- US companies operating captive models reported better performance on average than operations based on third-party sourcing – a pattern that holds true when controlling for the size of the respondent companies.
- During the first year of launch, captive operations generated average savings of 38 percent average, compared with only 24 percent for outsourced operations, according to the recent survey.
- For 2011 Survey respondents, the cost improvement achieved from captive operations the previous fiscal year was 34 percent on average, while the cost improvement from outsourced operations was 22 percent on average.
- For captive operations, 74 percent reported being “very satisfied” with the service level achieved, while only 49 percent reported the same for the outsourced operations.

Table 3. Performance Comparison by Delivery Model*

<table>
<thead>
<tr>
<th></th>
<th>Captive</th>
<th>Outsourced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings Achieved in First Year</td>
<td>38.4</td>
<td>24.3</td>
</tr>
<tr>
<td>Cost Improvement from Last year</td>
<td>34</td>
<td>22</td>
</tr>
<tr>
<td>Time to Achieve Service Level</td>
<td>Captive</td>
<td>Outsourced</td>
</tr>
<tr>
<td>0-1 month</td>
<td>1.6</td>
<td></td>
</tr>
<tr>
<td>2-5 months</td>
<td>14.1</td>
<td>27.9</td>
</tr>
<tr>
<td>6-12 months</td>
<td>53.1</td>
<td>45.6</td>
</tr>
<tr>
<td>&gt; 12 months</td>
<td>21.9</td>
<td>11.8</td>
</tr>
<tr>
<td>Not yet</td>
<td>9.4</td>
<td>4.4</td>
</tr>
<tr>
<td>Never achieved</td>
<td>0.0</td>
<td>10.3</td>
</tr>
<tr>
<td>Percent Indicating Very Satisfied with Service Level</td>
<td>74%</td>
<td>49%</td>
</tr>
</tbody>
</table>

*Saving achieved in first year was based on initial delivery model type, all the rest are based on current delivery model
Understanding the Growing Preference for Outsourced Service Centers

The findings outlined above underscore that a variety of considerations enter into global sourcing decisions, and cost clearly is only one of these. When a captive investment is associated with high transaction volumes, economies of scale help cut the payback period. In contrast, when a company uses a service provider to widen the organization’s footprint in a new market, operating costs are not the only factors it is closely managing. Among the other factors are speed to market and access to qualified personnel.

A similar argument can be made about the changing perception of, and experience with, labor costs. The 2011 Survey found a decrease in the percentage of respondents that consider labor costs to be the most important driver for global sourcing over time. In previous ORN surveys, over 80 percent of respondents reported that “labor cost” is an “important” or “very important” strategic driver. In the 2011 Survey, however, only 72 percent of respondents selected “labor cost” as one of the three most important strategic drivers.

One argument supporting the outsourcing model is the expectation to benefit from ever improving best practices that service providers acquire by serving multiple clients in need of similar service offerings. It is not surprising that large international providers, for example in India, have been willing to renegotiate contracts and offer lower costs in return for longer term contracts.

Centers of Excellence Have Become a More Integral Company Resource

The 2008 ORN Corporate Client Survey report, Offshoring Reaches the C-Suite, illustrated key best practices/capabilities that support the corporate global sourcing strategy, as well as related follow-up interviews and case studies. A key practice this report identified was the establishment of global offshoring/outsourcing resource centers, now frequently referred to by industrial practitioners as “centers of excellence” or project management offices. By the time of the 2011 Survey, respondents were increasingly adopting such practices: 27 percent of the companies now operate a center of excellence, compared with only 17 percent the previous year. At 70 percent, the financial services industry features the highest proportion of companies with a center of excellence, according to the 2011 Survey.

When asked to specify in their own words the capabilities developed by these centers of excellence, 26 percent of the companies mentioned vendor management. Another 19 percent of respondents indicate their centers are directly involved with global sourcing strategy formulation, and 13 percent of respondents indicated that their centers engage in sharing best practice across offshoring implementations.
“Vendor Management” is By Far the Most Frequently Identified Capability Developed in the Center of Excellence

Labor, Service Quality and Security Risk Remain Major Concerns.
When asked to identify the risks involved in offshoring, about 70 percent of companies that currently run operations in India noted labor risks. For respondents who were considering offshoring at the time of the 2011 Survey, the risks that were identified involved “service quality” and “data security.”

Broken down by function, respondents noted “data security,” “service quality,” and “IP protection” as their biggest concerns associated with sourcing IT, ADM, and innovation services abroad. Another 21 percent of the respondents were concerned about building “flexibility” for IT offshoring. The comparison of margins for Indian service providers and the large international providers (e.g. Accenture, HP, Capgemini, and IBM) reveals a steady decline for Indian providers, from 25 percent in 2007 to 17 percent in 2010, according to the most recent ORN Service Provider Survey. This comes at a time when the international service providers have been able to raise their profit margins over the past three years, from 20 percent in 2007 to 30 percent in 2010. This suggests that the India-based service providers’ business model does not match client expectations that service providers become partners in contributing value to their client’s business processes.
### Table 4. Service Quality and Data Security are Most Frequently Identified Functional Risks in 2011 Survey

<table>
<thead>
<tr>
<th>Risk</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service Quality</td>
<td>39%</td>
</tr>
<tr>
<td>Data Security</td>
<td>31%</td>
</tr>
<tr>
<td>Intellectual Property</td>
<td>19%</td>
</tr>
<tr>
<td>Loss of Internal Process Knowledge</td>
<td>17%</td>
</tr>
<tr>
<td>Attrition</td>
<td>17%</td>
</tr>
<tr>
<td>Political Backlash/Loss of Reputation</td>
<td>16%</td>
</tr>
<tr>
<td>Geopolitical</td>
<td>9%</td>
</tr>
<tr>
<td>Communications</td>
<td>7%</td>
</tr>
<tr>
<td>Language/Cultural Barriers</td>
<td>7%</td>
</tr>
<tr>
<td>Speed of Delivery</td>
<td>6%</td>
</tr>
<tr>
<td>Flexibility/Agility</td>
<td>5%</td>
</tr>
<tr>
<td>Training/Skills/Education</td>
<td>5%</td>
</tr>
<tr>
<td>Regulations and Tariffs</td>
<td>5%</td>
</tr>
</tbody>
</table>

### Table 5. Respondent Self-identified Risks by Function in 2011

<table>
<thead>
<tr>
<th>Contact Center</th>
<th>Finance &amp; Accounting</th>
<th>IT</th>
<th>Innovation</th>
<th>ADM</th>
<th>Knowledge/Analytical Service</th>
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</thead>
<tbody>
<tr>
<td>Service Quality(40%)</td>
<td>Service Quality(38%)</td>
<td></td>
<td></td>
<td></td>
<td>Data Security(43%)</td>
</tr>
<tr>
<td>Data Security(24%)</td>
<td>Political Backlash(33%)</td>
<td></td>
<td></td>
<td></td>
<td>Service Quality(26%)</td>
</tr>
<tr>
<td>Geo Political(24%)</td>
<td>Data Security(33%)</td>
<td></td>
<td></td>
<td></td>
<td>IP Protection(32%)</td>
</tr>
<tr>
<td>Customer Satisfaction(16%)</td>
<td>Regulations(19%)</td>
<td></td>
<td></td>
<td></td>
<td>Service Quality(24%)</td>
</tr>
<tr>
<td>Loss of Internal Capabilities(14%)</td>
<td>Loss of Internal Process Knowledge(21%)</td>
<td></td>
<td></td>
<td></td>
<td>IP Protection(30%)</td>
</tr>
<tr>
<td>Attrition(14%)</td>
<td>Attrition(16%)</td>
<td></td>
<td></td>
<td></td>
<td>Loss of Internal Process Knowledge(17%)</td>
</tr>
<tr>
<td>Domestic Political Backlash/Reputation(14%)</td>
<td>Cost(15%)</td>
<td></td>
<td></td>
<td></td>
<td>Loss of Internal Process Knowledge(19%)</td>
</tr>
<tr>
<td>Language Skills(12%)</td>
<td>IP(15%)</td>
<td></td>
<td></td>
<td></td>
<td>Political Backlash(14%)</td>
</tr>
<tr>
<td></td>
<td>Geo Political(12%)</td>
<td></td>
<td></td>
<td></td>
<td>Communication(10%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Management(10%)</td>
</tr>
</tbody>
</table>

*Academic Research Informed By and Informing Managerial Practice*
Figure 20. Indian-based Providers Have Been Struggling to Maintain High Margins While Large International Providers Have Been Successful in Increasing Their Margins

A comparison of average margins achieved by large international and Indian based providers across years

<table>
<thead>
<tr>
<th>Year</th>
<th>Large International Providers</th>
<th>Indian Based Providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>20%</td>
<td>25%</td>
</tr>
<tr>
<td>2009</td>
<td>29%</td>
<td>20%</td>
</tr>
<tr>
<td>2010</td>
<td>30%</td>
<td>17%</td>
</tr>
</tbody>
</table>
Looking Forward: Global Sourcing Will Continue to Expand

Companies report plans to continue to expand existing global sourcing activities. The 2011 Global Corporate Client Survey revealed that 52 percent of existing global sourcing operations are to be expanded. This a slight decrease compared to the previous survey. In addition, companies report a slight increase in the percentage reporting plans to relocate and transfer current operations.

Compared to the previous year’s survey, growth in the functional areas of IT, finance and accounting is slowing among companies currently engaged in global sourcing. Meanwhile, for companies planning to add new offshoring services, the survey showed slight increases for contact centers, application development and maintenance (ADM), as well as knowledge services.

Nevertheless, for most industries reflected in the 2011 Survey, about half of the existing offshoring operations are to be expanded in the next 18 to 36 months. By comparison, responses to the 2010 Service Provider Survey indicate that 49 percent of providers are planning to expand their service capacity over the next 18 to 36 months.

When asked about their plans to initiate new global sourcing activities, nearly 40 percent of responses from financial services and software sectors noted plans to add ADM services in the next 18 to 36 months. In addition, 25 percent of responses from the financial services sector reveal plans for new knowledge and analytical services in the next 18 to 36 months, while 15 percent of responses from the software sector indicate plans for new knowledge services during that time span.

Compared to the previous year’s survey, the 2011 Survey found a substantial increase in the proportion of respondents considering offshoring IT, ADM, and contact center services: 25 percent to 38 percent for IT, 26 percent to 40 percent for ADM, and 19 percent to 32 percent for contact centers.
Figure 22. Percent of Companies Planning New Services by Survey Year

- Application Development & Maintenance: 32% (2011), 34% (2009/10)
- IT Infrastructure: 29% (2011), 39% (2009/10)
- Knowledge Service: 24% (2011), 27% (2009/10)
- Contact Center: 18% (2011), 20% (2009/10)
- Finance & Accounting: 17% (2011), 27% (2009/10)
- Research & Development: 9% (2011), 11% (2009/10)
- Human Resources: 10% (2011), 19% (2009/10)
- Engineering Service: 10% (2011), 11% (2009/10)
- Marketing & Sales: 9% (2011), 9% (2009/10)
- Supply Chain & Facilities: 8% (2011), 20% (2009/10)
- Legal Services: 6% (2011), 4% (2009/10)
- Design Services: 5% (2011), 10% (2009/10)

Figure 23. Risk Perceived by Non-Offshoring Companies by Company Size

- Service quality
- Lack of acceptance from customers
- Operational efficiency
- Legal/contractual risks
- Increasing difficulty in finding qualified personnel...
- Loss of synergy across firm activities
- Loss of internal capabilities / process knowledge
- Data security
- Lack of acceptance from internal clients
- Political instability
- Cultural differences
- Loss of managerial control
- Lack of intellectual property protection
- Lack of buy-in of offshoring in corporate culture
- High employee turnover
- Wage inflation
- Industrial relations / trade unions at home
- Political backlash at home
- Incompatibility between IT systems

[Diagram showing risk perception by company size (Small, MidSize, Large)]
Acknowledgements

Many individuals, executives, and companies have contributed to the preparation of this report. We especially thank the company respondents of the 2010-11 Offshoring Research Network (ORN) survey and senior executive roundtables participants for their valuable feedback and input to get behind the numbers. We want to especially thank Pricewaterhouse Coopers for their financial support of the annual surveys and this report.

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