



# Offshore Outsourcing:

## A Business Perspective

Outsourcing in foreign lands can save time and money - but only if companies do it right.

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**N**ot long ago, most IT services for the business were built and delivered in-house by the IS. When the approach became too expensive and took too long, IS turned to external service providers (ESPs) to reduce costs, expedite delivery and tap outside expertise. In the new connected economy, with globalization, competition and massive adaptation of the Internet, cost and quality have become the key differentiators. Because these factors will continue to drive decision-making and limit competition, organizations and ESPs are exploring their offshore options.

While offshore promises to deliver value, the benefits can at times be hard to capture. All software solutions in an organization require a detailed understanding of business processes and the way IT supports them. Hence, building offshore partnerships require much effort and a well-formed strategy. Despite the drawbacks, the rewards of offshore are so compelling, that today, four out of five Fortune 500 companies outsource at least some of their software requirements offshore. The big question today about offshore software development is not whether to do it, but how soon.

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Companies will spend more than \$ 17.6 billion on offshore outsourcing by 2005.

- IDC

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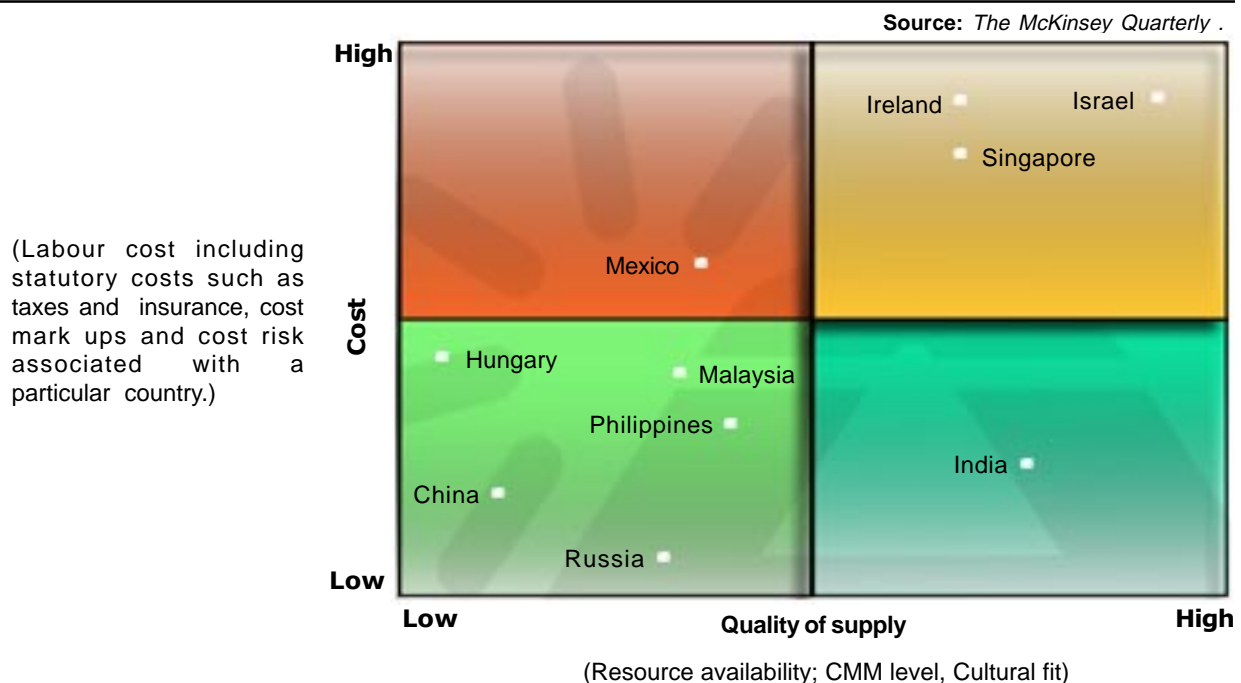
## The Offshore Attraction

With Globalization in the 1970s more and more manufacturing companies started shifting their bases to Mexico, Philippines, Taiwan and China, where lower labor costs made them more competitive. In the late 1980s, a lot of companies started to experiment with offshore software development but it took the enormous amount of reprogramming required by the Y2K transition to catalyze the process. By late 1990s most offshore firms transformed: many of them did high-quality work and used sophisticated application-management processes to do it.

In the last five years, more and more companies have started to gain from the offshore model. According to IDC, companies will spend more than \$17.6 billion on offshore outsourcing by 2005 (more than triple the current spending), with electronic commerce and web-based application development becoming the fastest-growing offshore outsourcing segments. The most popular offshore location is India, which combines high quality with low costs. Other possibilities, involving a variety of trade-offs include China, Ireland and Israel (refer Exhibit I).

### Exhibit I

#### Popular Offshore Locations



Nowadays, most offshore locations have excellent capabilities and are in an ideal position to provide more sophisticated value added software development. In fact many offshore development companies have standards equal to or higher than those of US companies. More than half of the companies in the world, that have achieved the valued level-5 CMM certifications are based in India.

## Advantages

In organizations today, outsourcing has become a powerful tool to gain strategic advantages. “Strategic Outsourcing” differs from outsourcing. It goes beyond asking the traditional question of how to outsource those IT services that appear appropriate for outsourcing, to asking about the best source for every IT service. This realization has convinced more and more companies to adapt the offshore outsourcing model.

This model offers four basic advantages.

**Cost:** Labor accounts for more than 75 percent of the cost of developing software. Although local outsourcing to software firms may be possible, companies can gain a strategic advantage from the lower wages and benefits prevailing in countries like India, where hourly, fully loaded programming rates can be 40 to 60 percent cheaper.

**Resource availability:** Recruiting, hiring and training people to meet the constantly changing needs of the IT environment not only costs a great deal of money but can also delay the completion of projects. Instead of adding to its internal fixed cost as salary and compensations, organizations have the option to staff their offshore teams on a need basis. This Just-in-time staffing capability at significantly reduced costs, help the companies reevaluate and define the elusive business value they desperately seek from their own IT assets.

**Speed:** Companies can distribute their development teams across various time zones resulting in a balanced 24 hrs work cycle. Most high-end software development and product companies (where time to market is critical) use the global delivery model to expedite the development cycle of their products and gain competitive advantage.

**Skills:** Companies spend a large percentage of their corporate IT budgets on the up-keeping of the skills of their IS professionals. Despite their best efforts, often, the solutions to business problems are constrained by the limited internal skill availability of the IS. Companies can now take advantage of their offshore partners who have a wider range of skills and are more familiar with the latest technologies.

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Outsourcing can help cut down cost and significantly increase the ROI.

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Millions of dollars are lost today, struggling with implementing and maintaining complex technologies, migrating from legacy to web-based systems, fragmented infrastructure and lack of skilled IT staff. Alternatively, for each requirement outsourced, companies just need to focus on results and not on “how to get there”. Since companies pay only for results, outsourcing can help cut down cost and significantly increase the ROI.

### Exhibit II

#### Measuring Advantage

Source: Acidaes Knowledge Base

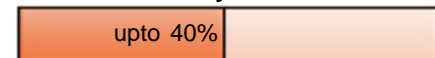
##### Cost savings



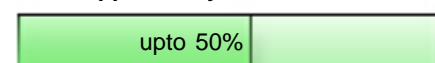
##### Increase in resource availability



##### Reduction in development time, with 24 hr work cycle



##### Skills applicability



## Addressing Risks

While outsourcing may make more sense for many companies, it is not simple or entirely without risks. Consequently, a critical issue is how can companies make the right decisions about what to outsource or not outsource, and go about the whole process in ways that reduce risk and enhance the chances of success. One must first clearly identify the risks that this model is exposed to.

The risks can be grouped in four key categories.

**Behavioral:** Organizations need to address their internal apprehensions and preparedness while undertaking an offshore outsourcing initiative. Like most organizational changes, the probability of a favorable outcome significantly increases with the involvement of senior management. It is important for the senior management to clearly outline an outsourcing strategy and communicate it effectively across the ranks. Internal apprehensions regarding expectations and individual impressions from previous outsourcing engagements characterized by failures also need to be addressed.

**Motivational:** During the evaluation process, an organization must gauge the level of commitment it can expect from the offshore partners, beyond words. It is important that the relationship must be “reasonably profitable” for the service provider, commensurate with the value delivered and risks assumed. Additionally, as a part of its outsourcing strategy, the company must address key issues of employee redundancy and the company’s approach in dealing with such an eventuality.

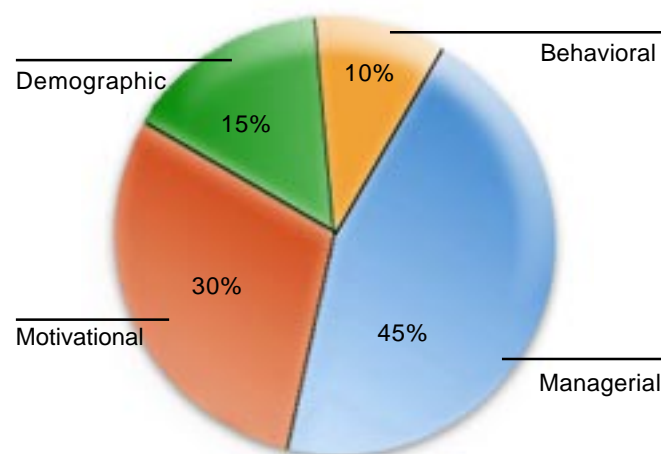
**Demographical:** Clash between the different languages, cultures and work practices can make collaborating with offshore teams a challenge, especially in the early stages. Regional politics can have a lot of impact on offshore efforts. While most of the offshore destinations are politically friendly to the western governments, flash points exist. Certain security constraints imposed by local government can cause inconvenience for example encryption regulations in the United States might wholly prevent certain work from being done offshore.

**Managerial:** Outsourcing requires capable people, who use appropriate processes, and focus on favorable outcome. Despite a good outsourcing strategy, a weak team can lead to poor decisions, inadequate planning, weak communications and unsuccessful implementations. Communication is the key. The company in its outsourcing strategy must provide a framework for communication with special focus on efficiency and accountability. The company should make every effort to ensure that

### Exhibit III

#### Risk Distribution

Source: Acidaes Knowledge Base



Overall risk distribution of a typical offshore outsourcing initiative.

its in-house staff stays up to speed technically with its offshore vendors so that it doesn't entirely become dependent on their assistance. Such dependencies can be very costly, as a vendor can take advantage of its "indispensable" status. This is especially applicable for legacy or propriety systems. Despite challenges, rewarding offshore partnerships can be forged but it requires a high degree of commitment on both sides.

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## Applicability

Despite the numerous benefits, not all IT requirements are good candidates for offshore outsourcing. As a thumb rule, the strongest candidates for offshore outsourcing are the ones that require least amount of interaction with the client companies. Typically, rewrites of core systems, re-architecting efforts, the maintenance of legacy systems, database management, etc are the most natural choice.

Products that have well documented requirements also make a strong case. To expedite product delivery, companies can use offshore teams to augment their onsite team and take advantage of the time zone difference, moving to a round the clock work cycle.

## Approach

The top management of the company must carefully plan and orchestrate their outsourcing efforts to ensure that they build long-term partnerships. Successful partnerships help organizations to shed load and respond with speed and agility to the market demands.

In this section, we outline an outsourcing framework for companies looking to gain from offshore outsourcing. This process model is a four-quadrant framework that covers the entire lifecycle of an outsourcing effort. The framework takes companies from the initial decision to outsource their requirements through day-to-day management of the partnership during the life of a contract.

**1. Sourcing Analysis :** Companies must re-evaluate their initiatives and attempt to define the business value they seek from their IT assets. The top management must define its goals and directions before trying to understand which services to outsource and to which service provider. Once established, these goals and directions would form the guidelines to evolve the organizations sourcing strategy. The sourcing strategy must be a bridge between the current status and capabilities of the enterprise and their desired future ability and business objectives.

### Exhibit IV

#### Outsourcing Framework

Source: Acidaes Knowledge Base



**2. Partner Identification :** Companies must clearly identify what they seek from a partnership. It is important to objectively understand and address these needs when selecting a service provider. Like any partnership, it is important that both side are committed to making the relationship work. Hence, it is important for companies to understand and analyze the motivation of their outsourcing partners. Like all business, service providers value size, profitability and long-term stability. Consequently for small-medium size enterprise, it becomes critical to analyze the value a service provider attaches to them.

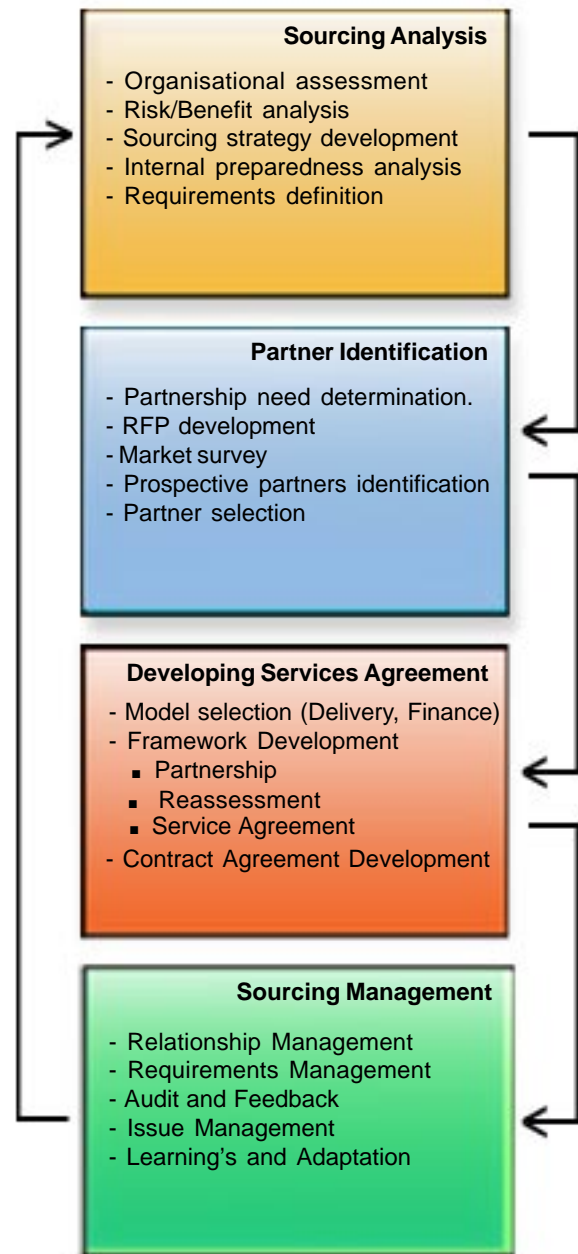
**3. Developing Services Agreement :** When developing services agreement and contracts it is important to have an underlined strategy and policy that guide it. Agreements must clearly outline the resource requirements, Integration issues, Compensation, measures for audit & feedback and communication guidelines. Additionally, a good agreement should also provide enough room for flexibility in specifications and change. As a policy, agreements must ensure that a framework is provided to account for scope deviations and related cost escalation.

**4. Sourcing Management :** Successfully co-managing contracts require a combination of technical, business and behavioral skills. One must continuously monitor the relationship and react to changes and events effectively. Communication strategy in this phase is a key. A weak communication strategy can result in perceptual issues, bad decisions and squander the cost and time savings. Learning's from this phase can be used by organizations to better iterate the process in future, by addressing it across all the four-quadrants.

## Exhibit V

### Framework Phases

Source: *Acidaes Knowledge Base*



## Conclusion

In today's world, offshore outsourcing can bring numerous advantages to an organization. Though the model is not entirely without risks, with a well-planned approach, the framework can deliver valuable cost and quality advantages to the organizations, all the while helping them focus on their core competence, and providing the necessary flexibility to react to the changing market needs.