

Chapter 1

Introduction : Overview of the outsourcing industry



The numbers tell a compelling story

As we look back at the IT calendar year that was, the 'Off-shoring proposition' clearly emerges as the silver lining. According to Deloitte Research, the world's Top 100 Financial services companies will make bottom-line annual cost savings of \$1.4 billion each by 2008.

Indeed, when it comes to the off-shoring issue, the CIO is now more likely to ask, "Where do I offshore?" rather than "Why not off-shore?". This question assumes critical importance in the light of the off-shoring phenomenon moving from a 'cost' paradigm to that of 'value'.

By 2004, 80% of US boardrooms will have seriously considered moving part of their technology services offshore. Nearly 40% will be using either near-shore or offshore services or will have experimented with a pilot.

Over 50% of Fortune 500 companies have off-shoring as part of their business Strategy. 42% of application management contracts now have some offshore component. Cost savings from off-shoring could be as high as 40%. Gartner calls it an irreversible mega-trend. And as the statistics prove, this is no hyperbole. So what's the buzz all about?

Start of something big

Offshore outsourcing is simply moving work from high-cost, developed countries to low-cost, developing ones. While cost has been a prime driver of the boom in off-shoring, it was not the factor that started the ball rolling.

Till the mid '90s, few companies had paid attention to a seemingly innocuous aspect of computer systems : most were incapable of keeping dates beyond 1999.

As the new millennium approached, companies rushed to make their legacy systems Y2K compliant. But the dearth of skilled information technology professionals in developed countries and the clock ticking away meant they had to look overseas. Many found answers in India. The period saw huge amounts of Y2K work pouring into India.

It was just the opportunity for the off-shoring model to prove its worth.

As the calendar turned and Y2K passed into oblivion, the US economy found itself in the grip of a downturn. The success of the Y2K model and the potential cost savings in moving work offshore were temptations that proved too hard to resist.

The early adopters were large Fortune 500 companies that either partnered with offshore companies or set up captive offshore centers. Their success spurred others to follow in their wake.

The rapid spread of the Internet and drastic fall in telecommunication costs made virtual management of offshore centers possible and feasible.

Meanwhile, at the other end of the spectrum, across time zones and oceans, the provider side of the market was fast maturing, further fuelling the growth of the off-shoring market.

An idea whose time has come

Opportunities for huge cost savings may have initially driven off-shoring. But, of late, offshore providers are stressing on quality and excellence.

Scaling the value chain :

Enterprises in countries like India are moving up the value chain. In the BPO segment, for instance, offshore service providers are moving into high-end niche and vertical markets. The focus is shifting from competing on cost to competing on domain knowledge and process expertise. In the IT arena, many providers are moving into consulting, design and implementation of large, complex and sophisticated systems and products.

Consolidation :

What till now has been a fragmented market is seeing signs of consolidation through large-scale M&A activity. This is enabling suppliers to provide a full spectrum of services and become one-stop shops.

Going global :

Offshore providers are also realizing the need to have a global presence and are setting up onsite offices. This is bridging cultural and communication gaps.

Government support :

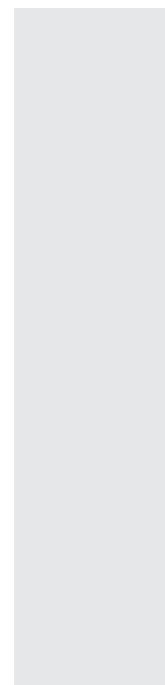
Local governments too are getting into the act, handing out substantial incentives and setting up infrastructure to enable their providers to remain globally competitive.

Geopolitical and economic stability :

A reduction in political tensions and robust economic numbers in countries like India are reinforcing confidence among buyers. In a fast globalizing service economy, outsourcing is no longer an option. It is a business necessity. Of course, off-shoring is not without risks and failures. But enterprises with a proper off-shoring strategy and the right outsourcing partner can reap substantial rewards, as many have already discovered.

An off-shoring relationship delivers optimal results when both parties are on the same wavelength in terms of language, culture and business practices.

In this regard, if the outsourcing organization invests in educating its personnel on the cultural nuances of its offshore vendor, it will go a long way towards establishing a harmonious relationship.



Chapter 2

Why Offshore : The benefits of off-shoring



While cutting costs continues to be an important reason for enterprises worldwide to send work offshore, it is no longer the only one. Everyone from Fortune 500 players to companies way down the revenue ladder, are turning to the offshore model to:

- * Refocus their energies on strategic and core issues
- ** Gain access to world-class capabilities
- * Reallocate capital
- * Reduce operational expenses
- * Reduce time-to-market

The cost factor

Off-shoring is not an easy decision to make. It calls for a tectonic shift in the way enterprises manage and perceive themselves. At a time when resources are scarce and competition fierce, there are few reasons in favor of outsourcing as persuasive as a reduction in costs. Cost savings from outsourcing typically fall in the 15% to 40% band. Companies can reap cost advantages in many ways:

Labor arbitrage:
IT labor costs in India are 50% to 80% lower than in the US and Europe.

Lower fixed costs:
For most companies employee and related overhead costs are fixed, regardless of market needs and realities. Outsourcing converts these costs into variable costs and gives companies the flexibility to adapt to changes in the marketplace.

Lower continuing investments:
Maintaining a workforce calls for ongoing investments in employee training, infrastructure, etc.

Companies can move this cost to an offshore service provider.

These factors allow companies to manage their cash flow better and redirect resources to strategic areas.

Non-core to strategic

“An important re-engineering principle is that companies should focus on their core competencies and outsource everything else.” Microsoft Chairman Bill Gates
When resources are scarce, it makes eminent business sense to offshore non-core functions, especially if there are cost savings attached to it. This enables companies to:

- Build on distinctive competencies and thus retain the competitive edge and create value for stakeholders
- Focus on strategic initiatives like marketing and brand-building
- Re-engineer for more efficiency : Budgetary constraints force companies to slacken on non-core functions, leading to operational inefficiency and lower productivity.
- Change focus from internal issues to customer

Gain access to world-class capabilities

If you decide to go offshore, the one thing you can be sure of is choice. Companies are often stymied by a lack of access to people with domain expertise and specific skill-sets, especially when resources are scarce. Instead of investing in training and personnel and chasing technology, companies can partner with world-class service providers, who have already made investments in technology, methodology and people.

Reallocate capital

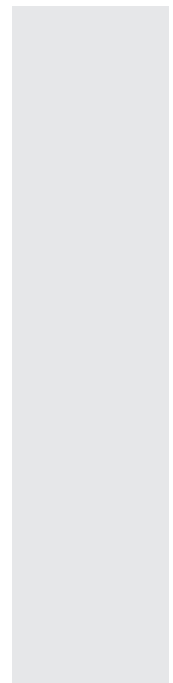
Outsourcing non-core functions frees up precious capital funds for core functions. Investments in outsourced functions can be accounted as operating expenses and this can have a positive impact on a company's financial measurements by eliminating the need to show return on equity from capital investments.

Reduce operational expenses

Expenses on research, development, deployment etc, add considerably to a company's operational costs. This is passed on to the customer. Companies can control these costs by outsourcing, because service providers leverage economies of scale to offer a lower cost structure.

Reduce time-to-market

To retain a competitive edge, companies have to constantly strive to reduce development and production cycles and get to the market quickly. Outsourcing significantly reduces ramp-up time, because the service provider already has trained manpower and infrastructure in place. By going offshore, companies can also use the time difference between Western and Eastern hemispheres to cut production and development times. A company could in principle be working round the clock by following the sun. For instance, a company in the US could allocate work during its waking hours; the offshore provider completes the tasks while the US sleeps; the company reviews the work the following day and allocates more work in a seamless cycle.





1) Why do you want to outsource?

Different companies outsource to achieve different objectives. The first question you need to ask yourself before you quote the ubiquitous RFP, is the obvious one: Why? Do you want to outsource because the rest of the world is already doing it successfully? Are you looking at outsourcing as a strategic move? Or do you just want to reduce and control costs? Is improving performance one of your objectives? Do you want to tap talent that is not internally available?

A detailed need analysis will help you decide what and how much to outsource as well as choose the right vendor and location. It is the first step in formulating a good outsourcing strategy.

3) Are you ready to outsource?

Outsourcing involves a lot of introspection. It entails a sea change in roles and responsibilities, work processes, resource allocation, infrastructure and communication protocols and management thinking. Are you prepared for the change?

- a. Employees are unsure of how outsourcing will impact their jobs. It is natural for people to resist any change from what is familiar to them. It is very important to redefine roles and responsibilities as early in the outsourcing cycle and as clearly as possible. Put in place a re-training program. Unify individual and company goals by offering incentives so that employees willingly participate in implementing the new process. Honest and open communication is the key to winning over internal resistance. Establish a hotline to counter the spread of rumors. Make presentations, hold enterprise-wide meetings and ensure that top management is accessible to quickly address concerns.
- b. Put in place a detailed plan to reallocate resources. Identify the project leaders and the team to give them enough orientation time, and back them up with the necessary resources and infrastructure. By the time you actually begin an outsourcing relationship, you would have a team that's comfortable with the new work regime.
- c. Communication with your offshore service provider will be largely through the electronic medium. Put new communication protocols in place. Digitize and update all your systems to support these changes. Revise network and security policies. The logistics department should understand all aspects of exporting hardware and software to a foreign locale.
- d. Understand and evaluate impact on the end user. For instance, outsourcing application development and maintenance might have a limited impact, whereas HR outsourcing might have a more enterprise-wide impact. Communicate the possible changes across and down the line.
- e. Understanding all the risks involved in outsourcing is the only way to mitigate them. Consider country-specific risks like geopolitical instability, socio-economic conditions, legal and labor issues, etc; vendor-specific risks like business continuity, quality, scalability, attrition, intellectual property, infrastructure, etc; and security risks like data privacy, network security, application security, etc. A proper risk assessment framework is crucial to the success of an outsourcing relationship.

2) What should you outsource?

Identifying what you want to outsource is the second step. Not everything in your portfolio is necessarily suitable for outsourcing. A detailed assessment of your portfolio and the need analysis will show you the most likely candidates. Here are some points to consider:

- a. How labor-intensive is the work? Obviously, the more manpower it requires the better the cost savings if you outsource.
- b. How core and critical is the work to your business? It's always better to start off with outsourcing non-core functions. You can always move other areas offshore once you are comfortable and clear about the dynamics of managing an outsourced relationship.
- c. How mature is the outsourcing industry with respect to the work? Has the kind of work you want to offshore been successfully outsourced before? If the market is mature, you are more likely to find suppliers with experience, domain expertise and process knowledge. You will find better systems and methodologies in place. And you also have successful examples to emulate.
- d. What is the level of interaction required? The suitability of a project for outsourcing is inversely proportional to the amount of end-user interaction required.
- e. How clear are the requirements? If the requirements are ambiguous, be prepared for changes and delays during the development cycle. Projects with clear specs and requirements are ideally suited for modular methodologies and remote execution.
- f. Also consider factors like stability and life stage of applications. Stable applications are ideal for running pilots. It allows supplier teams to get comfortable with the processes, methodology and workflow, rather than solving problems. Buyer companies, on the other hand, can benchmark cost savings and make assumptions for future projects. To allow enough time for paybacks to kick in, choose applications that will remain in use for at least two years.
- g. How much documented knowledge do you have about the work you want to outsource? In the early stages of outsourcing, your employees are likely to resist the change. Hence, it is easier to offshore projects where the knowledge is well documented because it will mean keeping interaction between supplier teams and your employees to the minimum.

Offshore Outsourcing Max

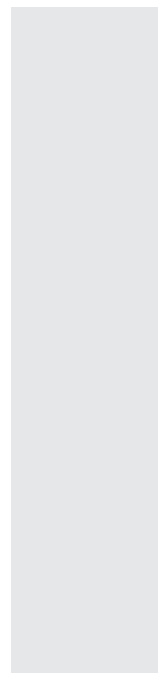
4) Where to outsource from? Factors to consider while choosing a location

- a. **Geo-political stability** : Examine the political health of the country. Is it prone to civil strife?
Is the government stable? A changing government means changing laws and a fluctuating economy. How cordial are diplomatic ties between that country and yours?
Strained relations between the two countries will affect your business. Also consider the law and order situation.
- b. **Economic stability** : Check for currency advantage and risk. How stable and strong are the economic institutions like banks, stock markets and financial watchdogs? The wage rate is an important factor since cost-reduction is one of the drivers of offshore outsourcing.
- c. **Legal factors** : How strong is the judicial system? Are the courts able to effectively enforce contracts? What is the country's stand on intellectual property rights, employment issues, data privacy issues, etc? Is there a strong legal framework that supports outsourcing?
How compatible are immigration and visa laws, customs and duties requirements, tax laws, and other local laws with your business goals?
- d. **Government support** : Study the government support offered to the outsourcing industry. Does the government see the outsourcing industry as an economic driver?
How quickly can you get the paperwork and formalities done?
- e. **Infrastructure and communication technology** : Examine the infrastructure available. The country should have satisfactory power and transport facilities. Good communication networks and telecom backbone are important because of the distance between you and the provider. Communication technology should be advanced, reliable and cost-effective.
- f. **Labor pool** : Evaluate labor on quantity and quality. Is there a sufficiently large labor pool? If employees resign midway through your project, will replacements be found easily? Can your project be quickly scaled up? Examine the strength of the education system in the country. How educated and experienced is the labor pool?
- g. **Cultural compatibility** : Culture plays an important role in business relationships. Different cultures have different perspectives with regard to contracts, employees, deadlines, etc.
Management style and 'how things get done' shape business processes. Language difference may be crucial because they will affect communication. Search for a provider in a culturally compatible country.
- h. **Time advantage** : The time difference between countries in the Eastern and Western hemispheres can be leveraged to get a round the clock workday. Choose a location that gives you this advantage.



5) Whom to outsource from? Factors to consider while choosing a partner

- a. **Track record and expertise** : Has the provider done similar projects? Does his past work match your standards? Study how well the provider has met the Service Level Agreements (SLAs) with other clients. What kind of value-add have they provided their earlier clients? Do your due diligence thoroughly. Does the provider understand the intricacies and nuances of the industry, especially if it's a niche area? What are the skill levels and experience of its employees in doing the kind of work you want to outsource? Have they worked on similar processes before? You don't want a supplier learning on your job. Another important aspect to look into is attrition rate. The outsourcing industry has tremendous churn. Check how the provider is managing attrition. How is employee loyalty being rewarded? What are the retention initiatives?
- b. **Corporate culture** : Different companies have different work cultures. In offshore outsourcing, there is the added difference between the two countries' cultures.
Examine work ethics, decision-making processes, problem-solving techniques, attitude towards risk-taking, management culture, corporate governance and value system. The two work cultures need not be a perfect match. But it's better if the core beliefs are the same.
- c. **Communication infrastructure** : In offshore outsourcing, most communication will take place via the electronic medium. Does the provider have the infrastructure in place to enable virtual teams to work together?
- d. **Geographic footprint** : In an offshore outsourcing relationship, distance can be a major road block. A provider with a presence close to your shores can be a big advantage. It helps bridge communication and cultural gaps, and you also have quick access to someone you can hold accountable. A provider with a multi-country footprint is ideal to mitigate location specific risk to your project.
- e. **Financial stability** : Is the provider financially stable and self-sufficient? Do a due diligence on a provider's financials. You don't want a supplier going belly-up on you in the middle of a major project. Study whether it can make the required investments in people and infrastructure.
- f. **Security** : Outsourcing your project will require you to share confidential information with the provider. Put strict guidelines and measures in place to protect the privacy of your data. Sign iron-clad non-disclosure agreements (NDAs). Study issues like network security, application security and even the physical security at the location where your work will be done.



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Chapter 4

Keys to successful offshoring



1) Negotiating the deal

Outsourcing is no longer just about getting the best price. It's about entering fruitful relationships and obtaining long-term value. Most successful outsourcing deals have been built on a foundation of strong customer-supplier relationships. Outsourcing has to be a win-win deal. Negotiations should be focused on maximizing value for both partners.

Before you negotiate, don't just look at immediate gains via cost-savings. Understand the project's total cost of ownership and the value-add you expect from the supplier in terms of productivity and performance improvements, special skills, etc. While evaluating the value, also consider costs you would incur on managing the outsourced relationship. Put in place a proper communication framework, especially in offshore negotiations. Difference in time zones can be an advantage and a drawback. Negotiations can move forward more quickly because one team works while the other sleeps. On the flip side, this could also lead to gaps if communication protocols are not well established.

Because of cultural and language differences, it is always a good idea to keep the language simple.

2) Signing on the dotted line

Drawing up a contract is one of the trickiest tasks in an off-shoring relationship. Consider issues like jurisdiction, data privacy, employment issues, intellectual property rights, business continuity challenges, local laws and taxation issues. If necessary, hire a local consultant to vet all contractual documents. Establish a framework for escalation and resolution of disputes.

A comprehensive statement of work (SOW) will save a lot of heartaches while monitoring performance and productivity. Specify processes and deliverables in detail. Don't assume anything. Make sure the supplier understands your requirements and specs and get it put on paper. Ensure you have agreement about the agreement. Service level agreements (SLAs) are an important metric to measure and monitor performance. Some points to consider:

- a. Understand the level of service you require. An important thing is not to overshoot your expectations. While it's great to have 100% uptime, there is huge cost attached to achieving this. Does your project require that kind of uptime? Be realistic.
- b. Include information like duration of service, installation timetable, payment terms and issues such as warranties, indemnities, and limitation of liability.
- c. Use a carrot and stick policy. Give incentives when performance and productivity commitments are met and penalties when promised service levels don't materialize.
- d. Identify the critical components of your project. Define specific service levels for these components independently.
- e. Define a framework for monitoring service levels upfront. Spell out details like reporting mechanism, frequency and methodology of performance review, etc.
- f. Leave room for changes in scope, inclusion of new services and changed business requirements. Agree on how they will be treated.
- g. Clearly spell out the process for termination and disengagement. Define all the transitional and handover issues between serving the notice and actual termination.
- h. Specify buffers and redundancies. In a high attrition industry, it's important for your supplier to have sufficient bench strength to meet service levels at all times. Or if your project requires high uptime, your supplier will need to provide adequate redundancies.
- i. Specify clearly your disaster recovery and data backup requirements.

3) Managing Transition

Managing internal change :

To be successful in an outsourcing relationship, it is important for the company to understand and manage internal change. Top managers will have to play evangelists and win over resistance by clearly communicating the strategic payoffs and the value-add of outsourcing. Outsourcing also calls for a paradigm shift from control to monitoring. The management must sensitize employees to the new paradigm and help them ease into it. Clearly outline the new structure, work processes, roles and responsibilities well in advance. Don't spring any surprises.

Managing the provider :

Communication is the key. Customers need to align expectations and objectives with suppliers. Keep them constantly engaged. Involve them in planning and goal setting. In complex projects, consider posting a project manager at the provider end. This will ensure better monitoring and improve communications.

Manage the migration :

Document a migration strategy to define scope of processes to be off-shored, operating procedures, new roles and responsibilities, workflow, handoffs, etc. Assess the readiness of the supplier by asking questions like: Does the supplier have the required manpower in place? Are internal processes in place to manage your project? What is the level of training required? How will systems be integrated? What are the reporting mechanisms and what is the communication infrastructure?

Run a pilot :

The pilot is where work is concurrently performed at the client and provider ends. When a certain confidence and comfort level is achieved, the work at the client end is phased out. During the pilot, chunks are worked out and the foundation is laid for the supplier to take over.

Training and knowledge transfer :

If the supplier has inadequate knowledge of your systems, processes and culture, your relationship may be doomed before it begins. A proper knowledge transfer strategy ensures that the supplier's team is prepared for all the unique challenges that your work demands.

The approach to training will depend on the nature of the outsourced work. One methodology involves supplier and client project teams working together for a while at the client site. When the supplier's team is sufficiently clued in to the work processes and requirements, the client team hands it over completely. This approach is viable when teams are smaller and the processes complex, but may be too expensive for something like a call-center operation. A second approach is for suppliers to designate a core team for training at the client site. After training, the core team will be responsible for training the rest of the supplier's team. A third approach is for clients to train supplier teams at the offshore location.

It's important for companies to constantly monitor and evaluate the progress of training, so that handoffs happen smoothly and at the right time.



4) Managing relationships

Monitoring :

Constantly monitoring progress is an important aspect of successfully managing an offshore relationship because you are miles away from where the work is being performed.

- a. Identify your monitoring requirements. For instance, you may want a system to listen in on how a call-center is responding to your customers. Or you may require an online tool, where you can monitor schedules, status of work, milestones achieved, etc.
- b. Use communication tools like email, video-conferencing and the telephone to frequently touch base with your supplier's team.
- c. If the work being performed is critical, consider deploying a resource at the supplier location for hands-on monitoring.
- d. Most suppliers will provide daily, weekly and monthly reviews and progress reports.
- e. Assess performance on the basis of the service level agreement.
- f. Get feedback from end users and customers.
- g. Conduct quality assurance tests and audits.

Solving problems :

For better productivity and quicker turnarounds, you must have a robust problem-solving mechanism. Establish a protocol for communicating problems. Identify people who will resolve issues. Put in place an escalation framework. Ask questions like: Was the problem resolved quickly enough? If not, why not? How did it impact performance, productivity or service levels? Fix responsibility and make people accountable. Many companies treat problems on an ad-hoc basis. Don't. To avoid recurrence, identify and solve the problem at the root, rather than treating symptoms.

Watch performance over time :

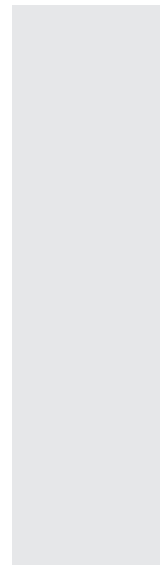
In long-term relationships, conduct yearly reviews. Assess issues like value-addition, achievement of desired goals, strategic gains, ability of supplier to adapt to changed requirements and business conditions, productivity and performance improvement, consistency of performance, etc.

The extended organization :

Treat the supplier as part of your extended organization and not merely as a contractor. It is important for customers and suppliers to align their visions and objectives. Encourage your project teams to interact and familiarize themselves with supplier teams. This will close cultural gaps and lead to better working relationships.

Preserve your knowledge base :

Outsourcing involves transferring knowledge to the supplier and a change in roles and responsibilities for your internal team. Ensure that your knowledge base is not eroded in the changed environment. Document and preserve it. There could come a time when you have to do it in-house all over again.



Chapter 5

Conclusion



Outsourcing is no magic pill. It is not going to transform your business and change productivity and performance levels overnight. But with meticulous planning, a clear understanding of immediate objectives and long-term goals, proper change management practices and systematic implementation outsourcing can deliver significant strategic and business value over time. It is also a tool that could help you seize the competitive edge in the marketplace. On another front, outsourcing is no longer a simple contractual relationship. It works best when customers and suppliers get into long-term, mutually beneficial partnerships. Almost 80% of the respondents in a recent survey by Vantage Partners said their strong working relationships with suppliers delivered at least 25% more value than their poor, adversarial relationships.

Outsourcing today is all about strategic alliances and partnership, and not just about getting the lowest price. Which is as it should be.

Chapter 6

Basic steps in Offshoring Processes

- Discovery Phase
- Scope of Activities
- Pace of Moving Offshore
- Structure
- System & Processes
- Culture & Values