Interest in the hybrid sourcing model

– a construct in which an enterprise and a service provider join forces to deliver services – is experiencing a resurgence in the wake of disruptions in global services market. Hybrid sourcing constructs were popular during the infancy of the global sourcing industry, as enterprises were testing the waters and service providers were establishing credibility. Since then, however, interest in hybrid sourcing has waned as both the outsourcing and shared services models have developed their own unique strengths.

However, Everest Group research indicates that, in the face of ongoing geopolitical, regulatory, and digital disruption, both enterprises and service providers are reconsidering the hybrid model.

Hybrid model adoption drivers

Although hybrid sourcing constructs are a means of collaboration between enterprises and service providers, the business case drivers are different for each party.

Key drivers for enterprises

- **Need for speed:** With the advent of digital technologies, enterprises are facing stiff competition and the pressure to launch new services. Hybrid constructs offer organizations greater visibility and collaboration, increasing their speed-to-market for new products and services.
- **Need for control / risk management:** Increasing regulation and scrutiny from regulators is forcing enterprises to heighten service delivery and risk management control and oversight. Furthermore, concern over the protection of Intellectual Property (IP) is a driving force for enterprises to consider hybrid constructs over pure outsourcing.
- **Flexibility:** The pressures of fluctuating demand, asset ownership, and process management are high; enterprises are passing the pressure to service providers, which are better able to balance the roles and responsibilities to address specific needs.
- **Protectionism:** Given the increasing global trend towards protectionism (e.g., visa reforms in the United States, United Kingdom, and Australia and proposals around outsourcing taxes), enterprises are considering insourcing service delivery capabilities. Hybrid sourcing constructs provide an opportunity to develop in-house capabilities while leveraging service provider expertise.

Key drivers for service providers

- Managing revenue streams and existing partnerships: The success of the pure GIC model and an increasing trend towards insourcing is stagnating service providers' outsourcing revenue potential. Hybrid constructs offer an attractive proposition to maintain existing relationships and augment revenue streams.
- New customer acquisition: Service providers leverage hybrid constructs as a foot-in-the-door approach to acquire new customers; these constructs allow service providers to work collaboratively with enterprises to gain trust. Once a partnership is established, the service provider is more likely to renew contracts and reduce overall sales investment.
- New skills development: Hybrid sourcing constructs help service providers to develop new capabilities, which they can then leverage for attracting or servicing other clients as well.

Evaluating hybrid sourcing constructs and selecting the right one

Hybrid sourcing constructs have traditionally taken one of three forms: Build Operate Transfer (BOT), Virtual GIC, and Joint Venture (JV).

Figure 1 *Hybrid sourcing construct characteristics*

Construct	Key characteristics
BOT	The service provider invests in setting up the center, takes responsibility of hiring and retaining the staff, manages operational risks, and runs the center for a specified period of time after which the enterprise has the option to exercise ownership over the service delivery entity.
Virtual GIC	The enterprise provides upfront investment and managerial resources. The service provider assists in setting up the center and in resourcing and managing day-to-day operations.
JV	The enterprise and service provider co-invest in setting up the center. Both the enterprise and service provider share the responsibilities of running the center and managing operational risks. Both parties have the option to divest their stake at a later stage.

The suitability of specific hybrid sourcing constructs varies by enterprise; there are, however, certain parameters enterprises can use to help them make the best decision.

Speed-to-market: Services that require niche skills and/or speed-to-market (e.g., digital solutions and product development) are particularly suited for hybrid constructs

Financial considerations: Enterprises need to consider their Capital Expenditure (CAPEX) and Operating Expenditure (OPEX) needs. The success of the hybrid sourcing construct is closely linked to incentivizing the service provider with downstream revenue generation opportunities. Different constructs offer varying levels of capital and ongoing investments; understanding the specific benefits of each model and comparing to expenditure appetite is vital.

Extent of control: Hybrid sourcing constructs offer enterprises an opportunity to have greater control over operations versus pure outsourcing, a particularly important benefit as enterprises have started to position their offshore centers as strategic entities. Again, different constructs are better suited to different levels of control.

Figure 2 *Rating of global sourcing constructs on three key parameters, the enterprise perspective*

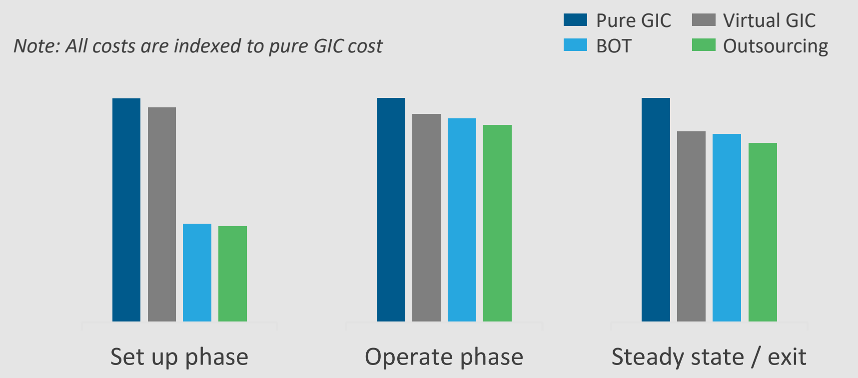
● High ◑ Medium ○ Low

	Pure GIC	Virtual GIC	Joint venture	Build-operate-transfer	Pure outsourcing
Speed-to-market	○	◑	◑	◕	●
Extent of financial commitment	●	◕	◑	◔	○
Extent of control	●	◕	◑	◔	○

While all parameters are important, the extent of financial investment can play a vital role in the selection of the ideal hybrid construct. In a pure GIC construct, the enterprise is responsible for all investments needed to set up and run the center. In a pure outsourcing construct, the enterprise pays only for services, while the service provider pays the capital and operating expenses.

Hybrid constructs fall somewhere between pure GIC and pure outsourcing constructs. While the enterprise invests in the center setup in the virtual GIC construct, in the BOT construct, the service provider bears all expenses initially and passes them to the enterprise following the transfer of the entity.

Figure 3 *Financial implications of various hybrid sourcing constructs*



Challenges

Of course, the hybrid structure is not a panacea, and it is not without its unique challenges for both parties.

Talent and culture

Enterprise-specific

- Aligning the service provider's recruitment engine to manage the enterprise's unique talent requirements
- Building a workplace culture that aligns with the broader enterprise

Service provider-specific

- Managing a talent development and maintenance engine in accordance with the enterprise's needs
- Managing the risk of losing experienced resources once the enterprise takes over operational control
- Isolating hybrid operations from regular outsourced operations to avoid potential cultural conflicts

Both

- Defining and differentiating each party's resources' roles and responsibilities to limit overlap

Pricing

Enterprise-specific

- Ensuring transparency in service provider pricing based on the contract's terms and conditions and the service provider responsibilities
- Incentivizing service providers for productivity/technology improvements

Service provider-specific

- Structuring fees to manage revenue impact once the transfer option is exercised
- Building in pricing for adequate incentives to implement productivity/technology improvements
- Establishing a business case showcasing the benefits of partnership despite the concern over potential revenue and resource loss at a later stage

Governance

Enterprise-specific

- Maintaining optimum visibility and control over operations
- Ensuring minimum conflicts through clear demarcation of roles and responsibilities

Service provider-specific

- Delivering support services and overall governance in a smaller-than-usual organization
- Minimizing conflicts by clearly demarking roles and responsibilities
- Minimizing conflict with other parts of the business catering to the same client or to a different client

Ownership

Both

- Defining clear guidelines around ownership of physical assets and resources
- Defining each party's financial obligations and making provisions to effect ownership structure changes through the life of the agreement

Knowledge and IP

Enterprise-specific

- Setting guidelines for ownership of knowledge and IP
- Avoiding misuse of confidential information following the dissolution of the hybrid entity
- Handling issues arising out of co-ownership of IP created during the deal

Service provider-specific

- Minimize conflicts arising from the transfer of IP and leverage of IP for use with other clients

Hybrid sourcing constructs offer an opportunity for enterprises and service providers to leverage each other's strengths. Inevitable challenges can be managed through meticulous planning and clear articulation of roles and responsibilities. When all is said and done, contractual transparency and a strong business case highlighting the benefits for both the parties can mean success for both parties.

For additional details, including areas of customization across hybrid sourcing contracts, see Everest Group's full report, Can Hybrid Sourcing Constructs Define the New Global Sourcing Paradigm?

Additional Resources

- Small But Mighty: Corporate Functions Delivery from GICs
- Global In-house Center (GIC) Landscape Annual Report 2017 – Will President Trump's Job Protection Initiatives be a Wake Up Call for the GIC Model?
- Global Sourcing Centers of Excellence (CoEs): Helpers vs. Shapers!

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