## STRATEGIC APPROACH FOR OFFSHORE OUTSOURCING

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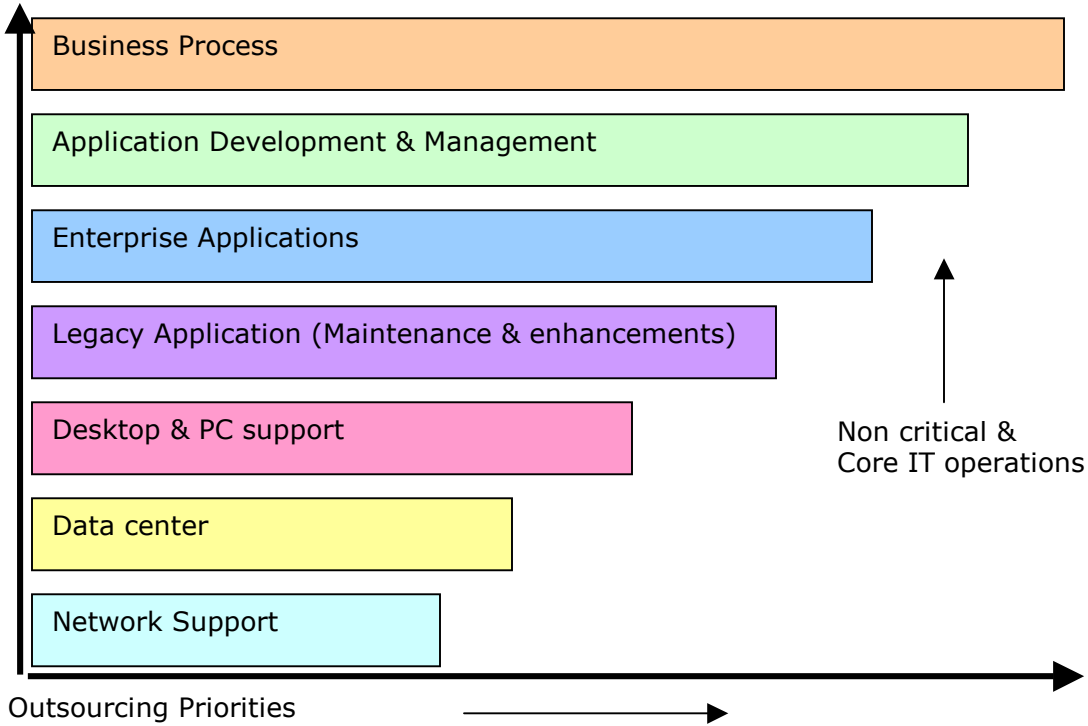
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## OUTSOURCING TRENDS:

Strategic priorities of outsourcing including non critical & core IT operations:



Distribution of IT budget in non critical & core IT operations (Initial assumption):

| IT operations | Allocation of IT budgets in % |
|---|---|
| Business Process | 30%-40% |
| Application Development & Management | 25%-35% |
| Enterprise Applications | 15%-20% |
| Legacy Application (Maintenance & enhancements) | 15%-18% |
| Desktop & PC support | 10%-12% |
| Data center | 5%-8% |
| Network Support | 4%-6% |

## OFFSHORE OUTSOURCING - ORGANIZATION'S READINESS

Regardless of primary inclination of offshore outsourcing by organization, we need to analyze the organization's readiness for offshore outsourcing. Our objective of organization's readiness analysis is to provide a tool-kit for making high-level strategic sourcing decisions.

**The need for organization's readiness analysis:**

The 2005 Global IT Outsourcing Study by Diamond Cluster Intl. vividly illustrates why organization's readiness for outsourcing really does matter.

The study, which polled 210 buyers of outsourced IT services, found that nearly 100 percent of respondents had outsourced at least some of their IT functions and 74 percent (versus 64 percent in 2004) expected to increase their use of IT outsourcing. Yet the same study found that most buyers of outsourced IT services – who have had at least one external delivery relationship for several years – **still lack the right metrics to measure their success in these initiatives.** Such metrics should be in place before migration to an external provider. They are one of the critical components in the outsourcing readiness index. Moreover, the study identified that only 62 percent of respondents expressed satisfaction with offshore service delivery, compared to 79 percent in 2004. The study's authors noted that, "... While their experience with outsourcing is growing, buyers still find it very difficult to execute an optimal sourcing strategy. Buyers that viewed outsourcing as a series of transactions over the last few years are now recognizing the unintended consequences of not having a sourcing strategy."

**Our organization's readiness analysis comprise of these critical steps:**

1. Need Analysis
2. Internal change management & steps of resistance
3. Support from organizational leadership and management
4. Business impacts and risk management
5. Identification of core competencies
6. Technology requirements
7. Process stability and continuous improvement
8. Resource adequacy
9. Intelligent project selection
10. Alignment between outsourcing and business objectives

## 1. Need Analysis:

- What are the prime reasons to outsource?
- What are the long-term goals and objectives of outsourcing?

Strategic Approach:

Need analysis is first and primary step of analyzing organization's readiness for offshore outsourcing. Need analysis will be done by analyzing the existing IT operational issues like shortage of skilled IT resources, cost of IT operations, organization intention to focus on core business and getting competitive advantages.

Identification of long-term goals is essential as a part of need analysis as benefits of offshore outsourcing can only be achieved through long-term objectives.

## 2. Internal Change Management & steps of resistance

The new service delivery paradigm that outsourcing brings to an organization impacts all stakeholders—employees, users, and support groups. Many employees will be concerned about the implication of this change to their jobs and to their futures. For some employees, a clear understanding of the required changes and their rationale will foster immediate buy-in and support. Other employees will express their concern by asking questions, challenging rationales, and finding holes in the implementation plan and process. And still other employees may resist the change by either avoiding involvement or causing real or potential disruption.

Strategic Approach:

The three basic stages that have been identified within the organization for internal change management or stages of resistance:

- Holding On
- Letting Go
- Moving On

**Holding On** is the initial the resistance to change that occurs when individuals "hold on" to that with which they are most familiar and comfortable. Many users are used to getting served in a particular way from a team. There is mutual trust as well as fear of the unknown. In the case of offshore outsourcing, their team may now be thousands of miles away instead of just down the hall. This naturally causes concerns such as: How do I know what my team is doing offshore? How do I speak to my team during my workday? Where is everybody? Signs of this stage include "forgetting" to attend meetings about the change, coming into work late, an increase in employees calling in sick, or when people become irritable or withdrawn from others with whom they have previously had good working relations.

The second phase individuals typically experience when confronted with change is **Letting Go**. We may start hearing people say things like it just might work if management will let it happen. I'll do it once I see others do it without any backlash. It might work somewhere else, but I don't know how it would work here.

Letting Go is visible when people start attending meetings and either don't contribute or take opposing perspectives or when individuals question the issues associated with the change and start challenging thinking. They begin spending more of their personal time discussing how it "might just work if only..."

The third phase is called **Moving On**. At this stage, we may hear comments like: When am I going to learn how to do this? How can I get this going already? This isn't so bad after all. Moving On is visible when individuals spend time planning how to make things work or make an effort to keep them going when problems occur. When individuals appear energized about the change or speak with optimism about how things are really getting better around the office, they are in this stage.

## 3. Support from organizational leadership and management

▪ Whether offshore outsourcing initiative supported by management and organization's leaders?

Strategic Approach:

Success in outsourcing is rarely achieved through a bottom-up movement. Instead, leadership – and the commensurate support - must flow in a top-down direction. Outsourcing initiatives that lack this component usually have short, troubled life spans. If outsourcing is not treated as a high priority, it will suffer from low priority attention – a virtual death sentence in outsourcing.

The business decision to outsource should be considered – and made – at the executive level with the assent and support of the board of directors and C-level executive leadership. A clear understanding and acceptance of both benefits and risks is pivotal in solidifying support of organization's leadership over the long haul

## 4. Business impacts and risk management

▪ What business impacts and risks management issues involved with offshore outsourcing?

Strategic Approach:

All potential effects should be evaluated in the risk/reward assessment before a decision to outsource is ever made.

The possible impacts and risks, which may arrive due to offshore outsourcing:

1. Impacts upon the various stakeholders (i.e. shareholders, employees, partners, etc.), which can re resolved by regular communication and details provided for offshore outsourcing initiatives.

2. Impacts on existing processes, functions & business outcomes, which can be resolved by presenting the benefits of offshore outsourcing to key decision makers.

3. Impact upon customers, communication with key customers and making them aware of organization's change for their benefits will resolve the issue.

4.  Possible risks, which can be resolved by proper risk management plans and exit strategy for offshore outsourcing.

## 5. Identification of core competencies

▪ Whether organization has clear identification of their core competencies?

Strategic Approach:

Effective outsourcing can reinvigorate focus upon company's core competencies and value drivers to raise competitive fitness.

## 6. Technology requirements

▪ Whether identification of comprehensive technology requirements is finalized for offshore outsourcing?

Strategic Approach:

Of the many considerations that bear upon this requirement, key issues include security (i.e. data, network, intellectual property) and integration (software, platforms and hardware). Security issues are very much at the forefront of business IT priorities right now. Due consideration must be accorded to security when assessing how ready your organization is for the necessary secure connectivity to outsourced service providers.

## 7. Process stability and continuous improvement

▪ Whether organization had defined any process stability and continuous improvement method for offshore outsourcing?

Strategic Approach:

An outsourced process, whether it is IT outsourcing or BPO, needs to be optimized across the entire delivery chain before organization outsource it.

Need to define continuous improvement plans for quality and cost with offshore outsourcing partner, which will also lead to long-term relationship.

## 8. Resource adequacy

▪ Whether organization had done analysis for offshore outsourcing financials, resource planning and selection of technologies?

Strategic Approach:

Relating offshore outsourcing with cheap labor options never gives maximum advantage. A thoughtful and detailed analysis of required finances, people and technologies is essential in paving the way for any successful outsourcing project.

A good resource plan must account for all of the basics but also travel budgets, legal costs, contingency costs, variations in foreign exchange rates, etc. High quality resources will return high quality results. Investing in the necessary training and/or recruitment of a dedicated project manager, for example, can pay vital dividends, whereas tasking an inexperienced manager will invite immediate problems. In the same way, choosing the vendor that lodges the lowest bid for a project does not necessarily assure the best outcome.

## 9. Intelligent project selection

- Whether organization had made clear demarcation between non-critical and core IT operations?

- Whether organization had defined Resource Commitment, Project lifespan, Technology Requirements, Project Scope and Scale, Fixed vs. Variable Requirements and Operational complexity

Strategic Approach:

An intelligent project selection is an important factor for successful offshore outsourcing. Before finalization of any outsourcing contract organization needs to define a clear demarcation between non-critical and core IT operation. Along with that a clear understanding and analysis of all what part of core IT operation can be outsourced.

A successful offshore outsourcing requires clear understanding for resource commitment, expected life span of project and technology preferences. Clear project scope and project scales will enhance the vendor's performance. Here are few facts finding related to need for intelligent project selection.

- Greater codifiability of a process creates lower operational risk.
- A lower objectivity quotient creates higher operational risk.
- A greater number of parameters of process quality create a lower operational risk.
- Operational risk increases with the number of information dependencies within a process.
- Operational risk increases with the number of information workers per process cycle.
- The extent of operational risk decreases with higher trained information workers.
- Greater experience of information workers creates lower operational risk.

## 10. Alignment between outsourcing and business objectives

- Whether alignment between organization's business objectives & organization's offshore outsourcing need are done?

Strategic Approach:

Need to establish an executive steering committee that includes members from the relevant lines of business that sets project priorities and guides the outsourcing initiative through planning, implementation and management.

Strong governance mechanism to manage overall relationship supported by regular meetings with the service provider to evaluate project performance and relationship issues.

Project management office and senior project manager to oversee day-to-day operations of the project.

Flexible master contract that allows for changes in service scale/scope, pricing, staffing and contains a valid exit clause for service termination. Clear and detailed requirements definitions and work orders that define the scope/scale of the project and vendor/client obligations and responsibilities

Service level agreements that clearly define minimum performance criteria and performance goals. Rigorous and reliable metrics to measure vendor performance, project performance and their contribution to business performance. Collaborative, negotiated performance incentives and penalties to promote good performance and continuous efficiency and costs improvement.

## OFFSHORE OUTSOURCING- VENDOR RELATIONSHIP MANAGEMENT

"*To ensure a successful outsourcing arrangement, the relationship has to be mutually beneficial to both the client company and the service provider. Such alignment does not magically occur. It needs to be developed and managed on a proactive and ongoing basis*."

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Vendor relationship management plays an important role in successful offshore outsourcing. A strategic approach to successful vendor management comprise of these critical steps:

1. Organization needs to set the priorities of offshore outsourcing and the same has to be shared with outsourcing vendor.
2. Utilizing vendor to suggest and prepare business case for your organization, which will also help them to understand organization core business and refine their proposal so it better meets organization's needs.
3. Establishing a true collaborative partnership with vendor by treating them not only as vendor but also as business partner. It will help organization to develop long-term relationship with vendor.
4. Organization needs to look for creative ways to develop relationship with the vendor. There shouldn't have to be only price-delivery relationship with vendor.
5. Ongoing relationship building apart from cash flow exchange. Organization also needs to understand business functions of partner. Organization also needs to evaluate time to time whether vendor helped organization in their business growth.
6. The approach of organization for vendor will be to get competitive bids all time. A proper communications needs to be set between organization and vendor to understanding each other's decision-making points.
7. The approach for offshore outsourcing relationship needs to be long-term. A win-win relationship will make establish a true relationship.
8. Offshore outsourcing contract negotiation with final two vendors, organization needs to avoid discussion with only final one.
9. A balance of value vs. price during vendor selection and negotiation.
10. Foundation of trust and respect needs to be established between organization & Vendor.
11. Helping Vendor in their business growth by referrals, testimonials etc.
12. Analyzing vendor's capability by actions, like prototypes or small project implementations before finalizing offshore contracts.

## Vendor Management Office (VMO) - Strategic approach for vendor relationship management

### How to start a VMO?

1. Expanding a group within IT as the vendor management office (VMO).
2. Appointment of VMO Director or Manager with strong Financial and IT experience.

### Duties & responsibilities of VMO:

1. Set up formal RFP process and oversee all RFPs.
2. Monitor vendor performance using balanced scorecard or other method.
3. Negotiate contracts with Vendor.
4. Work with project managers to oversee IT budgeting.
5. Develop form agreements and contracts in order to avoid signing contracts always drawn up by vendor.
6. Learn vendor tactics and how to use them to company's advantage.
7. Stay abreast of market conditions and pricing trends.
8. Categorize suppliers into groups such as "strategic" and "commodity"; a strategic supplier should have good access to the CIO.

### Advantages of VMO:

1. Multi-vendor relationship model compare to single sourced vendor relationship.
2. Organization will get competitive pricing and quality of executions.
3. Vendor competition, which will lead to organization benefits.

### VMO-Key to success:

1. Centralize the function under IT and get executive support for the plan.
2. Win over internal customers. During vendor negotiations, those in the VMO should include the internal customers whenever possible. If they see the benefit and are included, they will be less likely to try to circumvent the VMO or aid vendors attempting to do the same.
3. Start small. Pick some areas to apply the VMO to initially and build it over time.
4. Appoint a VMO director with legal or financial experience—or both. Experience as a vendor helps as well.
5. Use your own contract whenever possible to minimize risk. If that's not possible, mark up the vendor's contract to make sure it's in your favor.
6. Keep vendors competitive by making sure they know about each other.

**Comparison between traditional outsourcing & VMO:**

|  | Traditional Outsourcing | Strategic Outsourcing(VMO approach) |
|---|---|---|
| Key motivation for offshore relationship | Cost | Long term strategic value |
| Definition of goals and objectives | Tactical | Strategic |
| Management of relationships /engagements | Activity focused | Outcome focused |
| Vendor management | Vendors as contractors | Vendors as partners |
| Management's approach towards offshore program | Disjointed principles | Common principles and goals |

## EXECUTIVE SUMMARY:

Offshore outsourcing is a start of new relation for organization, which can hamper stakeholder, investors, internal customers as well as external customers if the approach for outsourcing and proper strategy is not executed. Successful offshore outsourcing models will give business benefits and organizations growth along with organization's business focus on their core competencies. To implement a successful offshore outsourcing model within the organization, a detail organization's readiness analysis and proper strategy and execution plans for vendor relationship management is essential.