# To bundle or not to bundle? Effective decision-making for business and IT services

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# Foreword

As outsourcing has grown over the past couple of decades into a $300+ billion industry, buyers and providers alike have learned to increase the value derived from the outsourcing relationship. In its youth, outsourcing was primarily a cost play. As outsourcing has matured, we are seeing new, more collaborative engagement models that enable more strategic kinds of business value.

One of the most important current developments is the move to combine or "bundle" multiple processes and technologies with a single provider. A decade or more ago, such a move might have been looked at with some suspicion, but companies have become aware that whatever savings they might have realized from a multi-sourcing approach have been more than negated by the hidden costs of managing an ever-more-complex roster of providers.

Bundling is already delivering significant value for major companies around the world. Unilever, for example, has gained from bundling the management of its applications and its HR functionality. A comprehensive bundling arrangement at Bristol-Myers Squibb—application development and maintenance, finance, and R&D—has helped the company adjust to regulatory and industry challenges, and has helped the company in its productivity and transformation initiatives.

A bundled approach to outsourcing comes with its own set of challenges, to be sure. A more effective enterprise-level governance model is needed, for example, along with advanced relationship management capabilities. The initial choice of provider also becomes more important, too—one that can provide multiple services. It's also important to look for a firm that can do things with your organization, not to it—one that complements your long-term business strategy, not just the transactional needs of the moment.

This research report is one of the first comprehensive analyses of the potential of bundled outsourcing. It provides documented insights into some of the myths and realities of bundling, and the factors that shape sourcing decisions. It also offers guidance in structuring the sourcing decision-making process for best results, and points the way towards a new model of strategic collaboration between providers and buyers, one that has the potential to drive high performance through outsourcing.

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# Executive summary

This paper details the key research findings on the purchasing decisions clients make on bundling, or not bundling, IT (ITO) and business process outsourcing (BPO) services. We studied over 1,850 outsourcing contracts, and carried out interviews with 69 leading clients and suppliers in ITO and BPO services. At the macro level we found IT, IT infrastructure and applications bundling accounting for over 70 percent of bundling activity, followed by bundled BPO, (for example billing, finance and accounting) representing some 15 percent of bundling activity. As yet we found few clients who outsourced to the same supplier their main IT together with BPO.

Key findings are:

- The maturity of the organization to manage innovation and suppliers has a big influence on their ability to contemplate bundled services.
- Clients lack clarity on how to assess getting value, especially cost efficiencies, from bundled services. As result they tend to evaluate based on function or silo.
- Lack of reliable, economically based reasons push decisions towards individual judgement, logic, and political influences.
- Organizations mature in their sourcing strategy and management capability are attracted to bundling where they can get innovation and if they can offset risk to, or share risk with the vendor.
- More mature organizations all emphasize that if the relationship with a supplier is strong, and it has performed, the client is more likely to go for bundled services. Relationships need to be many-to-many between client and supplier with lots of touch points and 'glue'.
- Some organizations bundle as start-ups or to achieve fast change. If they are immature in outsourcing management terms and have poor experiences subsequently, they move to multi-supplier sourcing in their second and third generation outsourcing arrangements. Some of these organizations look subsequently for supplier consolidation.
- Bundling occurs often where there is a strong and large-scale change agenda, through peer pressure, or in a belief that, in a recession, with limited resources available, it will be cheaper.
- A bundled service proposition of any scale needs a client Board member driving it.
- Some organizations reach a tipping point where the client is likely to pursue an add-on strategy, gradually bundling services over time, until they decide to go for a more comprehensive bundling strategy.

The paper assesses the myths and realities inherent in the trade-offs between bundling and unbundling. We uncover the key role that 20 drivers play when considering bundled or unbundled ITO and BPO services. These drivers are grouped into five areas: client factors, relational factors, supplier market and capabilities factors, and cost effectiveness characteristics, and form the basis of a decision-making matrix designed for client use. From the research we also distill five client profiles—Strategic Explorer, Service Extender, Operational Exploiter, Experimentor , and Multi-sourcer—of those organizations more, or less, likely to buy bundled services.

# Contents

# Introduction

We define **bundled services** as:

A mix of business process and/or IT services purchased separately or at the same time from the same supplier where synergies and efficiencies are sought in end-to-end processing, governance, relationship management, cost and performance.

On this definition there can be bundling *within IT*—for example the same supplier for infrastructure, applications, development; *within BPO,* for example training and development and payroll in the HR function; or *across ITO and BPO services,* for example procurement, IT applications, selected HR activities. The possible choices for bundling are considerable, making these complex decisions, with important cost and service consequences. In our view, bundling is an important trend that will grow considerably in the next five years, as suppliers mature their ability to deliver bigger scope offerings, and clients develop their ability to plan for host and manage such deals. How does bundling fit with the overall trend lines for ITO and BPO?

The global IT outsourcing (ITO) market has increased each year since we've been tracking it. In 2008, the global ITO market was estimated to be between a $230 to $250 billion market. The BPO market in 2008 was less than the ITO market, but growing at a faster rate. We estimate that the market for mainstream BPO expenditure is likely to grow worldwide by 10 percent to 20 percent a year from $140 billion in 2005 to over $300 billion by 2012. BPO expenditure will be in areas such as the human resource function, procurement, back office administration, call centers, legal, finance and accounting, customer facing operations and asset management. BPO is outpacing ITO because many executives recognize that they under-manage their back offices, and do not wish to invest in back office innovations. Suppliers are rapidly building capabilities to reap the benefits from improving inefficient processes and functions. IT provides major underpinning for, and payoff from, reformed business processes. Thus, many of the BPO deals will swallow much of the back office IT systems[1].

Although ITO and BPO spend is increasing, the average size of individual contracts and the duration of contracts has been decreasing. For example, the Everest Group found that among the ITO contracts signed in 1998, 24 percent of contracts were worth more than $400 million and 33 percent of contracts were worth between $50 and $100 million. In 2005, only 11 percent of contracts were worth more than $400 million and 57 percent of contracts were worth between $50 and $100 million. Concerning contract duration, the Everest Group found that 37 percent of contracts signed in 1998 were more than nine years in duration compared to 18 percent in 2005[2]. Into 2009, in recessionary conditions, we were seeing more contracts with shorter terms in years, and smaller total contract value, more frequent renegotiation and repricing, and more multi-sourcing.[3] At the same time

many organizations were looking to consolidate suppliers, and searching for cost efficiencies in management and governance.[4]

How can we reconcile smaller, shorter deals with an overall increase in the ITO/BPO markets? Undoubtedly many client organizations have been actively pursuing more multi-sourcing. Multi-sourcing has always been a major practice, and the overall growth is driven by client organizations signing *more* contracts with *more* suppliers. While multi-sourcing helps clients access best-of-breed suppliers and mitigates the risks of reliance on a single supplier, it also means increased transaction costs as clients manage more suppliers, interdependencies and interfaces. Governance, contracting, measurement and comparison become complex tasks.[5] Multi-sourcing also means that suppliers incur more transaction costs—suppliers must bid more frequently because contracts are shorter, suppliers face more competition because smaller-sized deals means that more suppliers qualify to bid, and suppliers need to attract more customers in order to meet growth targets. Given these experiences, especially in the 2003-2009 period, this suggests that bundled and unbundled outsourcing produce different trade-offs that need to be assessed more closely than they have been.

In what follows, we analyze, first, the major market developments for bundled outsourcing, then provide a series of insights from recent client and supplier interviews on when bundling is attractive and feasible. We then look more closely at the trade-offs and the logic applied to the decision to bundle or not to bundle to suggest under what circumstances bundling makes strategic and operational sense. We discuss the 20 key factors that emerge from our study that determine whether a bundled or unbundled decision is the optimal route for a client organization. From this, and as a way of consolidating the lessons from the research study, we provide a weighted 20-factor framework to enable clients make more effective decisions in this important area. Finally, we detail from our research base five client profiles, distilling the alternative routes organizations have been pursuing into bundled ITO and BPO services.

# Market analysis: Bundled ITO/BPO services 2003-2008

**Table 1:** High level analysis of bundled services contracts 2003-2008

| Bundle | # contracts | % contracts | Secondary vendor | Solution area | Leading client industry | Client charact. | Market size |
|---|---|---|---|---|---|---|---|
| AO-BPO | 20 | 2.3% | 23.8% | Application management | Local gov | Varies | 4.5B |
| AO-IO-BPO | 47 | 5.4% | 27.1% | AM, data centers, various BPOs | Banking/fed and local gov | Varies | 17B |
| Bundled BPO | 127 | 14.5% | 11.8% | Billing, finance and accounting | Banking/fed and local gov | Most large firms | 21B |
| IO-AO | 658 | 75.4% | 5.0% | AM, data centers | Banking/fed and local gov/health care/process manufacturing | US/UK, varies | 149B |
| IO-BPO | 21 | 2.4% | 9.1% | Customer care, billing | Local and fed gov | Varies | 3.7B |

**IO**=IT outsourcing; **AO**=applications outsourcing; **BPO**=business process outsourcing)

We have analyzed 865 bundled outsourcing contracts signed between 2003 and 2008 to draw a conclusion about bundled services market trends, as described in Table 1. The value of bundled outsourcing contracts signed in 2003 was $US 38 billion. This rose to a peak of $95 billion in 2006 when 204 such contracts were signed. In 2007 200 contracts were signed at a value of $46 billion. Clearly bundled outsourcing is an interesting and dynamic market, with revenues never less than $35 billion in any one year between 2003 and 2008[6].

When comparing the different types of bundled services, the following market trends emerge:

**1.** IO-AO is by far the most popular bundled services between 2003 and 2008 (per number of contracts and per market size).

**2.** For both AO-BPO and AO-IO-BPO it is more common to have a second provider than in the other bundling arrangements (e.g. IO-AO).

**3.** The leading industries (i.e. with the highest number of contracts and total contract value) vary depending on the bundling arrangement. Local and federal government is the leading industry in AO-BPO and IO-BPO. It is also among the leading industries (either 2nd or 3rd) in AO-IO-BPO, bundled BPO and IO-AO. Banking is the leading industry in AO-IO-BPO and bundled BPO. Health care and process manufacturing are among the 3 top industries in IO-AO.

**4.** The average contract length is 76 months, with the varying averages for the bundling arrangements as follows: AO-BPO: 99 months, AO-IO-BPO: 97 months, bundled BPO: 77 months, IO-AO: 74 months, and IO-BPO: 90 months.

**5.** Competitive bid type is by far the most common bidding practice than any other approach (e.g. incumbent or sole sourced)

# To bundle or not to bundle? Insights for client organizations

Our work has thrown up a range of insights that are useful to clients considering whether to bundle or not to bundle.

## Insight 1

The maturity of the organization to manage innovation and suppliers has a big influence on their ability to move into bundled services. This was the case with a major oil company and a telecom multinational, both mature and with their in-house capability sorted, and both willing to bundle services as they felt necessary going forward. Secure in their own ability to manage and implement sourcing strategy, they had high propensity to buy bundled services if they could find the right supplier and right risk/reward deal. Other players that were relatively smart clients—for example a global mail company and a European telecoms firm—rated the relationship dimension as very high as an attraction into bundled services, but also saw innovation with a supplier as dependent on their own (client) shaping of the context, contract and relationship. Both still went down the multiple (relatively few) suppliers route but could see the point of bundling, especially as they were confident of their own in-house capability to manage that. This needs to be contrasted with another client who seemed to move into bundling because the supplier was incumbent for consultancy services, with whom they had a good relationship, and felt they did not really have the capability in-house to manage multiple suppliers. Also another client organization moved into bundling because of poor governance and learning capability in-house.

## Insight 2

We found that **clients do not know how to evaluate getting value from bundled services. As a result they tend to evaluate based on function or silo.** This is quite an important, if worrying finding. We would suggest that this inhibits their ability to identify the value of the bundled service proposition and pushes them into uncoupling services and leaves them open to multiple vendor solutions. Clients need some way to identify in detail the synergies from bundled services, and how to value those synergies. In interviewing one European and one Indian-based major supplier we found that they also struggled to demonstrate the financial advantages accruing from both technical synergies (production costs) and from common management arrangements (transaction costs) though could point to how such financial advantages could arise. Clients would then ask: 'show me actual examples'.

## Insight 3

The follow-on insight from the above is that as a result, on bundled services, an organization will tend to take an even more 'political' than 'economic' approach to decision-making. With no strong financial support for gains from bundling, other client and relationship factors take on much greater weighting in the decision. This is supported by our 20 factor framework detailed below. Of course, if our factor weightings turn out to be correct, client and relationship and political factors will also be key, but this shaping context would be greatly assisted if a way of providing reliable economically-based reasons for bundling services could be found.

## Insight 4

Mature organizations will look at bundling if they can get innovation—i.e. they have high ambition in these sort of deals—and if they can shift risk to, or share risks with, the vendor—they see large vendors as more able to absorb such risk over long periods of time. The message here to a supplier is to offer both.

## Insight 5

More mature organizations all emphasize that the relationship—if you know them well and the track record is OK to good—you are more likely to go for bundled services. This was not a prompted response.

## Insight 6

Some organizations we interviewed did bundle as start-ups (e.g. a major Asia Pacific telecom) or to achieve fast change but were immature in their ability to manage outsourcing and had poor experiences subsequently. One consequence was a move to multi-supplier sourcing in their second and third generation outsourcing arrangements. All seemed unlikely to move back to one major supplier, but on the other hand, all worried that, through a combination of poor sourcing strategy and over-reaction, they had commissioned too many suppliers, and were working on consolidation and reduction. This offered some scope for bundling, but recognizing that such clients still rated the importance of retaining a semblance of competition between their suppliers.

## Insight 7

Bundling occurs often where there is a strong and large-scale change agenda, through peer pressure, or in a belief that, in a recession, with limited resources available it will provide a cheaper alternative.

## Insight 8

A strong insight from talking to clients about how their organizations make decisions is that a bundled service proposition really does need a client Board member driving it. The ancillary strong finding was that the relationship factors we identified as key (see below) received strong independent endorsement but that relationships needed to be many-to-many between client and supplier with lots of touch points and 'glue.'

## Insight 9

One interesting route to pursue further is the notion of a tipping point where a client is likely to pursue an add-on strategy, gradually bundling services over time. What factors create this tipping point? Our weighted 20-factors framework can be used here to help a client make decisions (see Table 2).

# Assessing the trade-offs: Myths and reality

This is an assessment, based on our findings, of the common trade-offs clients consider and how far these trade-offs are based in reality.[7]

Five common concerns emerging from our interviews were:

- Control—Does multi-sourcing or bundling give you more control? How?
- Risk—Is going with one supplier more risky, or less risky?
- Incremental or big bang?—Should we grow into bundled outsourcing or can it be done in one deal?
- Tidy then outsource?—Should we straighten out our technology and processes first, or does bundling obviate this need?
- Cost and operational gains?—Is there really a big difference in the costs of management for bundling versus multi-supplier and silo outsourcing? Does a primary contractor model solve the problem?

On control, multi-sourcing may well give you more power and more control over each individual supplier, with less dependence on each. However, increased control comes at a price in terms of increased management cost, time, effort and measurement. At the same time, an argument can be made that bundling makes a client larger and more important to a provider, thus making the provider more responsive. In multi-supplier environments retained management capability needed to manage outsourcing regularly costs between 4-10 percent of total contract value[8]. As multi-sourcing governance has been moving up the outsourcing agenda in the last three years, we are seeing these costs also rise further[9].

On risk, there is more risk in depending on one or two suppliers—much depends on their capabilities and their financial strength, for example. However, with multi-sourcing the risks move into other areas, including cracks between service, security issues, hidden costs with continued monitoring and renewal of contracts, and possible replacement of suppliers. One must also ask how big the risks are with bundling or not bundling relative to the other risks a business will take in its main line of operations. In other words, often an organization will often impose—inconsistently—a higher standard of risk for a back office deal than even for a strategic business initiative.

On incremental bundling, we found many organizations taking this route over time, but we also found several organizations gaining from making a major one-off bundling deal, though this was a relative rarity when it came to complex BPO arrangements (see Table 1). As we indicate elsewhere in this paper, much depends on the ability of both the client and supplier to manage such arrangements and such capabilities are not yet commonly held. A related approach that we have seen in organizations is where they have straightened out their own IT

## When does bundled outsourcing make operational sense?

The major advantages experienced with bundling included:

- Simplifies and expedites procurement and contracting (sole-source v. tendering)
- Simplifies the governance process
- Reduces duplicate management layers, processes, and costs
- Reduces operating risk by limiting points of failure
- Can achieve operational synergies across business processes and between a business process and supporting IT
- Standardizes and simplifies operations
- Mitigates delivery risk through simplified points of contact
- Reduces service provider costs/prices through simplified management and scale economies
- Supports a pre-existing standardizing technology and process trajectory. A prime example is with ERP
- Can drive larger holistic back-office change

and/or business processes first, sometimes through a shared services route, then sought a bundled outsourcing arrangement. This is a more tactical route and mitigates some of the risk of outsourcing inefficient IT and processes, though the risk may well be worth taking, if it saves time and cost, as we saw in some cases. On cost, the cost gains of bundling two or more business functions, for example IT and HR, or procurement and HR, rather than outsourcing them separately to different suppliers can be of the order of 10-15 percent[10]. This may well be more where a supplier can bring in a more standardized management and measurement process, and can truly implement standardized business processes and IT. A primary contractor model can be a half-way house but it is unlikely to achieve significant cost savings or process standardization or innovation over a bundled outsourcing arrangement. The primary contractor model also runs its share of risks and has not always had a happy history[11].

However, this does not make bundled outsourcing a 'no-brainer'. Far from it. These gains from bundling (see "When does bundled outsourcing make operational sense?" above) are possible but a great deal really does depend on the maturity and capabilities of both client and supplier to deliver on the promises inherent in the bundling deal they go for. Given this, then it is not surprising to find clients display a range of profiles when it comes to bundled outsourcing.

# Drivers of bundling/unbundling decisions

We analyzed prior literature drawn from strategy, economics, marketing, information systems, and our own research work. We also placed our preliminary model in front of outsourcing specialists to gain further feedback. From this we arrived at a provisional list of *factors.* For each factor, from prior research, we established the rationale as to why each factor would influence buying behavior. At this stage we called each rationale a *hypothesis,* indicating that it required further testing.

From our [e.g., LSE] database of 650 plus outsourcing arrangements we selected 300 deals where there was sufficient data to draw conclusions on all 20 factors. We established, through piloting ten deals, that a total scoring of 100 seemed to work. Using this as the total 20 factor score we worked through each deal. Each factor was weighted in importance in that deal. For the whole 300 sample we then found the median for each factor (see also Appendix 1—Note on methodology). We then tested the factors framework against our 69 interviewees and finalized a weighted 20 decision factors framework (see Table 2)[12].

Figure 1 shows that the key factors shaping bundling and unbundling decisions group into five major areas. Let us look at each of these in more detail.

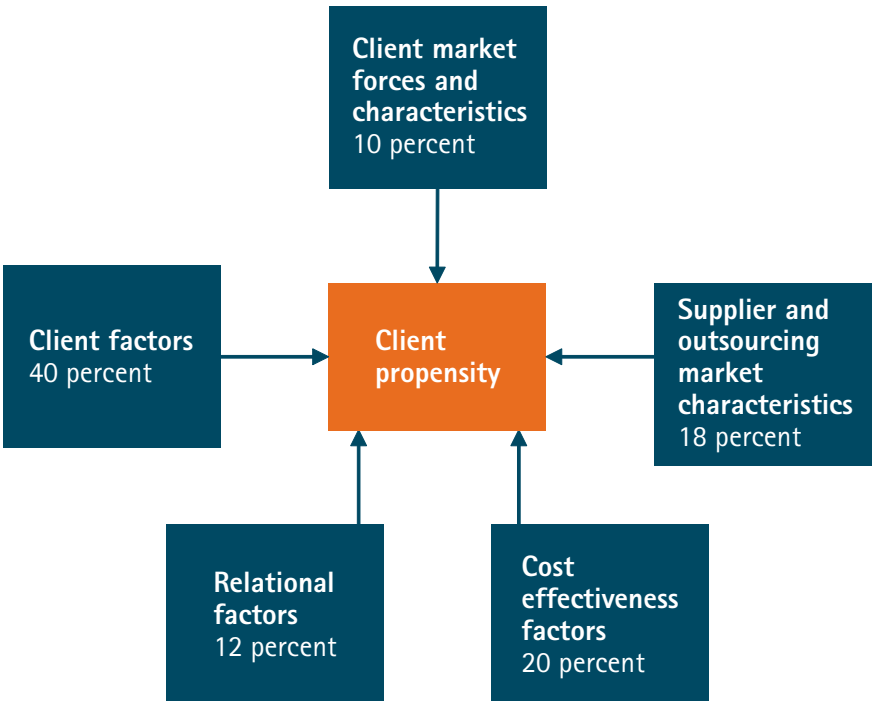
## Client factors

There are eight such factors. Their combined weighting of 40 indicates client factors to be the most influential of the five groupings shown in Figure 1. The first factor is whether the **decision-making process** is centralized or decentralized. A more centralized process favors a bundled service decision. It is interesting to note that organizations that multi-source wrestle continually with the issue of needing to simplify and coordinate governance and decision-making, but while decision-making processes remain more fragmented, bundled service decisions, especially across ITO and BPO, are unlikely.

Who the main decision-makers and influencers are in the sourcing decision, and their preferences, have a considerable role to play in what decisions get made. Is procurement in charge, what is the influence of advisers and their recipes, how CEO, CIO and COO knowledge and preferences play out—these are difficult to predict and need close attention to understand. But key influencer preferences are important in shaping a **'dominant coalition'** in favor or against a degree of bundling services.

The **maturity of an organization's ability to develop sourcing strategy and manage suppliers,** its history of success, learning, and of requisite capabilities built—these all influence bundling decisions. Mature clients are in a better position to undertake a bundled services option. But a strong preference for competitiveness among suppliers, and question marks on supplier capabilities can also lead mature clients to adopt a best-of-breed strategy. On the other hand we have examples of clients with limited resources or weak learning capabilities also going for single source contracting.

**Figure 1:** Main factors in bundling/unbundled outsourcing decisions




Source: Willcocks, Oshri, Hindle, 2009.

**Organizational and technological factors** also have a bearing on bundling decisions. These relate to size, infrastructure, interdependence of activity, degree of reliability, transparency of information needed. Large size, high complexity, high interdependence of activities, and high reliability needs will favor longer-term bundled service contracts. Organizations needing technological integration and seamless information and technical service will prefer to go for bundled services, where available.

**Business profile,** and the existence of a **'burning platform'** may well work in favor of a bundled decision. A business doing badly, or needing to do something different, may well see bundled services as a cost-driven, low management solution. But we also found also large, well performing firms tending to buy bundled services, where other factors were favorable. A burning platform—we found examples relating to cost reduction, a new CEO/CIO, a change in business strategy, or in acquisition policy—may well favor a bundling decision.

**Heavy users and high spenders on outsourcing** will tend to consider bundled services. A further factor we identified related to **risk attitude.** Organizations with a high risk perception concerning IT or back-office back up, security, complexity tend to favor bundled services.

## Relational factors

We identified three sets of relational factors, scoring them a combined weighting of 12. **Culture**—whether clients were transaction-orientated or relationship orientated had a role to play here. For example the USA and UK tend to be more transaction-orientated than South Korea and Scandinavian countries. Other things being equal, relationship-oriented cultures will favor service bundling. **Prior relations** between client and supplier, especially where the supplier has had good communications with a client's dominant coalition, can influence client's propensity to contract for bundled services. However, more influential is where relationships were developed as an **incumbent supplier.** Strong relationships as an incumbent where combined with a track record of service delivery, inclines a client to outsource more services to the incumbent supplier.[13]

## Client market forces and characteristics

We gave a combined weighting of 10 to four factors under this heading. In a highly regulated environment the strong requirement for **regulatory compliance** will favor bundled decisions, on the whole. Bundled services will lower complexity, especially if the supplier

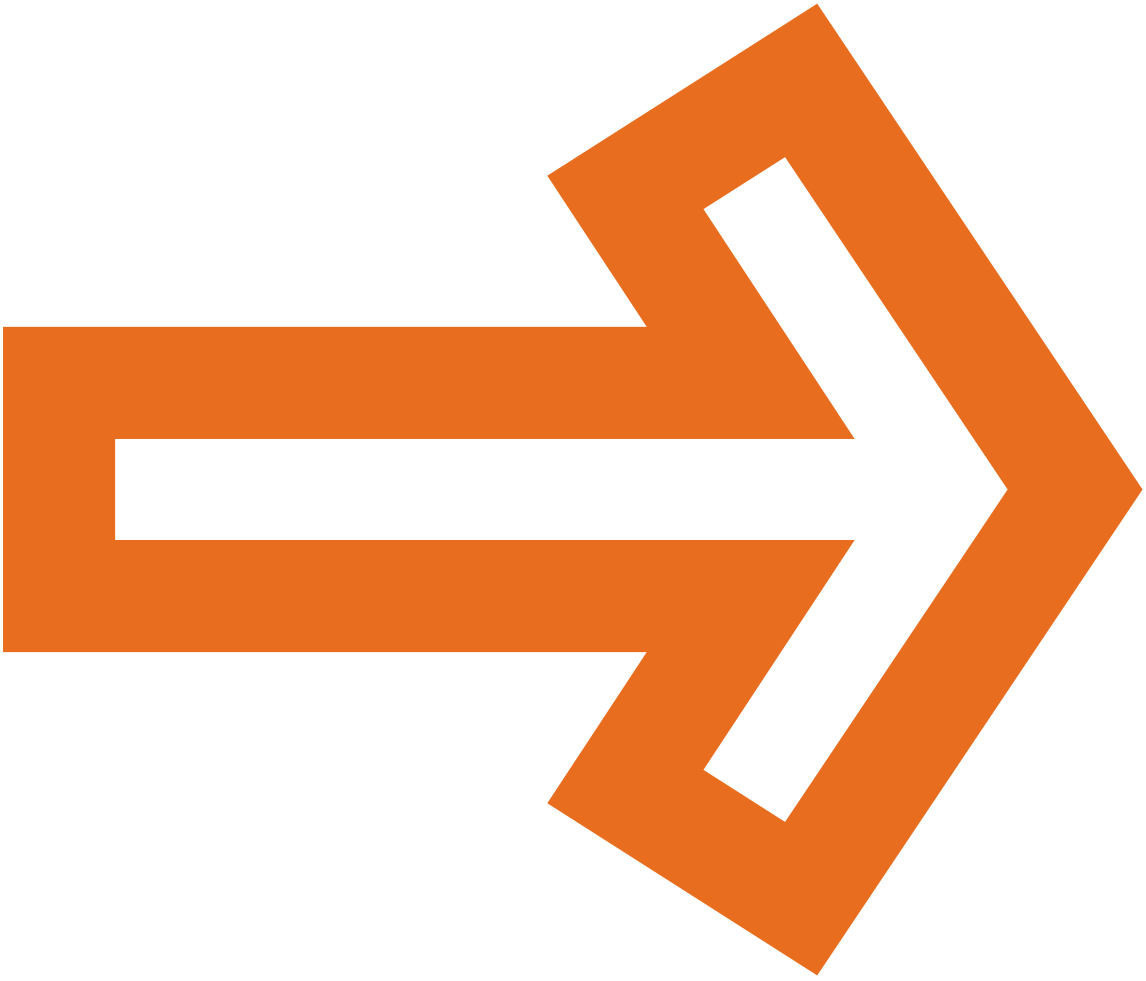
offers assistance with regulatory mandates. **Geography** can have an effect. Bundled service options are more likely to be taken up in the lead markets of the USA and UK, perhaps cancelling out their transaction-orientated cultures, but more relationship-orientated cultures not in USA and UK could now start to grow faster into bundling. We found strong propensity amongst large companies in Norway and Netherlands, for example, and also in South Korea. Additionally bundling is favored by organizations requiring a higher **level of innovation** from a supplier. Here, bundling is the quid pro quo to the supplier for its innovation investment and its provision of more integrated services. There is also **sector influence.** For example telecoms, manufacturing and utilities sectors take the lead on bundling, especially where a firm is based in a single region and is large buyer. Some sectors prefer industry verticals for example UK military logistics in 1990s. Thus certain sectors are to be found creating a momentum in favor of, or against, bundling.

## Supplier and outsourcing market characteristics

Here we identified four factors, with a combined weighting of 18. **Initial choices and incumbent vendors shape future bundling**—incumbency and capability to do other services lead to client propensity to given them bundled services. This goes beyond the relationship effect mentioned above. Incumbents with additional capability shape bundled services strategy and stand to gain from these. Reinforcing this finding, a 2007 Everest Research Institute survey of BPO scope aggregation found that if a buyer initially selected a generalist supplier, 40 percent of the time the buyer will select the same supplier for other functions.[14]

Part of this incumbent advantage relates to demonstrable additional capabilities. Indeed **provider capabilities** are a bigger influence than mere incumbency. Here clients look for a supplier that is widely capable across different services and able to use IT in each, offers a wide scope of service geographically, and can deal with large contract size. The few suppliers that can service large scope, bundled deals will be prioritized, but there is a caveat—a limited number of supplier options may also inhibit bundled service decisions.

We identified two lesser factors under this heading. Where a supplier offering is of **interdependent services** then a 'lock-in' effect can occur, where the client is more likely to buy the combined service, already integrated, as bundled services. Finally, external media attention given to bundled services can create a **bandwagon effect,** increasing a firms' propensity to look for bundled services.



However, this effect can be short-lived if performance does not improve and should suppliers fail to develop dependencies between bundled services, and deliver on their promises.

## Cost effectiveness factors

The area of cost is weighted 20 out of 100. Cost emerged as a constant key concern in our research, and received even more emphasis in the 2008-9 interviews. In particular two types of costs emerged from the study, namely **management and integrated services efficiencies.** As we discussed above, management and transaction costs should be demonstrably lower, and integrated service efficiencies much more achievable with bundling of services.

From a client perspective we suspect the transaction cost saving from bundled service purchase are large but hidden. They include typically:

- Risk reduction
- Less governance
- Simpler contracting (cheaper legal costs)
- Ability to move to standardized practices
- Synergies across services and processes
- Less management time getting to contract
- Lower relationship management costs

It is possible that the transaction cost savings between a single and multiple supplier route may be substantial enough to offset where a single supplier might offer a less attractive deal on production costs, but it is likely—if the supplier is instituting the practices listed below—that these will also be lower anyway.

Most large suppliers are now busy reducing their internal transaction costs (the costs of doing business with themselves), and their production costs through focusing on standardizing as a shared service across **all** processes, the customer contact part of a process they run for a client, and likewise for its administrative back-end e.g reporting. This leaves the middle sections of a process which tend to be more domain-specific e.g procurement or sub-components, HR (recruitment, training remuneration) and here the idea is to standardize for the client globally on the relevant process and charge the client for idiosyncrasies away from that standardized process. This then enables the supplier to provide a standard contract for all standardized shared services (but not necessarily the domain specific ones). Obviously the reduction in both transaction and production costs is large if this can be achieved across a client's several IT/BP activities. The size of this gain as passed on to the client will be one attractive aspect of bundled service purchase.

# Action point: Making the optimal decision

'There is a surprising thing in mathematics. In a multi-variate problem, the optimal result is often reached with none of the variables at its maximum value.[15]'

This observation applies equally well to decisions on bundled/unbundled services. Organizations have pursued, and will continue to adopt, multi-sourcing and 'best-of-breed' strategies and will find plenty of good reasons for doing so. However, the market has moved on, technologies have developed, client and supplier capabilities have grown apace and new possibilities have opened up. One important growing trend, containing several mini-trends within it, has been the bundling of ITO and BPO services. Under what circumstances can a client take business advantage of this rising set of capabilities? What sort of client is likely to gain from bundling rather than unbundling? And what sort of client is better suited to multi-sourcing approaches? In Table 2 we provide a summary of our research, and a decision matrix for client use.

## How to use the decision matrix

Your evaluation is based on five sets of factors. Each set is weighted, with the sets combined forming a total possible score of 100. The factors and weighting are:

| | |
|---|---|
| 1. Client factors | 40 |
| 2. Relational factors | 12 |
| 3. Client market forces and characteristics | 10 |
| 4. Supplier and outsourcing market characteristics | 18 |
| 5. Cost effectiveness factors | 20 |
| **Total** | **100** |

### Step 1

The unit of analysis is a group of services that an organization is wishing to outsource. For example, this could be HR payroll, related IT applications and HR training and development. Should these be bundled and outsourced to one supplier, or left unbundled and outsourced to several suppliers?

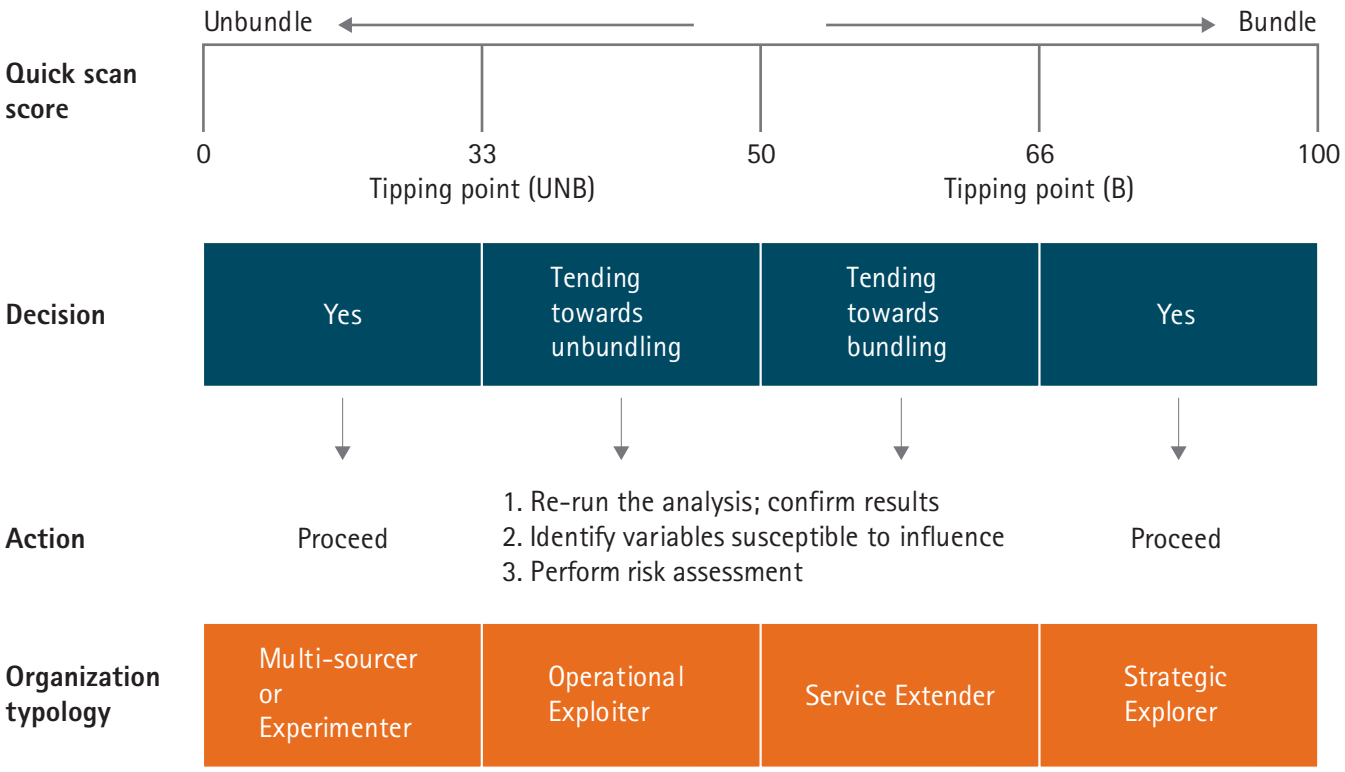
Each factor has a group of factors has an individual weighting as indicated.

An informed stakeholder discussion group should assess carefully the appropriate score for each factor group. If a supplier really can support bundling then score it 9 or 10; otherwise make a judgment as to what the supplier can support, and score it to suit. As a final example, under Cost Effectiveness Characteristics, does bundling lead to demonstrably lower management and transaction costs? If so, score this factor between 7-10. If not score it lower than this to suit.

## **Table 2:** To bundle or not to bundle outsourcing services—The decision matrix

| Client factors (weighting 40) | Tend to bundle | Tend *not* to bundle |
|---|---|---|
| 1. **Decision-making process** | Centralized | Decentralized |
| 2. **Dominant coalition preferences**<br>i.e. – procurement, COO, CIO, CEO, advisors | Possible | Possible |
| 3. **Maturity of company with outsourcing**<br>i.e. – history of success/learning, internal capabilities built | Yes | Best-of-breed if desire for vendor competition |
| 4. **Organizational and technological factors** | | |
| Size | Large | Small |
| Complexity | High | Low |
| Interdependent activities | High | Low |
| Reliability needs | High | Low |
| Technological integration | High | Low |
| Seamless information/technical service | High | Low |
| 5. **Burning platform** | | |
| Cost crisis | Yes | No |
| New CEO or CIO | Possibly | Possibly |
| Acquisition/merger | Likely | Possibly |
| New consolidation strategy | Yes | Unlikely |
| 6. **Business profile** | | |
| Business doing badly/Need to do something different | Yes | Unlikely |
| Large, well performing firm | Likely | Possible |
| 7. **Heavy users and high spenders on outsourcing** | Yes | No |
| 8. **Risk attitude to back-up, security, complexity** | Perception of high systemic risk | Perception of low risk |
| **Relational factors (weighting 12)** | | |
| 9. **Culture** | | |
| Transaction-orientated e.g. UK, USA | Less likely | Probably |
| Relationship-orientated e.g. South Korea | Very likely | Less likely |
| 10. **Prior relational aspects: client and supplier** | | |
| Strong relations between senior managements | Very likely | Less likely |
| 11. **Relationships/performance as incumbent supplier** | Strong relationships<br>Track record of service delivery | Weak<br>Poor record |
| **Client market forces and characteristics (weighting 10)** | | |
| 12. **Strong regulatory compliance needs** | Reduce complexity<br>If supplier assistance | If no complexity reduction<br>If no supplier help |
| 13. **Geography—advanced market**<br>e.g. USA and UK<br>e.g. North and South Europe | More likely | More likely |
| 14. **Level of innovation required** | More supplier investment<br>More integrated services | Low innovation required<br>Low integration |
| 15. **Sector influence** | | |
| e.g. telecoms and utilities | Likely | Possible |
| e.g. retail | Possible | Likely |
| e.g. high preference for industry verticals | Likely | Possible |
| e.g. high competition intensity | Likely | Possible |
| **Supplier and outsourcing market characteristics (weighting 18)** | | |
| 16. **Initial choices and incumbent vendors shape future bundling** | Incumbent vendor with additional services and integration capabilities | Poor record<br>No strong additional capabilities |
| 17. **Provider capabilities** | | |
| Widely capable across different services | Yes | Concern over too few suppliers |
| Able to use IT in each scope of service geographically | Yes | |
| Can deal with large contract size | Yes | |
| 18. **'Lock-in' through supplier services** | | |
| Supplier offerings as interdependent services | More likely | Less likely |
| 19. **External media and bandwagon effect** | | |
| High media attention on bundled services | Likely | Likely if performances do not improve and if suppliers fail to develop dependencies between bundled services |
| **Cost effectiveness factors (weighting 20)** | | |
| 20. **Management and integrated services efficiencies** | | |
| Management and transaction costs | If demonstrably lower | Possible |
| Integrated service efficiencies | Yes | Unlikely |

## **Table 3:** Sourcing factor analysis




### Step 2

Having scored each factor, total the scores to make a single score out of 100.

### Step 3

See Table 3. A score between 66 and 100 means that the organization is past the tipping point for bundling, and should certainly make a **bundled** decision for the services under consideration. A score between 0 and 33 is past the tipping point for **unbundling** and means that an unbundled decision is the right one. Scores between 34 and 65 need much further analysis. A score between 34 and 50 suggests unbundling is the right way to go but, you need to assess which factors need to be leveraged to make this a good decision, and perform a risk assessment of the consequences of leveraging these factors. Alternatively a score between 51 and 65 suggests bundling is a better decision but only after further assessment, leveraging salient factors, and ensuring that the risk profile of the consequent decision is sensible.

While this analysis is at the level of several services, we also found five types of clients, each type tending to be making bundled or unbundled decisions (see Table 3). The next section develops Table 3 and provides details of these five types of client organizations.

# Emerging client profiles

Our analysis included generating client profiles of those organizations more, or less, likely to buy bundled services. Five client profiles emerged:

1. The Experimentor type
2. The Operational Exploiter type
3. The Multi-sourcer type
4. The Service Extender type
5. The Strategic Explorer type

## The Experimentor type

The Experimentor type has just got on the learning curve with outsourcing, therefore its outsourcing management capabilities are underdeveloped, and are based on sporadic experimentation with various sourcing models and settings which addressed some specific needs. In most cases, these are small scale outsourcing contracts covering low value, stable services. At the same time its lack of experience can result in the Experimentor making sometimes quite serious mistakes in outsourcing risky, or critical areas to the wrong vendor(s) on poor contracts. The Experimentor type tends to switch between vendors and sourcing settings in a continuous search for superior performance. Bundled services is just another value proposition in this regard. As the Experimentor type's approach is neither strategic nor operational—its philosophy is 'This could be gold'.

The issue for the Experimentor type is its under-developed internal outsourcing management capabilities, making it unable to manage large-scale contracts, form strong relationships with suppliers or assess the economics of different outsourcing models. This may well be combined with an understandable orientation amongst decisions makers and influencers towards risk mitigation through multi-sourcing, shorter term contracts, and a 'best-of-breed' approach to suppliers. Experimentors were much more frequent in the period 1992-2003, but in our most recent sample, only a small number of firms demonstrated this profile of behavior.

## The Operational Exploiter type

The Operational Exploiter has very likely developed good outsourcing management capabilities focused on the daily operational aspects of managing individual outsourcing contracts through SLAs but less on the long-term, strategic, innovative and relational aspects. The Operational Exploiter will have developed routines and practices to ensure the delivery of value from each single outsourced service, but will be less aware of or concerned with synergies between the various outsourced services. The Operational Exploiter tends to outsource mainly low value but also some high value activities and has experimented with both single and multi-vendor settings. Bundling outsourced services would become an option when more and more services are outsourced and where potential operational efficiencies start becoming self-evident. The Operational Exploiter may be aware of the synergies between the outsourced services, but less able to extract value from these synergies mainly because its outsourcing management capabilities

have been focused on extracting value and efficiencies from individual contracts, and because it lacks the ability to assess the business impact of synergies between individual outsourced services. Its approach to bundled services is 'I should outsource another service because there are cost advantages and efficiencies in bundling this service with the others'. Some of the firms we studied have focused on developing operational excellence around the management of outsourcing, which in turn drives their vendor selection. In such cases the services to be outsourced and managed have been geared towards what we have titled here as operational exploiter.

## The Multi-Sourcer type

Typically, the Multi-sourcer type has built a strong capability to manage multiple suppliers, and is into its third generation of outsourcing contracts. Its dominant coalition favors both outsourcing, which it does extensively, and also a best-of-breed strategy, which it manages tightly, in an aligned way with business strategy, and with strong governance mechanisms in place. The Multi-sourcer tends to outsource in ways which keep low the switching costs in and out of different suppliers, while retaining advantages from keeping suppliers in competition for work. The Multi-sourcer will readily incur the management and transaction costs required to maintain this multi-supplier strategy, though it works hard to continually reduce these costs. The organization may well be large and in parts complex, but does not have high needs for reliability, interdependence, seamless service and technological integration, or manages these aspects itself, or is willing to manage the gaps between supplier service and what is required on these aspects. Where a Multi-sourcer achieves integrated service cost efficiencies, this will be because it manages and runs these itself. A Multi-sourcer tends to look to itself for innovation rather than through relationships with a vendor, though more recently Multi-sourcers have been looking for closer relationships with, and more value from, their longer-serving suppliers.

## The Service Extender type

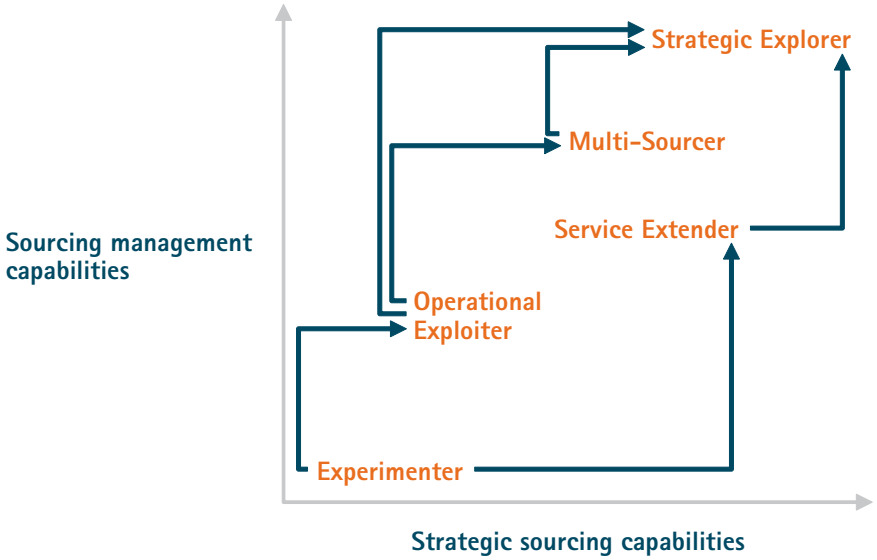
The Service Extender type has been outsourcing for a while; however, this type tends to work with one vendor or a very small number of vendors. Its outsourcing management capabilities have been developed mainly based on long-term relationships with one or a very small number of service providers. For this reason, bundling services is the next logical step in the outsourcing activities that the Extender type has pursued. Its approach to bundled services is 'it is only making sense to outsource another service to my service provider'. In other words the Extender moves further into bundling services through an incremental 'add-on' strategy, as it builds its internal capability to manage suppliers, strengthens relationships with incumbent suppliers, and satisfies itself that supplier capabilities merit extending both contract length and scope of work. An Extender buyer will have a dominant coalition favoring supplier consolidation, and will recognize that its size, complexity and interdependence of operation is continually pointing towards the need for reliability, technological integration, and seamless service. An Extender buyer will also be looking to outsource more IT and business processes in the future, though it may not be primarily focused on the cost advantages of bundling rather than unbundling specific services. Instead, an Extender type will be concerned about becoming more strategic in its approach to use of the market and aligning its sourcing approach with the firm's business strategy Quite a few of the cases we have studied fell into this category.

## The Strategic Explorer type

The Strategic Explorer possesses highly developed outsourcing capabilities in most areas critical for successful outsourcing projects such as vendor selection, relationship management, vendor management, domain expertise, learning capabilities, all of which developed through scale and advanced management systems. The Strategic Explorer outsources both low-value and high value activities in both single and multi-vendor settings, is confident in its ability to enter a large bundled services contract mainly because of its strong retained organization and highly developed domain expertise. This type will expect innovation from the vendor and the ability to realize synergies between the different services outsourced. The Strategic Explorer will be able to assess the degree to which synergies between the different services have been realized and will aspire systematically measure these outcomes. Its approach to bundled services is 'My vendor and I can improve my value proposition only when we innovate across my end-to-end services'. In our sample, we found that some firms are thinking strategically about bundled services; however, they may fail to design and implement a system that leverages the potential value across the range of services.

# Changing lanes: Building client capabilities for managing bundled services

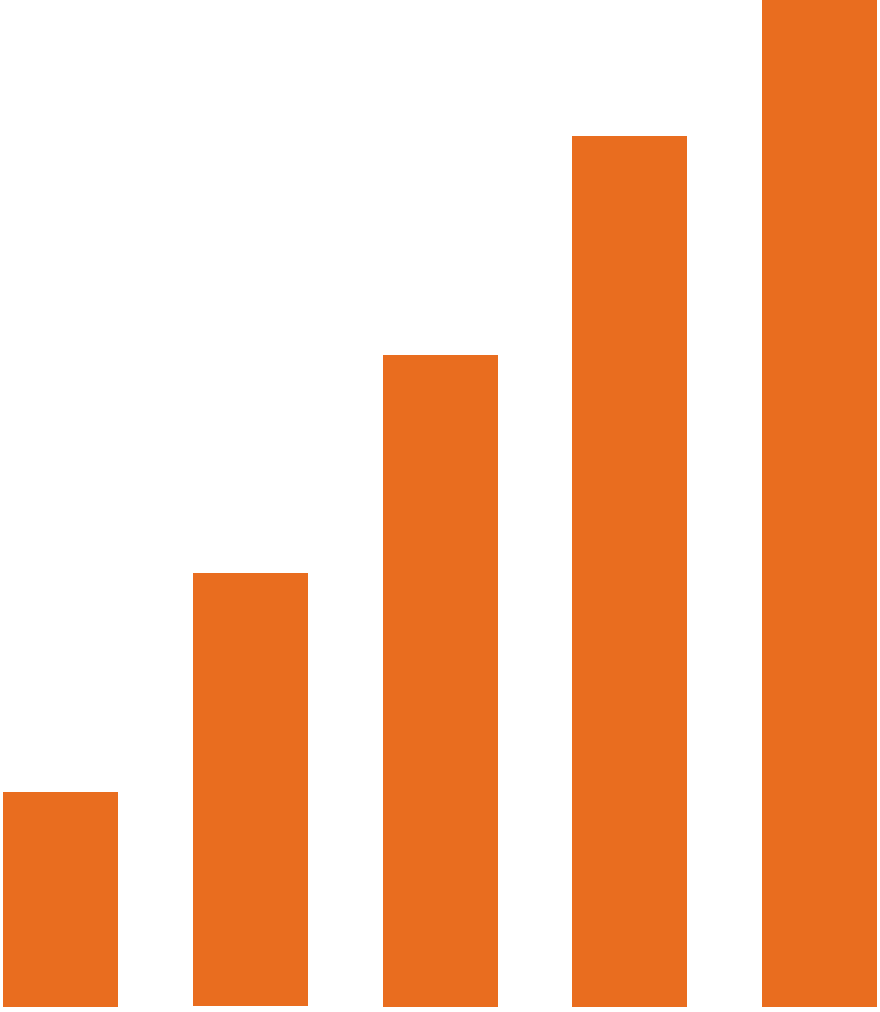
**Figure 2:** Developing bundled services client capabilities




Our analysis demonstrates that many clients have not sufficiently developed their outsourcing management capabilities to realize the synergies and efficiencies offered by bundled services. As discussed above, none of the firms studied have, to date, managed to develop an ideal Strategic Explorer profile, though some have begun to move in that direction. Most of the firms have developed their outsourcing management capabilities to correspond with the Operational Exploiter or Extender type. At the same time the Multi-sourcers in our sample revealed a strategic sourcing approach that worked for them, based on their assessment of the limited capabilities suppliers were offering in the marketplace, the need to engender competition amongst suppliers, the advantages of retaining considerable internal capability, and their own specific needs that would not necessarily be served by bundling certain services.

While all the types (save Experimentor) present viable outsourcing strategies for organizations, depending on their culture and dominant corporate governance model (e.g., centralization v. decentralization), for companies that would consider pursuing bundled services as a strategic approach, we offer the framework shown in Figure 2. For those organizations that wish, and have strong rationales for, retaining a Multi-sourcer stance, the recommendation is to still improve their management and strategic sourcing capabilities.

In examining the primary buyer types, there are two areas needing development within the firm in order to capitalize of the promises of bundled services. One is the strategic sourcing capabilities developed in-house, mainly focusing on aligning sourcing strategy with dynamic business strategy over a five-year period, and creating the conditions for partnership with the various vendors. The second area is sourcing management capabilities—focusing on extracting efficiencies, building management capabilities, and developing tools and methodologies to realize the potential in strategically partnering with vendors. On our analysis, most of the firms identified as Operational Exploiters are well positioned to improve the benefits from bundled services by further investing in relational capabilities and vendor development. Firms identified as Extenders are even more inclined toward bundling and will be even more willing to make the necessary investment in strategic sourcing and sourcing management capabilities. But Experimentors require massive investment in both areas, and therefore should first assess whether bundled services is a strategic direction they need to take.



In Figure 2 we map the development path emerging from our research. The Experimentor tends to move towards being an Operational Exploiter. Its hard-won experience leads it to take a multi-supplier route, outsourcing relatively stable, mature activities on 3-5 year contracts. It has learned to mitigate operational risk with outsourcing, and will look to build up its sourcing management capability but will not focus strongly on building strategic sourcing capability. The Operational Exploiter will tend to develop that strategic sourcing capability based on its heritage in multi-supplier outsourcing and will tend to evolve into a Multi-sourcer. A Service Extender has a different heritage and more strategic understanding. Improvement lies in evolving towards the Strategic Explorer profile. Multi-sourcers have a huge learning and capability investment in a multi-supplier approach but, because they have strategic sourcing insight, may well see the advantages of bundling some services where they identify that suppliers have the requisite capability, the technology has developed to support integration of services, they can see a strong economic rationale, and they feel confident that reducing supplier numbers will not lose them control of their sourcing arrangements.

# Notes

[1] Willcocks, L. and Lacity, M. (2009) *The Practice of Outsourcing: From Information Systems To BPO and Offshoring.* Palgrave, London. Chapter 1 reviews trends and statistics.

[2] See Tisnovsky, R. (2006) "IT Outsourcing in SME Businesses," *Everest Research Institute White Paper.* See www.everestresearchinstitute.com.

[3] See Lepeak, S., Toon, M. and Morris, P. (2009) *Equaterra Pulse Survey Period 4,* 2008. Equaterra, London

[4] Willcocks, L. and Lacity, M. (2009) op. cit.

[5] Ways of managing multi-supplier relationships are suggested by Sharma, A. (2008) *Challenges with Multi-sourcing.* IDC, New York. Simonson, E. (2008) *Managing Multiple Outsourcing Relationships.* Everest Research Institute, New York. These focus on developing simpler, enterprise governance models, supplier portfolio strategies, strengthening internal management capabilities and applying multi-sourcing to mainly commoditised services. See also Willcocks and Lacity (2009) op. cit. and Lacity, M. and Willcocks, L. (2001) *Global Information Technology Outsourcing: In Search Of Business Advantage.* Wiley, Chichester.

[6] Raw data on these outsourcing deals was collected by IDC. Analysis was by John Hindle and Ilan Oshri.

[7] This section was strengthened by conversations with Martin McPhee, Simon Sammons, Barbara Duganier and Charles Sutherland of Accenture. Their perspectives and sharing of experiences were very helpful and we gratefully acknowledge their contribution.

[8] Willcocks and Lacity, M. (2006) *Global Sourcing of Business and IT Services.* Palgrave, London. Our more recent analysis finds these management costs for offshoring to be even higher—to be between 12-15 percent of total contract value. See Willcocks and Lacity (2009) op. cit.

[9] Lacity, M. and Willcocks, L. (2009) *Information Systems and Outsourcing: Studies in Theory and Practice.* Palgrave, London

[10] This figure comes from a report by Equaterra (2005) *Bundled versus Unbundled Outsourcing Deals.* Equaterra, London September.

[11] Lacity and Willcocks (2001) and Willcocks and Lacity (2009) op. cit. point to cases where management costs were not noticeably lower than other models, and best practices were not shared between the different suppliers.

[12] It should be noted that the final weightings represent the collation of judgments, and that for each weighted factor the median expresses the middle value. In such a large sample we found many cases where certain factors outweighed others in different ways than the ones expressed here (note that the median tends to be more robust than the mean in the presence of such outlying values).

[13] From a 2007 Everest Research Institute private analysis—*Scope Aggregation in Outsourcing: Why the Strong Get Stronger.*

[14] Clearly the first outsourcing decisions and who the incumbent suppliers are can have considerable affect on subsequent bundling patterns. From a 2007 Everest Research Institute private report—*Scope Aggregation in Outsourcing: Why The Strong Get Stronger.* Everest call this the 'penetrate and radiate' model.

[15] Our thanks to Simon Sammons of Accenture for this observation.

# Appendix 1: A note on methodology

Our review of extant research examined firstly a number of reliable third party databases comprising some 1200 outsourcing deals (including 865 bundled contracts) signed globally between 2003 and 2008. This exists as a listing of headline characteristics of these deals and gives insight into propensity to buy bundled services at the level of who is buying, what they are buying, where these services are being delivered, and who is delivering those services. We also reviewed the existing ITO and BPO literature from 1990-2008. Virtually none focuses on client propensity to buy bundled services. But there are major studies on determinants of outsourcing decisions, goals sought from outsourcing and sourcing strategies pursued during this period. These provided insight into buying behavior, outcomes, and how these affect subsequent buying patterns. Our own research in ITO and BPO from 1991-2009 was also reviewed, including recent studies into BPO, offshore outsourcing, the configuration of outsourcing arrangements and objectives pursued by clients. This database consists of 650 plus outsourcing arrangements. We also reviewed the marketing literature to seek further insight on factors that explain the purchasing of bundled services. We developed two deliverables. Firstly, a provisional model of the weighted factors that need to be investigated to establish outsourcing purchasing behavior, with the specific purpose of attempting to identify which factors can explain propensity to buy bundled services either as ITO bundles, BPO bundles, or ITO/BPO hybrid bundles. Secondly, we developed an open-ended questionnaire for using with interviewees at organizations that do buy, or potentially will buy bundled services, to determine the key factors for them.

For this paper we then conducted 54 further interviews with 32 client organizations of ITO and BPO services in USA, Europe and Asia Pacific. This sample was opportunistic and gave insights into a range of sectors and cultures including energy, mining, retail, oil, insurance, telecoms, ICT services, gaming, utilities, financial services, manufacturing, healthcare, parts distribution, mail and communications, We also interviewed a further 15 outsourcing experts drawn from three major suppliers, including Accenture. The analysis of the interviews provided insights into buying practices, helped us to refine the weighted model of client propensity to buy bundled services in the ITO/BPO space, and develop the five major client profiles.

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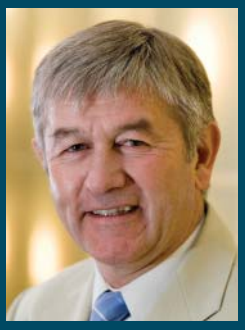
# About the authors



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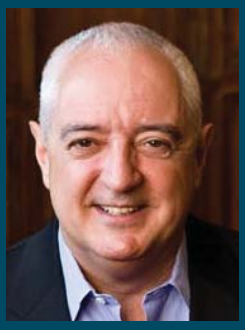

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