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## Develop your hybrid sourcing strategy

This article is based on a recent study conducted by the Loughborough Centre for Global Sourcing and Services. The study was carried out by Prof. Ilan Oshri, Dr. Angelika Zimmerman and Dr. Eleni Lioliou.

### Body copy:

Many firms nowadays pursue a concurrent sourcing strategy, i.e. set up shared service centres as well as engage in contracting out IT and business processes to third party service providers. This is not new in the manufacturing world. Indeed, the manufacturing literature has taken interest in this sourcing strategy and examined the plural (both make and buy sourcing strategy for the same component) and hybrid (pursuing both make and buy as part of a general procurement strategy) approaches. Much attention has been given in the manufacturing literature to understanding and optimizing these sourcing strategies, in an attempt to realize which function should be 'made' in house and which function should be 'bought' from an external vendor.

As a complete contrast, the ITO and BPO academic and professional literature has paid little attention to plural and hybrid sourcing strategies. In particular, the IS outsourcing literature has tended to examine *either* the make *or* the buy option separately or as alternatives to each other. The main reason for that is the way these strategies have evolved over time in many firms. By and large, in most organisations, individual managers have made the decision to pursue either a make or a buy strategy as a de-centralized activity at the manager level, with little oversight of a central sourcing function.

However, recent years have witnessed a gradual shift towards a new model: a 'hybrid' sourcing strategy – the orchestration of both 'make', in the form of managing captive shared service centres, and 'buy' in the form of managing third party providers, in an attempt to maximize the value extracted from internal and external suppliers. At the basis of this strategy is the understanding of what value SSCs and third party providers deliver as an input to the firm's hybrid sourcing strategy.

In this study we examine the benefits of the hybrid sourcing strategy and compare the perceived value extracted from the SSCs and third party providers. Such value can be in the form of the effort to govern internal and external suppliers (formal governance) but also the closeness of the firm to its internal and external suppliers (informal governance). These indicators may inform decision makers about the relative advantage and comparative effectiveness of SSCs as compared with third party providers and therefore will assist in orchestrating a hybrid sourcing strategy, in particular if switching services between SSCs and third party providers is needed.

### **About this study**

A survey targeting managers from client firms directly involved in managing both third party service providers and shared service centres was carried out by the Loughborough Centre for Global Sourcing and Services in 2013. One hundred

and fifty useable responses were obtained from firms in the UK (44%) and the USA (56%) with the majority of the firms (over 60%) with over 3000 employees. Responses also represent numerous industries including manufacturing (19%), finance (15%) and retail (14%). Firms in the survey have been outsourcing for over five years (66%) and some firms with ten years and more outsourcing experience (36%).

**The benefits of a hybrid sourcing strategy**

The vast majority of client firms still manage their internal and external sourcing engagements as two separate activities. As such, the transformation of the firm’s sourcing function will require significant changes in the organizational structure, definition of roles and even attitudes of the sourcing managers. We were interested to understand what benefits been achieved from hybrid sourcing strategy.

Managers indicated that a hybrid sourcing strategy has had an impact on the internal sourcing function in various ways. 73% of the managers responded with strong confidence that the hybrid sourcing strategy improved the overall sourcing performance. High percentages of our respondents further agreed that the hybrid sourcing strategy has helped reducing overheads in the internal sourcing function and improved relationships with external vendors. However, only 53% of the managers agreed that a hybrid sourcing strategy has transformed the internal sourcing function into a professional sourcing unit.

Pursuing a hybrid sourcing strategy has...	Strongly Agree
Improved our overall sourcing performance	73%
Reduced overheads in the internal sourcing function	71%
Improved our business performance	70%
Improved our relationships with external service provider	68%
Standardized our vendor management approach	60%
Made us a professional sourcing unit	53%

Caption: **The governance of the hybrid sourcing model**

***Are we in this for long?***

It has been argued in the professional and academic literature that client firms and service providers have adopted a partnership approach in which both parties work closely together on both service and innovation projects. The results of our survey show that SSCs are still by far more accommodating in their partnerships than third party service providers. Only 11% of the managers stated that they have maintained very close working relationships with their third party service providers compared with 32% that agreed to this statement with regard to their SSCs. When examining the nature of the relationships, only

23% of the managers said that they were close to third party service providers while 34% of them said they were close to their SSCs. Forty-four per cent of hybrid sourcing managers thought that their relations with the SSCs were long term compared with only 34% who saw long-term relationships with third party service providers.

### ***Are we on the same page?***

Understanding each other in terms of goals, business domain and objectives is key for a long-term collaboration. Managers thought that they understood their SSCs' procedures and practices far better than those of their third party service providers. More importantly, 43% of the managers strongly believed that SSCs understood their business domain and objectives compared with only 31% who held a similar view about their third party service providers.

One important element in ensuring that the firm and its internal and external providers are on the same page is the exchange of knowledge between these entities. In this regard, managers perceived SSCs to be more forthcoming in sharing methodologies (42% vs 28%) and know-how (38% vs 22%) than third party service providers.

### ***Can we trust you?***

Trust is an important indicator of the health of the relationship and can have serious implications for performance and long-term collaboration. When asked about pursuing beneficial decisions for the client under all circumstances, 34% of the managers believed SSCs were doing so, while only 26% thought the same with regard to third party service providers. More managers thought that SSCs (36%) presented a truthful picture of the issues as compared to third party service providers (29%).

### ***Are we in control?***

The formal governance of internal and external suppliers consists of multiple control mechanisms that allow the client firm to monitor the timely delivery of quality service. When asked about the actions taken by SSCs and third party providers to ensure that the client is in control and is capable of monitoring outcomes, managers were in agreement that both entities have pursued such practices at a satisfactory level. For example, both SSCs and third party service providers 'followed an understandable written sequence of steps in delivering services'. However, managers indicated that disagreements with SSCs were almost always successfully resolved (40%) as compared with third party service providers (33%). Also, 37% of the managers indicated that, in the case of SSCs, differences of opinion were resolved to the mutual satisfaction of conflicting parties, as compared to only 30% in the case of third party providers. Results also show that attrition levels at SSCs were about 7% lower than third party service providers.

### ***Who is doing better: SSCs or third party providers?***

In the eyes of client firm managers, third party providers have performed better than SSCs with regard to the ability to achieve desired cost savings (36% vs

32%). However, SSCs were seen by managers to be performing better by 5-10 points per each item concerning: (i) services meet expectations, (ii) satisfaction with overall benefits, (iii) helping to refocus the client business, (iv) enhancing customer satisfaction and (v) introducing new ways to compete. Clearly, SSCs are not perceived to be a source of cost savings but rather a centre of excellence with the ability to have an impact on the client firm at the operational and strategic level.

### **Towards a hybrid sourcing strategy: three key issues to consider**

There are three main issues that emerge from this study concerning the hybrid sourcing strategy, SSCs and third party service providers.

First, client firms need to consider the relational advantage of shared service centres over third party service providers when deciding on which functions should be provided from SSCs versus those by external providers. Currently, such decisions are mainly taken by cost and skill availability consideration, with little given attention to the effect of relational governance on performance. It is common knowledge that strong relational governance is more likely to deliver innovation and transformation and therefore SSCs should be given more opportunities to leverage on their advantageous relational position and get involved in innovative work for the parent firm.

On the other hand, third party service providers fell behind SSCs with regard to obtaining relational governance qualities such as the sharing of knowledge with the client, being close to the client and understanding the client's business. Even more alarming for third party service providers is the perception of client firm managers that while third party service providers outperform SSCs on cost saving, they are doing worse on any other indicator that signals adding value to the business. Clearly, service providers need to strengthen their relational governance if they are to stand behind their promise to transform the client's business.

Last but not least, client firms that have moved into a hybrid sourcing strategy may have seen some operational benefits; however, many of them still lack a standardized approach to carry out a hybrid sourcing strategy and even more firms have not professionalized their internal sourcing function. There are great opportunities in standardizing and professionalizing the sourcing approach towards SSCs and service providers such as learning spillovers and a flexible utilization of internal and external resources based on the optimization of skills, costs and value added services. As the hybrid sourcing strategy is still in its infancy, now is the time to make such adjustments to maximize returns on this investment.