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*[Outsourcing mit Offshore Business Modellen - Entwicklung und int. Märkte]*

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# Forbes

## Face Of The Year

*[Lisa DiCarlo](#), 12.19.03, 7:00 AM ET*

NEW YORK - Recently, our readers voted "offshoring"--the movement of traditionally high-paying jobs from rich countries to poorer ones--the most significant business trend of 2003. We agree, so for our Face Of The Year, we have selected **Kiran Karnik**, a man trying to direct the path of the offshoring tsunami.

As president of the National Association of Software and Service Companies, or NASSCOM, Karnik is in a unique position to do just that. NASSCOM is the self-proclaimed voice of the Indian information technology industry. Its charter is to promote India's technology strength to the world, and to foster a business-friendly environment for companies setting up shop there.

And a lot of foreign companies are doing just that. Over the last few years, many crucial "white collar" tech jobs such as application development, database design, integration and services have moved to India. Tech currently accounts for some 3% of India's gross domestic product, or \$16.5 billion, up from just \$1.7 billion nine years ago. The big driver? Exports of software and services to the United States.

By 2015, experts predict that 3 million U.S. white collar jobs will be farmed out to other countries, up from about 300,000 today. Whether that is good or bad news for the U.S. economy long term is a matter of considerable debate, but it could already be having an impact. Consider that in the third quarter, U.S. GDP grew 8.2% but the unemployment rate dropped only two-tenths of 1%.

"Offshore outsourcing was triggered by the intention to cut costs, but now it's not just driven by cost factors," says Karnik, 56. "We are helping [U.S. companies] tap into talent that is scarce in the United States."

It's the "scarce" part that grates on some American captains of industry, such as **Intel's** (nasdaq: [INTC](#) - [news](#) - [people](#)) **Andrew Grove** and **IBM's** (nyse: [IBM](#) - [news](#) - [people](#)) **Sam Palmisano**. Both have pointedly expressed fear that the United States is losing its technical edge to other countries. Palmisano says that IBM will pledge \$200 million to train employees for jobs that might otherwise leave the country. (It's somewhat ironic, since unconfirmed reports recently said that IBM will send up to 4,700 software jobs outside the United States.)

A backlash may already be beginning. Both **Dell** (nasdaq: [DELL](#) - [news](#) - [people](#)) and **Lehman Brothers** (nyse: [LEH](#) - [news](#) - [people](#)) recently elected to bring back some jobs to the United States.

Karnik acknowledges the rumblings. "We began to see some concern [about loss of U.S. jobs] in 2003 that has not been there in the past, but by and large, that is not the mainstream view."

In the meantime, Karnik says it's his goal to more than double India's share of the global software production to 6%. Dennis McGuire, too, acknowledges growing protectionism but says U.S. companies will search the world for whatever makes them more competitive. McGuire is president of TPI, a Houston-based consultancy focusing on outsourcing deals. He says companies need to outsource commodity processes so they can focus on their own competencies. "Does it matter if you have world class accounts payable?"

Karnik, who is a physicist by training and spent two decades with the Indian space agency, is keening aware of an impending shortage of sciences and engineering-based talent in the United States.

India, with a population topping one billion, turns out 75,000 IT graduates annually, by far its most popular area of study. In the United States, the number of students graduating with computer and information science degrees have grown more than 70% since the mid-nineties but are still far outpaced by business, social science and education degrees.

Offshore outsourcing has been quietly building up for years but 2003 will likely be remembered as the year that it



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burst into the mainstream. Despite concerns in the United States about unemployment and lost innovation, there is no turning back. The pressure on U.S. companies to cut costs and compete globally is too compelling. Will India continue to receive the lion's share of outsourced jobs from U.S. companies? Probably, but Karnik needs to be aware of growing competition from professionals in China and Russia. Skilled labor there is equally plentiful, and equally cheap. And equally hungry.

Says McGuire, "China has seen the Indian miracle, and they want a piece of it."

# Financial Times

## A long-distance relationship

*By Priscilla Awde FT.com site; Feb 18, 2004*

Corporations based in developed economies have long taken advantage of skilled and cheap labour in developing countries. But though this is a familiar tale in manufacturing, back-office software projects or round-the-clock operations, there is a new twist to this story.

Lured by promises of dramatic payroll cuts, an increasing number of companies are re-locating their customer-facing operations abroad - call centres are being "offshored", as the new verb has it.

Yet closing or downsizing call centres in established western markets and re-locating them in emerging regions is proving contentious. In Britain (a mature call centre market second only to the US in size), government incentives successfully encouraged call-centre growth in regions hit by manufacturing job losses. Threatening jobs in this "replacement industry" increases insecurity and raises concern over the social, political and economic implications of redundancies.

Whilst Datamonitor estimates that only five per cent of all call centre agent positions worldwide will be moved offshore in 2007, recent adverse publicity has made those involved in the offshore industry reluctant to discuss their plans.

At first glance, moving centres offshore makes business sense. People-related costs make up about 70 per cent of the cost of running a call centre, making the prospect of shaving up to 60 per cent off the payroll very attractive. Average starting salaries for British call centre agents are just under £13,000 a year; an equivalent agent in India (the most established market for offshore call centres) makes £1,500 a year.

Compelling as the economic argument may appear, the process of moving offshore is neither simple nor quick. The technical complexities of integrating remote sites and corporate applications may be expensive, time-consuming and require long-term management. Savings in salaries may be offset by the expense of training agents in the national or corporate culture and language either abroad or at home.

As the public face of an organisation, call centres are often the company's first and perhaps only point of contact with customers. The way in which people are treated and the efficiency with which their queries are handled have a direct effect on customers' perception of the organisation and therefore their loyalty to it. It costs more to find new customers than it does to keep existing ones - hence the emphasis on customer relationship management (CRM).



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While it takes years to build a favourable brand or corporate image, damaging it takes far less time. Steve Morell, principal analyst at UK research firm ContactBabel, questions the motivation for offshoring: "There is too much emphasis on cost. Companies need to concentrate on efficiency because customers walk if queries are not properly answered. Companies can afford to have customers call back when they are paying low salaries but that has an impact on the brand and how the company is perceived. People are annoyed because they're getting less well served.

"Although companies benefit economically from offshoring, the advantages are not passed on to customers. It's very difficult for customers to see what's in it for them."

Comparing Britain and India, ContactBabel's research showed that although Indian agents answered phones faster and worked six hours a week longer, they handled nine calls per hour compared to 11.2 for British agents. Further, the mean average for first-time call resolution in India is 66 per cent, against 77.1 per cent in Britain - which translates into varying levels of customer satisfaction. Staff attrition rates are higher in Indian centres, with graduates staying an average of 11 months compared to three years.

Alex Kwiatkowski, senior consultant at Ovum, believes: "Corporations can't just make the decision to locate offshore without taking other factors into consideration, including the effect on brand image. Some customers may not want to deal with an offshore call centre however the risk can be mitigated if they get what they need. Locating simple, low-value ... transactions offshore is less likely to damage customer satisfaction. Keeping major, high-value enquiries, disputes and complex issues at home means that the offshore centre complements existing operations. The costs balance out. It makes good use of existing staff and increases customer satisfaction - a realistic and achievable utopia.

"There is a minefield of issues to consider, especially for offshore call centre operators. The industry is loosely regulated, if at all, but the EU has tight rules about exporting personal data. Many may just ignore data protection legislation, leaving it up to customers to suffer the inconvenience - but this is wrong."

Unlike the human issues, the technical challenges of connecting people two or three thousand miles apart are largely solved. Although successful offshore service providers are located in regions that have sophisticated communications infrastructure, there may still be problems. "The challenge is in the access layer not the core network," explains Peter Finter, marketing director of enterprise business at Nortel. "The interconnect between carriers and the last mile are the real challenges. It's important to ensure that wide area network [Wan] technologies fully exploit core network capabilities. Network management infrastructure processes are critical."

Regardless of their geographic location, agents must have real-time access to the same kind of networks - computer telephony integration (CTI) applications that run over high-speed, secure, broadband IP networks. As the value of outsourced transactions increases, it becomes vital for remote sites to be properly integrated with corporate functions and onshore centres. Reputable outsourcers not only use leading technology but have the necessary on-site expertise to run and manage these complex systems.

"In the past, call centres were standalone units but are now deeply integrated - especially with CRM systems creating a challenge for offshore locations," says Carsten Stehr, vice-president for multimedia applications at Siemens Enterprise Network Group. "Offshore centres are part of the overall business process and require network connections between the remote site and home base. Centres were networked over leased lines, which is reliable but expensive. IP networks are more flexible and remote agents can be located anywhere, managed and supported from one location in virtual call centres. Technical integration is more complex but, enabled by IP technology, is driving the need for careful, up-front planning. Integrating applications into the CRM or ERP [Enterprise Resource Planning] worlds requires professional services."



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Apart from the technology, the success of any offshore project lies in the extent to which an organisation understands CRM and the potential impact of offshoring on the corporate brand. "People are getting smarter about brand impact," believes Ryan Powell, an analyst at Datamonitor. "Organisations should put in place key performance indicators (KPI) specifically linked to brand image, and clear service-level agreements so the service delivered meets the requirement to enhance the brand. Offshoring can have positive benefits depending on what is outsourced and how it is measured.

"The big question is: are companies rigorously adhering to their own standards and do they understand and know exactly what they want to outsource and how it impacts on and interfaces with the rest of the organisation? Companies need to concentrate on what they want to do with CRM and shouldn't blame the outsourcer for what are essentially internal business process problems."

CRM is about improving and streamlining the customer experience and, linked into call centres, is ideally a better, more cost-effective way of creating loyalty. Sarah Faux, chief executive of Datapoint, suggests: "There is a very real argument for moving low-value, high-volume transactions offshore. If all systems are properly integrated so that agents have real-time access to screen pops, and customer queries are answered fast and dealt with efficiently, how much do people care about where a call centre is?" Whoever answers that question wins the jackpot.

## How the old economy can reclaim youth

*By Joanna Chung FT.com site; Feb 23, 2004*

Operators of oilfields in the North Sea face a serious demographic problem. The average age of the offshore worker in the UK is 49 and rising, while fewer younger people are studying science and engineering.

The number of graduates studying chemical engineering in Britain is estimated to have fallen 32 per cent in the past five years. US graduate student enrolments in geo- science in 2000 were only half of those seen in 1996, according to the American Geological Institute.

That the demographic time bomb is to have a profound impact on all businesses is already clear. But the ultimate survival of some of the most important industries round the world - such as the energy and chemicals industries - depends on their ability to attract and retain employees with highly technical skills in sectors that some now consider unglamorous.

Globalisation is already offering a solution, widening the pool of workers that companies can access. Energy companies are venturing further into new and unfamiliar exploration territories - such as Russia and Africa - while chemicals companies are increasingly outsourcing their activities to lower-cost producing countries in the east.

More and more companies recognise the value of training and retaining local employees. Schlumberger, the oilfield services group, aims to recruit local employees in the same proportion to the amount of business it conducts in a specific country. "We are hiring in Russia and China because we have activity in Russia and China," says Stephen Whittaker, director of communications at Schlumberger.

Replenishing skilled professionals in industries that require deep skills and experience will be costly.

Carl Dugdale, general manager for the UK at Celerant Consulting, says: "Companies will look in one of two directions. Either they will pay up and fill vacancies, which might take time, or they will look further afield. That will create more competition in these fields."



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Technology will be another part of the solution. Technological advances have diminished the number of workers needed within industries and, in some cases, precluded the need for human beings altogether.

Some energy companies, for example, are already operating oil and gas fields remotely. Dr Ian Moore, a consultant with Cap Gemini Ernst & Young, has been working with a Canadian oil company that is collecting technical data on more than half its 4,000 wells from a remote location.

He says the use of "smart field" technologies has allowed the company to gather more accurate data more frequently - even minute by minute - than when people were taking various readings and measurements.

Changes in technology will also mean that companies will demand a different set of skills in the future. Innovation and entrepreneurship will also become increasingly important across all technical sectors.

Beyond attracting the talent, companies must also find efficient ways to transfer the knowledge and skills needed for a job from one generation to the next. The knowledge of experienced workers can increasingly be recorded and catalogued for training purposes.

Cogent, the employer-led sector skills council in the UK for the oil and gas extraction, chemicals manufacturing and petroleum industries, this month started Evolvonline, the world's largest e-learning library, to train technical employees in those sectors.

But many in industries such as oil and chemicals argue that there must also be changes in the way technical disciplines are taught in schools, which some blame for failing to engage many young people in these subjects.

"Teaching science in an exciting and engaging way is important. Kids are not generally so attracted to science and engineering as they were 15 years ago," says Sue Ion, director of technology and operations at BNFL, the nuclear fuels and engineering company.

Industry associations and companies have started to take the skills shortages issue on board. The UK Offshore Operators Association has been sponsoring a training programme for secondary school teachers to inspire them to make subjects such as earth science exciting for children.

BNFL, alarmed by the lack of relevant college courses, has created alliances with four UK universities to establish a skills base of 140 researchers using a research budget of about £40m. It is also in the early stages of setting up an institution in Manchester that will focus on education in nuclear subjects.

But the struggle to secure the most talented graduates is made harder by the "old economy" image surrounding many of these industries. The perception that some of the jobs are dangerous or come with an inflexible lifestyle does not help.

"The real issue has to do with perception," says Dr Ion. "People perceive the industry as winding down and not having a future. They have got to see the industry as attractive and as having a long-term future."

Rachael Bartels, the partner at Accenture's chemical practice, says: "The chemicals industry doesn't really portray itself as 'sexy' any more. Starting in the 1990s, the attractiveness of the industry has slowly started to drop in terms of a career choice. There is a lot of subliminal stuff about science and chemistry as being dirty and smelly."

Companies themselves often fail to offer the kind of reward structure and exciting career path the best and brightest have come to value. Mr Dugdale at Celerant Consulting says: "Some of these companies have difficulty finding bright young people to come through. They tend to blame it on the fact they are in the mature industries. But that is a



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myth. How does [a company] do it? Offer a meritocratic system and management process that allows people to achieve fulfilment and success rapidly."

Many would argue that a skills crisis would be unlikely in a global marketplace. But in the energy sector the impact of the shortage will be felt within five to 10 years, according to Susie Gear, the oil and gas partner at Accenture.

"This is a strategic issue and a competitive advantage issue," she says. "The companies that will succeed in the future are the companies that can connect talent supplies with demand."

## The Guardian

### Outsource options: Offshore savings are a sure thing

The public sector is following its private counterpart and reaping the financial rewards of offshore deals, as the Scottish Parliament and the NHS look overseas for IT skills

*BY JOHN LAMB The Guardian - United Kingdom; Feb 25, 2004*

When members of the Scottish Parliament finally take their seats in the much-delayed new parliament building in Edinburgh this September, the system that provides their emails, office software and internet facilities will be tended by a small group of IT specialists from India.

Some 18 systems engineers from outsourcing company Wipro Technologies, based in Bangalore, have been providing IT infrastructure maintenance, development and a help-desk service for the parliament's systems for over two years under a pounds 5m, five-year deal.

Although the contract is a drop in the ocean compared with the pounds 5.4bn that the UK public sector spent on IT last year, the arrival of overseas IT workers in Scotland has been greeted with suspicion, especially since Wipro Technologies is the world's largest offshore IT company.

The firm, which earned \$711m last year, has contracts with big names such as electricity provider National Grid Transco and technology companies Microsoft, Compaq and Nokia. Wipro Technologies also recently won a contract from the Office of Government Commerce to conduct web-based auctions for government departments that want to buy IT supplies.

In Scotland, Wipro Technologies has come under intense political scrutiny. "There have been almost weekly questions in parliament," says the company's business development director Tom McCormack. "These range from enquiries about whether overseas IT workers have access to confidential information, to whether IT has been responsible for the delays in moving parliament into its new home at Holyrood House."

Behind the concern of politicians is the fear that local firms will lose business and that jobs may go abroad. Outsourcing is already a sensitive issue in the public sector - staff at Bradford city council recently threatened to strike over plans to offer a pounds 100m contract to run the city's IT to one of three competing companies.



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Such union militancy is unusual these days. The big battles over outsourcing took place in the 80s, when departments such as the Inland Revenue first handed their computing over to outside companies.

"These days, over 50% of public sector IT is outsourced," says Robert Morgan of outsourcing advice company Morgan Chambers. "It is government policy to put services out to tender."

However, outsourcing overseas is much more of a hot potato. In the private sector, offshoring to low-wage countries such as India, the Philippines and China is big business.

High technology companies already subcontract much of their software development abroad and many have set up their own subsidiaries in India, a favourite because of its well-educated work force and low wage demands. India's IT industry represents 85% of the offshore market.

Indian companies such as Wipro Technologies, Tata Consultancy Services, Infosys Technologies and Mastek are keen to do business in the UK public sector. Some have already picked up work by forming joint ventures with UK companies. Mastek, for example, linked up with Capita to carry out software development offshore for London's congestion charging project.

More recently, Tata Consultancy Services won pounds 120m worth of contracts as its share of a pounds 896m project for the NHS, which was awarded to a consortium led by Fujitsu. Over the next 10 years, the Fujitsu alliance will be responsible, as a local service provider, for delivering IT services to support healthcare in the south of England.

Tata, the first offshore firm to win a major contract like this, will implement clinical applications and be responsible for migrating data to new systems.

So far, offshore companies have yet to break into the public sector in a big way. "Hardly any work has gone offshore," says Phil Codling, an analyst with the Ovum research firm. "It is simply a matter of sensitivity in areas such as tax and defence. It is not worth the government taking the risk."

New projects like those involved in modernising the NHS are politically more palatable because they do not involve a transfer of existing work. Other Indian companies, many of which already have experience in working for the US healthcare industry, hope to follow Tata in winning business from the NHS.

Although savings of two-thirds or more are commonly quoted for offshore outsourcing, not everyone is so bullish. Professor Leslie Willcocks of Warwick University, a leading authority on outsourcing, has his doubts. "UK and US firms offshoring to India should now expect 30-35% net cost savings because it is not just about labour," he says. "Transaction and infrastructure costs can be uncertain."

Public opinion may also act as a brake. Efforts in the US to send local government work offshore have met with protests, the cancellation of offshore contracts and attempts to frame state legislation to stop the practice.

For now, British ministers are encouraging offshoring. Industry secretary Patricia Hewitt has commissioned a report on the topic, while e-commerce minister Stephen Timms recently visited India where he reassured officials and local business leaders that the UK government actively supported offshore outsourcing.

However, the public sector has yet to bite the bullet. "Politically speaking, the government is willing to do it. It is prepared to import technology to do what they do better. But it will be a while before they send large numbers of government jobs overseas," McCormack says.



# ZDNet

## IT firms expand from PCs to payroll

By [Ed Frauenheim](#)

CNET News.com January 14, 2003, 4:00 AM PT

Faced with weak information technology spending, companies that provide IT services are expanding beyond their traditional role as overseers of networks, PCs and computer help desks and moving into "back office" areas such as accounting and human resources.

So-called BPO, or business process outsourcing--which involves an outside company taking over various back-office functions including procurement, invoice processing and the like--has become a vital market for IT companies as corporate spending on conventional data-center services has dropped.

Computer services giant Electronic Data Systems (EDS), for example, calls "enterprise shared services"--when a company outsources several back-office operations at once--its top growth opportunity. About 14 percent of EDS' annual revenue, or \$3 billion, comes from BPO, said spokesman John Clendening. And the company is shooting for more BPO income.

In November, [EDS](#) said it [planned](#) a multimillion-dollar investment over the next five years to meet customer demand for help-desk operations and BPO services, including customer relationship management (CRM), human resources, finance and accounting and procurement.

The total investment will come to about \$100 million and include upgrading the technology at customer contact centers, said Paula Kruger, EDS' president of CRM services. Those contact centers would be used to handle questions from employees at companies that are outsourcing their HR tasks to EDS, she said.

Although EDS has processed transactions such as insurance claims for decades, Kruger said the comprehensive offer to outsource internal business functions has emerged more recently. "We've been pretty excited by it," she said.

The trend for computer services companies to move into back offices is accelerating in part because traditional business functions are now enmeshed in the computing backbone, said Rebecca Scholl, an analyst with research firm Gartner. Shifting from providing IT assistance--running computer help desks, fixing and installing PCs, and managing networks--to handling payroll checks and related tasks is less of a jump than it used to be.

But Scholl warns that the transition into the growing BPO market may be bumpy for companies historically focused on IT services.

Possible hurdles range from an overly technological approach and a short-term "project-based" mentality to a range of unfamiliar competitors, including BPO providers based in India and business services companies such as payroll specialist [Paychex](#).

"The competition comes from so many different angles," Scholl said.



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## BPO on a roll

Business process outsourcing is not a new field. Rochester, N.Y.-based Paychex, for example, has been outsourcing payroll processing for small businesses since 1971. But the market is heating up these days, thanks to companies' keen interest in cost cutting, their desire to improve business methods and their growing comfort with outsourcing arrangements.

Gartner estimates that the worldwide market for business process outsourcing grew from \$115 billion in 2000 to \$124 billion in 2001, and will expand to \$178.5 billion in 2005. Investment firm SG Cowen Securities expects the BPO market to jump by 10 percent to 15 percent in both 2003 and 2004, while IT services in general will grow just 5 percent to 6 percent this year, and 6 percent to 10 percent next year.

EDS, meanwhile, forecasts that the BPO market will grow at an annual clip of 9 percent to 11 percent through 2005, with sales of enterprise shared services growing three times that rate. IT services overall will expand at a more tepid 8 percent to 10 percent annually, EDS expects.

Processing insurance claims and handling student loan collections for banks may not be as glamorous as designing a new computer network architecture, but those business tasks represent a large expense that companies are eager to trim, says Lesley Pool, chief marketing officer for Dallas-based [Affiliated Computer Services](#), which provides IT services and business process outsourcing.

BPO results can be more dramatic than IT service offers, Pool says. While IT outsourcing, such as farming out control of a data center, can cut costs 10 percent to 15 percent, outsourcing a business process may shave 40 percent to 60 percent off the bottom line, Pool says. "What you're providing on the BPO side is much more valuable to the client."

One key to the savings is increased use of technology such as scanning systems that read data from paper forms and populate database fields. Whereas back-office transaction processing used to be labor-intensive, machines now do much of the work.

Outsourcing can also lead to more accurate results, Pool said. One client of Affiliated Computer Services found the accuracy of its transaction processing jumped to 97 percent from percentages in the low 60s, Pool said. At the same time, health care claims that had taken the client three weeks to process could be done in one day by Affiliated, Pool said.

Affiliated has followed the BPO money trail. Initially formed in 1988 strictly as an IT services provider, the company made a push into business process outsourcing about four years ago. Now two-thirds of its revenue comes from BPO deals. The company posted annual revenue during the last fiscal year of \$3.1 billion, and it employs more than 38,000 people.

## Wall Street takes notice

Affiliated's BPO strategy has won over some Wall Street analysts. In its "Tech Road Map 2003" report earlier this month, SG Cowen Securities called Affiliated one of its favorite investments. The brokerage said BPO, application outsourcing and facilities management were the exceptions to "lackluster" growth in IT services in 2003 and 2004.

"During the past two years, given the more widespread acceptance of the BPO concept at the corporate level, demand trends have been accelerating," the investment firm wrote.



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Also earlier this month, Bear Stearns said it was biased toward "transaction processing" computer services companies, including Affiliated and Alliance Data Systems.

"Relative to traditional systems-integration/large-scale outsourcing companies (such as Computer Sciences and Electronic Data Systems), transaction processors tend to have more predictable, leverage-able, and scalable businesses," the investment firm wrote in a report. "And, importantly, the transaction processors are less exposed to information technology...spending patterns and less vulnerable to increasingly rapid changes in technology."

EDS and rival [Computer Sciences](#) say they see the BPO light as well. EDS' roots are in processing Medicare insurance claims, and the company now processes more than 1 billion health care claims per year. It also supports credit card activity for 2 million merchants in 19 countries, EDS' Clendening said.

"We do a ton of processing," Clendening said. EDS also has about 14,000 employees working at help desks or contact centers. Some workers handle emergency roadside assistance calls for General Motors, for example.

Computer Sciences provides BPO services including claims processing, invoicing, human resources and payroll, and customer support. Computer Sciences has staked out a BPO claim in the energy industry by establishing an Energy Services Center in Dublin, Ohio. The company says its agreement with an energy company with \$101 billion in revenue is the first major deal in the energy industry in which full customer service operations are being outsourced.

"As more states deregulate their power industries, CSC (Computer Sciences) will be there, ready to take over back-office operations so that these companies can concentrate on their core business," Computer Sciences says on its [Web site](#).

Management consulting and technology services company [Accenture](#) also is a BPO player. Accenture's first BPO deal came in the early 1990s, when it outsourced finance and accounting functions for British Petroleum. Accenture now handles a variety of outsourcing tasks, such as airline ticket processing and call center staffing for AT&T.

Another Accenture client is communications technology company [Avaya](#). In late 2001, Avaya asked Accenture to manage a roughly \$50 million training program. Avaya leaders weren't interested in cutting the cost of the program so much as improving its efficiency and expanding online course offers--which would let sales employees spend more time in the field.

With Accenture managing the training program, e-learning course consumption rose from 17 percent of coursework to 40 percent, according to Avaya's human resources head Ron Kitlas. Kitlas said one trouble spot in the arrangement is that Accenture's courses don't always fill up, leaving Avaya with less bang for its buck. But Avaya leaders say Accenture has managed to develop courses in a timely way for the dozens of new products it releases each year.

IT services giant IBM also has a BPO strategy. Having [acquired](#) consulting and technology services company PwC Consulting last year for \$3.5 billion, IBM now trumpets its ability to help businesses run more efficiently through a combination of management advice and technology.

But its BPO approach is a bit different from that of other IT services companies, in that it focuses on processes that can be highly automated, such as developing an efficient procurement system.

"It doesn't make sense for IBM or the customer to just go after the cheaper labor play," said Dev Mukherjee, vice president for On Demand Services at IBM.

If a client wants to outsource manual tasks such as call center staffing, IBM finds a partner provider, Mukherjee said.



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## Tomorrow the world

One strategy that companies are using to keep labor costs low is going overseas, part of a broader [trend](#) of IT services providers trying to cut expenses with foreign operations. About a quarter of Affiliated employees, for example, work overseas in countries including Ghana, India and Guatemala. EDS for its part plans to open a new customer contact center in India this spring.

Some foreign nationals aren't waiting for U.S.-based firms to establish satellite operations. Locals in countries such as India and Jamaica are setting up BPO outfits. Prominent Indian BPO companies include Progeon, a unit of IT services company [Infosys Technologies](#), and [Daksh](#). India's National Association of Software & Services Companies says revenue in the country's call center and BPO industry grew by 70 percent during the 2001-2002 period to a total of \$1.46 billion, and should jump to \$16.94 billion by 2008, capturing more than 10 percent of the global market.

So far, however, a small portion of transaction-processing work has actually crossed overseas. A Gartner survey in late 2001 found that just 5 percent of U.S. corporations that had revenue ranging from \$100 million to \$4 billion outsourced--or had the intention of outsourcing--portions of their back-office tasks to offshore companies.

Still, Indian outfits are part of a challenging landscape, Gartner's Scholl said. Other competitors of IT services firms in the BPO world include consulting firms, human resources outsourcers such as Exult and Paychex, and companies such as Automatic Data Processing that, along with human resources outsourcing, offer other services such as auto-repair claims processing.

To set themselves apart, some companies, such as IBM and Accenture, talk about "transformational" outsourcing, which involves improving business processes instead of just managing existing ones. Scholl, though, warns that the concept may be partly hype. Service providers may not be able to continually enhance a customer's methods over the life of a 10-year deal, she said.

Scholl also points to the roots of IT companies as a possible obstacle to good business process outsourcing. Tech-oriented providers may focus too much on technology metrics rather than business results, and may suffer from a culture arising from short-term IT projects.

"Once they're done with the implementation, they just leave," Scholl said. "In outsourcing, you're there for the long term."

# InformationWeek

Customers say they want reliability, trust, skill, and value from their outsourcers. And they give Hewlett-Packard top marks.

*By Robin Gareiss, Nov 18, 2002 (12:00)*

Ah, the start of a promising courtship, the dreams and hopes for a happy future together. Then the first (then the second and the third) disagreement surfaces, and the reality of melding backgrounds, ideals, and goals looks so complicated.



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So it is with the continuing love affair between corporate America and the outsourcing companies that run their business-technology systems. But surprisingly, this long-running, sometimes stormy romance is doing better than most marriages. Two-thirds of companies say their outsourcing experiences have met expectations, according to 700 business-technology professionals in *InformationWeek Research's Analyzing The Outsourcers* study.

As in love, the perfect mate might not be the beauty queen. We asked customers to rank their satisfaction with their outsourcers, and the best-known names in the business, IBM and EDS, don't top the list. No. 1 is Hewlett-Packard, a company some consider a sleeping giant among outsourcing providers because it's better known for hardware, followed closely by Sprint and Accenture. The differences separating the companies were fairly close, with the exception of one: WorldCom, which ranked a distant ninth.

Alas, few of these unions reach the level of bliss. Only 8% say their outsourcing relationships exceeded expectations, and one in five says they haven't lived up to expectations. On a 1-to-10 rating scale where 10 is extremely satisfied, most scores ranged between 6 and 7. Respondents are most impressed with outsourcers' industry knowledge, range of services, reliability, and skill, which all averaged 7.5 or higher, but less impressed with cost/value (6.8), innovation (6.7), and strategic advice (6.6). Customers want a company that's reliable, technically skilled, and able to save them money. They're less worried about an organization delivering strategic advice and innovation.

Even as they rank outsourcers' performance, these business leaders know they're the ones responsible for making the relationships work. Executives experienced in outsourcing tick off a few keys to success, including detailed service-level agreements, realistic commitment of management time, and accurate cost-saving estimates. And it's almost always going to be tougher than expected. "There's absolutely no doubt that if you're entering into an outsourcing environment, it's going to take more time than you imagined," says Keith Morrow, CIO for convenience-store chain 7-Eleven Inc. "You could do it with a hands-off, laissez-faire approach, but you'll double your costs." The greatest dissatisfactions from these relationships are that they take more management time than anticipated and they don't live up to performance expectations.

Nearly half of the respondents underestimated the amount of management time their outsourcing deals required. "When companies turn to outsourcing, their initial idea is that they're going to go in and hand over everything," says Tim Wilson, senior analyst with consulting firm Enterprise Management Associates. The level of involvement varies, but executives experienced in successful outsourcing deals say it's vital to stay directly engaged.

Continental Airlines Inc. CIO and senior VP Janet Wejman, for example, wants to maintain frequent contact with EDS, which has a 10-year, \$1 billion deal to run Continental's data center, network, and legacy systems. To do so, she's had to make it clear to EDS managers that they must let her know, directly and immediately, of any major problem -- no matter what time it happens. "The outsourcers were originally confused by the fact that if any airport [IT system] goes down, I want to know about it," she says. "If an airport goes down in the middle of the night, I want them to know that I'm awake. If they think I'm sleeping, they'll think they've got more time to fix the problem." Such expectations need to be spelled out at the start of the relationship, with an understanding of how the outsourcer's action will affect the amount of time CIOs spend managing the relationships. When EDS appoints a new account manager for Continental, Wejman needs to spend time making sure that person understands things such as when it's necessary to make the midnight phone call. That's why it's written into the contract that the airline must be involved in EDS layoff discussions, so Wejman can tell EDS executives which people the airline values most highly.

It's a responsible move for any CIO who views outsourcers as part of the IT staff. "You never outsource the responsibility, just the execution," says Dave LeFave, CIO at Nextel Communications Inc., which hands over about 60% of its IT operations to EDS, IBM, and Amdocs, a communications industry outsourcer. He expects his managers to view the vendors' employees as part of the team and allocate their skills to get the job done.



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LeFave also spends time educating the CEO and CFO about the contract and what to expect -- both good and bad. "As much as you try to prepare yourself, within the first year of an agreement you're going to find things you didn't expect," he says. "So conditioning people for that is very important."



The outsourcer's staff should be viewed as part of the team and their skills allocated to get the job done, Nextel CIO LeFave recommends.

Outsourcing customers put trust high on their list of criteria -- 85% rank it highly important, the second most-often mentioned trait -- but at the start of most deals, there's inevitably an us-versus-them attitude on both sides. It's up to senior management to spend time dispelling that through monthly or quarterly meetings to discuss performance, problems, or strategy. The American Automobile Association is very concerned about outages, so its internal staff understands how critical it is to quickly get things running again. "With outsourcers, we have to create [that] sense of urgency," CIC Satish Mahajan says.

But Dan Rosman says the time he spends managing outsourcing is going down. The IT director for Jelly Belly Candy Co., a privately held company with more than \$100 million in annual revenue, has outsourced its E-commerce applications to Accenture for nearly a year, and now he reviews Accenture reports and gets involved only when problems arise.

After years of outsourcing experience, Jim Saber, CIO of bank holding company Provident Financial Corp., says that making internal executives accountable is paramount. When outsourcing deals fail, he says, it's almost always because the CIO shifts responsibility to the outsourcing company. "Outsourcers must be one component of your resource pool," Saber says.

The No. 1 reason companies turn to outsourcers is to save money -- 64% say that's the main goal of their outsourcing contracts -- yet many aren't happy with the results they're getting. Respondents ranked Sprint No. 1 for cost/value, followed by HP and Computer Sciences Corp. At the bottom are IBM and Accenture. Companies generally report lowered costs with outsourcing, but at the outset, many overestimate the savings and underestimate the costs. Thirty percent of respondents say their cost savings fell short of expectations, and 38% complain of unexpected add-on costs after their contracts began.

But that suggests seven out of 10 are pleased with their costs savings, as Overhead Door Corp. is. The specialty door maker uses Sprint to manage 95% of its data-center infrastructure, which should shave \$1.2 million off Overhead Door's costs over the three-year contract. Farmers Insurance Group saves about half of its IT labor costs by outsourcing IT maintenance tasks to Wipro Technologies, an offshore firm (see story, "[Team Building: Managers' First Job Is Building Trust](#)"). Most large U.S. outsourcers claim that on average, they reduce customers' IT costs by 20% to 30%.



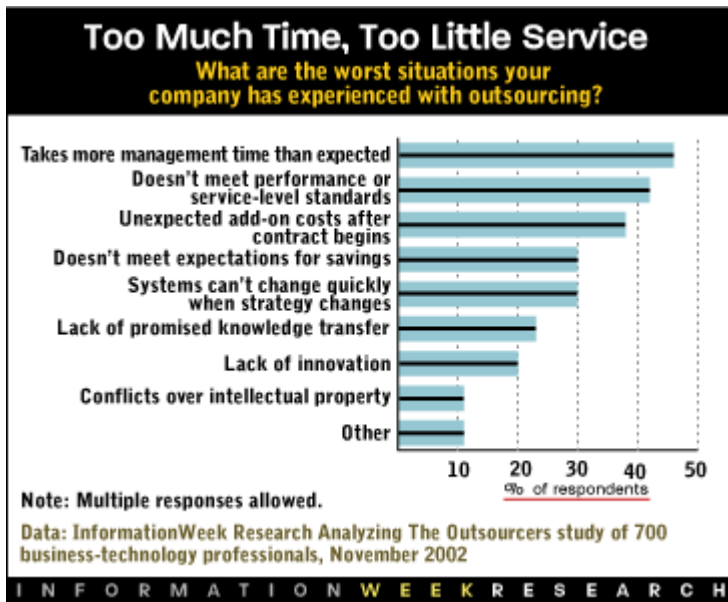
Outsourcing is time-consuming, 7-Eleven's CIO Morrow says.

The savings can be tough to measure. 7-Eleven has been outsourcing so long it's hard to quantify the cost of running its own mainframe and midrange data centers and network management. But CIO Morrow puts a premium on being able to leverage the outsourcer's buying power and adopt new platforms and technologies more quickly than if operations were in-house. "You can follow the technology curve much better with outsourcing," he says. In this sense, Morrow is in the minority -- only one in five survey respondents considers innovation or cutting-edge technology a main goal in an out-sourcing relationship. Good thing, because it isn't outsourcers' strong suit; they got their second-lowest average scores for innovation, trailing only strategic advice.



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A frequent complaint is that vendors charge extra for labor, software licenses, or other areas after a contract has begun. "We haven't figured out a way to manage it," says Mike McVeigh, senior systems engineer for the Federal Aviation Administration, which uses a variety of vendors, including IBM and Tivoli, Lockheed Martin, Raytheon, and WorldCom. "The vendor is trying to buy low and then add after the contract begins." The FAA tries to keep add-on costs under 10%, but there have been large projects for which those costs were doubled.



One solution: Managers need to build extras into the budget, because they're a given. Continental prepares for extras by setting a price up front for everything and paying as it goes each month. For instance, the contract outlines set prices for each processor or for each new piece of hardware at an airport.

One reason companies don't always save what they hoped to, especially with their first outsourcing deal, is because they don't have the correct internal staff: They don't lay off enough people to get savings, or they lay off too many. "They almost never get it right," says Douglas Frederick, executive VP for EDS. Sometimes the staff that remains is so small that employees don't have the resources to optimize the work. It often takes up to a year to balance it out. Companies are better at determining staff levels the second or third time they outsource, Frederick adds.

They're also smarter about their contracts. In outsourcing, flexibility is the key. It's crucial to write in terms that allow for changes in costs and service-level agreements and give either side the option to cancel. "Driving costs out of an outsourcing agreement is a tricky situation," Providian's Saber says.



The terms of contracts should be re-evaluated often, and outsourcers should pass on their savings to customers, Farmers Insurance CIO Claudio says.

One way to do that is to include terms that require the outsourcer to re-evaluate the contract often and pass on hardware and software savings. Farmers Insurance CIO Cecilia Claudio recalls her tenure at Xerox Corp. about 12 years ago when she was involved in one of the largest outsourcing deals of the time. Hardware prices were falling, but the contract didn't specify that the vendor, EDS, had to pass on the savings. "As the outsourcer achieves lower cost of ownership, they should and must pass that on," she says.

CIOs must be responsible for regularly benchmarking their companies' costs against their industry overall. "When you do desktop analysis and find out your desktop costs



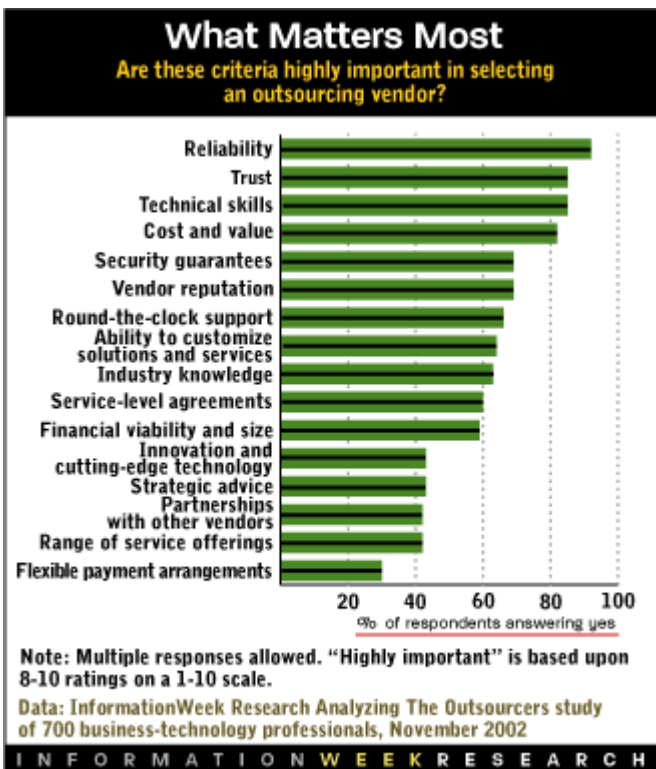
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are twice as much as others, then you're not doing a good job," Nextel's LeFave says. And it's time to reassess the contract.

General Motors Corp., which has probably the most extensively outsourced IT operation in the world. Twice a year, it gives its top 17 outsourcing suppliers report cards that rank each vendor in about 20 categories. But when it comes time to replace a poor-performing vendor or get several vendors bidding on a contract, the short list of viable choices can be far too small. GM CIO Ralph Szygenda is working with some of the automaker's vendors, which he declines to name, to get them to create service businesses. He and his business-unit CIOs also force vendors to work together, since too often they don't have the means to handle the size or complexity that GM needs individually. After spending his first years with GM unraveling its exclusive service deal with EDS -- a company that remains a critical partner -- Szygenda is determined not to get cornered by limited choices. "My biggest problem is I don't have enough suppliers," Szygenda says. "There aren't enough competitors."

After companies pick their outsourcing suppliers, one of the first steps to making a deal is certain to be writing a service-level agreement. Prenuptial agreements may be controversial in marriage, but they're a vital safeguard for both sides in any outsourcing relationship. Although reliability and trust top the list of what buyers look for in an outsourcer, CIOs say it's in service-level agreements where numbers are put to those ideals, defined by standards ranging from server uptime to transaction response time and even revenue.

Service-level agreements don't disappear into a drawer after an outsourcing contract is signed. Among large companies, 70% have invoked the terms of their agreements one or more times, and 41% of all companies have invoked them multiple times, according to *InformationWeek* Research. Doing so puts a strain on the relationship. "Very rarely have I seen clear-cut examples of someone saying, 'Yep, you're right, I've missed the SLA, and here's your check,'" says Saber of Providian, which outsources its Web site to WorldCom, its credit-card operations to Total Systems, and is speaking to IBM about handing over its data center. "There's always discussion and argument."





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HP, Sprint, and CSC do the best job when it comes to executing service-level agreements, while WorldCom and AT&T are the worst, according to survey respondents. HP tries to exceed its agreements and measures performance against objective business results, says Joe Hogan, VP of marketing for HP Managed Service. And when it messes up, it pays up. "The customer has a level of expectation, and if performance doesn't occur to that level, there really should be some type of liability to the outsourcer," he says.

WorldCom execs say its operating skill is getting a bum rap because of its accounting scandal and the related bankruptcy. "One of the false perceptions is that our service-level quality could be in jeopardy," says Dennis Richardson, director of managed-service solutions. "Our metrics continue to show that we're meeting service standards." There's no doubt the company's reputation is hurting. It ranked ninth in every category but cost/value, where it ranked seventh.

The first step toward creating effective service-level agreements is knowing what you need before sitting down with an outsourcer. Before revamping its deal with EDS, Continental spent months identifying and prioritizing its systems to calculate appropriate agreements. "You have to figure out the service levels needed to run the company," CIO Wejman says.

And the penalties need enough teeth to keep the vendor's attention. Though Wejman is pleased with the service EDS provides, Continental's IT systems, using customized monitoring software, automatically invoke substantial penalties outlined in the outsourcing contract when EDS doesn't meet a service level, which typically happens about once a year. "It doesn't compensate for our loss in revenue, but it gets senior-management attention, and there's no forgiveness," she says. Wejman adds that the fine is hefty enough that it goes across the desk of EDS CEO Dick Brown, ensuring that the problem gets immediate attention and repair.

Pinpointing the appropriate penalty is the tricky part. Businesses typically want to tie penalties to revenue losses, but vendors resist that because liabilities could be huge. Outsourcers generally get penalized less than it costs businesses but may pay in other ways. "Most companies don't want to earn a penalty because the amount of penalty won't make up what they'll lose in business," says EDS's Frederick.

Some executives think there's room for reason in outsourcing relationships, especially early on. "When we bring a new person or company in, we give them a runway," says Nextel's LeFave, who has negotiated seven deals. For instance, Nextel is giving EDS a six-month grace period as it moves Nextel's data center from Atlanta to Charlotte, N.C. On the other hand, Nextel renegotiates and ratchets up its service-level agreements each year. Amazingly, Nextel hasn't had to invoke any fines with any of its outsourcers.



Rather than pay substantial penalties, outsourcers try to work into their agreements options to earn back penalties -- if a vendor doesn't meet a service level one month, it can earn back that penalty based on superior performance the following month. But Providian CIO Saber warns that because outsourcing vendors are more experienced at the bargaining table, they're better equipped to write service-level agreements to their advantage. So rewarding outsourcers for superior performance must be tied tightly to business value and financial gain, he says. For instance, a hosting vendor suggested Providian pay a bonus for consistently providing 100% uptime. "If I wanted it at 100%, I'd ask for it," he says. "If you're not driving business value to me, I won't pay it."

Accenture prefers to measure performance by the success of a business and earn a bonus based on financial results -- as well as pay a penalty when it fails. Accenture runs all IT, computing, and applications for the London Stock Exchange under a deal that ties its bonus to the exchange's ability to process transactions. "If you're always using a stick on a provider, it's hard to [give it an incentive] to perform better than the base level," says Martin Cole, managing partner for global outsourcing at Accenture.

Another key for service-level agreements is to make sure they're flexible. As companies' needs change, IT executives must be able to renegotiate the agreements. 7-Eleven outsources 75% of its IT operations, including its mainframe data center to Affiliated Computer Services, midrange data center to EDS, help desk to Telvista, and network operations and management to AT&T. The convenience-store chain reworked its service-level agreements after Sept. 11, to include getting more granular network monitoring. And 7-Eleven made substantial changes to security relating to response time and limits of liability.

As the emphasis on service-level agreements suggests, an executive's relationship with an outsourcer in many ways is marked foremost by caution: "I'm bringing you in to save us money; don't screw it up." The slow economy, coupled with bankruptcies such as WorldCom's, have heightened executives' financial concerns. Six out of 10 survey respondents consider financial viability and size to be highly important. The companies have had their financial challenges, with the market capitalization for the publicly traded outsourcing firms we rated dropping nearly 47% in the past three years. In an effort to boost revenue, many vendors have expanded their offerings. "But the depth isn't there anymore. Many don't have a core group and a core expertise anymore," 7-Eleven CIO Morrow says. "Now, it's 'We do everything.' At the same time, technology has become more complex."



Executives are clearly spreading their risks across multiple outsourcers, including small and midsize vendors focused on specific areas. While we rated nine top firms, nearly everyone interviewed for this story had multiple outsourcing relationships, including many with ties to firms in India for application development or software maintenance. Two-thirds of people surveyed cite companies outside this top nine as among their three main outsourcing providers. Still, Enterprise Management Associates' Wilson recommends checking the books of outsourcing partners, big and small. "I'd look for a company that will be around for years to come," he says.

It's also clear that, differences aside, outsourcers and their customers are cautiously increasing their commitments to one another. A third of companies say they'll increase spending with outsourcers next year, and 44% will keep it the same. Almost 40% say they're more reliant this year than last on outsourcers, while only 17% say they're less reliant.

Continental's Wejman offers an example of why. Outsourcing relationships aren't always perfect, but she likes the fact that she doesn't have to worry about mundane necessities such as battery-powered backup in her data center. "I can focus on more important things to Continental's business," she says. That's the kind of value in a relationship that can be tough to measure. But it's even tougher to do without it.

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### Whitepapers about Outsourcing Trends in 2003

The changing economy and globalization of business, along with pressures on both the top line and bottom line, is forcing organizations to look at various ways to reduce costs. In the last decade it has become obvious that Information Technology can offer immense competitive advantages to companies. This period has also seen the evolution of newer business models and channels that require Information systems to rapidly evolve and respond to these changes. Offshore outsourcing which was less than \$100Million in the early nineties has suddenly grown to be a \$10 billion industry and despite major challenges continues to grow.

Offshore Outsourcing has served well in a hyper growth economy where shortage of skilled manpower was adequately met by outsource service providers as well as in a recessionary economy where arbitrage helps companies keep a tight control on IT budgets and projects. It is no wonder that the move to Offshore Outsourcing was led by the Fortune 500 in various verticals such as Securities (Fidelity, Franklin Templeton, Morgan Stanley, JP Morgan), Banking (Citibank, FirstUSA, VISA, ABN Amro, Deutsche Bank), Insurance (Aetna, NorthwesternMutual, Farmers, NY Life), Retail (HomeDepot, Nordstrom, Sears, JC Penney, Amazon), Manufacturing (GM, Chrysler, Nike, Boeing, Adidas, Monsanto, Nokia), Utilities and Energy (Dynergy, Siemens, Vivendi, Southern California Edison, Marconi), Transportation (APL, Roadways, Trafalgar Tours, BNSF, UPRR) and Technology (3COM, Cisco, HP, Compaq, IBM, Intel, Nortel, Sun, Microsoft, Apple, Dell, Seagate, Lucent, Mototola, TI).

These are joined by many small to large sized firms that have outsourced software development. The results have been a mixed bag. There are numerous examples of success - these are associated with projects that are stable with little or no variability. Examples of such projects include legacy applications maintenance, systems integrity testing, bug fixing, verification of protocol stacks or even ASICs and microprocessors verification. Other examples of success include porting of applications to different operating systems, internationalization and localization of software.



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Projects with a high degree of variability have seen different degrees of success or failures. Variability is driven by changing requirements, new developments with changing functionality. Factors that contributed to poor results include:

- 1) Distance
- 2) Variability
- 3) Inadequate skills or knowledge
- 4) Attrition in development teams
- 5) Poor architectural design
- 6) Absence of any development methodology or processes
- 7) Inadequate sponsorship
- 8) Unrealistic expectations
- 9) No user buy in or motivation
- 10) Poor project selection
- 11) Poor project management
- 12) Poor communication
- 13) Cultural mismatch
- 14) Technology risks
- 15) No acceptance or performance criteria

Some benefits of Offshore Outsourcing include:

- 1) Cost containment
- 2) Improved internal Software processes
- 3) Quick access to skilled resources
- 4) Better user responsiveness
- 5) Improved quality
- 6) Rapid response to changing customer needs
- 7) Enhanced productivity
- 8) Better ROI



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Offshore Outsourcing is a major organizational commitment and before taking a step in that direction it would be wise to sit back and assess your organization's readiness.

#### GETTING READY FOR OFFSHORE

Getting ready for Offshore Outsourcing requires certain critical steps:

- \* NEEDS ANALYSIS – What are the prime reasons to outsource? What are the long term goals and objectives of outsourcing?
- \* INTERNAL CHANGE MANAGEMENT – How do you prepare internally for Outsourcing, how and when do you communicate to people who will be affected by this
- \* BUILDING PROCESSES – If you thought internal development itself was complex, add time, distance and culture to this. How would a non-CMM company work with a CMM company?
- \* GATHERING DATA – How are you currently performing? How would you set goals for an outsourcing service provider if you did not have internal metrics?
- \* IDENTIFYING SUITABLE PROJECTS – which projects are least variable, least risky but essential
- \* BUILDING A RFP – What do you consider important in an outsourcing service provider? How would you establish the critical elements of a “relationship”?
- \* SCREENING VENDORS – What are the “must have” criteria?
- \* ANALYZING PROPOSALS
- \* REFERENCE CHECKING AND SITE VISITS
- \* CONTRACTS
- \* ESTABLISHING SERVICE LEVELS
- \* GOVERNANCE OF THE RELATIONSHIP
- \* IDENTIFYING AND MANAGING RISKS
- \* CULTURAL ISSUES

Offshore Outsourcing 101 will examine each of these issues in subsequent articles.

## Offshore Outsourcing - Communicating (Part 4)

*Surendra Saxena*

Change can be extremely traumatic especially if the change results in a reduction in workforce. There is extensive debate as to when you should communicate the desire to Outsource to your internal team. Some feel this should be done early on while others feel the decision to outsource should be communicated after the contracts have been



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inked. There are advantages and disadvantages to both. If the communication is done early on it may result in loss of morale, whereas if it is done late into the process there is a very good chance that word of the impending outsourcing will leak out leading to rumors, water cooler gossip, loss of faith in Management and again loss of morale.

Before you announce the desire to outsource prepare your facts.

What leads you to this decision?

What will be the impact?

- \* Reduction in force – what functions will be affected
- \* Change in the nature of work, how would the work change
- \* Redeployment, where would the re-deployment take place
- \* Additional responsibilities

Even if the affected people have seen this coming they will be surprised and angry when this occurs. That is normal. If you communicate early on you give them time to get over this and reconcile and accept the impending change. Even people who are not affected will be concerned with a loss of control over the result of the work product or the potential of external scrutiny on their work. Prior to communications therefore recruit Change Agents and participants:

- \* Executive Leadership who firmly support the program
- \* Project Managers who will be tasked to make this transition work
- \* Individuals who will be positively impacted

In many organizations change has had a positive impact on the nature of work IT people were doing. Outsourcing gives IT a real chance to transition their workforce from IT implementers to Managers interfacing with Business users day to day, understanding real business issues and then translating them to IT action plans. IT has more time to dedicate to understanding business issues, analyzing these issues and identifying IT action plans that help solve these real world problem. The role of the IT work-force gets richer in the process.

Change will affect all including people and Infrastructure.

The first step to manage this change is to set up an Outsourcing Project Office with a Chief Outsourcing Officer that reports to the Executive Management (CEO/CIO/CFO). This Office can begin the change readiness assessment and impact and will be responsible for implementation of the change.

**OUTSOURCING PROJECT OFFICE:**

The Outsourcing Project Office will be responsible for Governance of the Relationship, Infrastructure Planning, Defining Standards to be met, Analyzing and changing Processes for Outsourcing, Logistics, Vendor selection, Change Management, Setting Steering and Relationship goals, Outsourcing Relationship Management and Arbitration.

Once the Outsourcing Project Office is in place the decision to Outsource with the reasons should be communicated to the internal staff. The Chief Outsourcing Officer should be introduced to the Organization. He would then



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communicate the areas that have been identified for outsourcing as well as communicate any expected changes such as reduction in force. The HR department should work closely with the Chief Outsourcing Officer and ensure that attrition is managed as well as employees are appropriately counseled and assisted.

The Company should be prepared with a transition plan, a re-deployment/retraining plan and an outplacement plan in the event of planned attrition. All affected employees should be told of the timetable for this transition.

The next stage is to assemble an Outsourcing Task force. This taskforce will establish goals for outsourcing. It will map the existing process and interfaces between different stages of the current process. It will re-engineer these for Outsourcing, defining a Projects Management process and reporting needs for governance of the outsourcing. The team would establish escalation procedures if problems cannot be resolved.

At the same time the Project Office will interface with HR / Legal, Procurement, Systems and Network Administration and Finance and Accounting to setup processes for the Outsourcing.

## Whitepaper Offshore Outsourcing - Building Processes and Identifying Suitable Projects (Part 5)

*Surendra Saxena*

Offshore outsourcing will affect your infrastructure and your people. Companies have formal and informal processes in their development organizations. Some are documented many are not. When you outsource your service provider will not be savvy to your processes or your work standards. Every interface or facet of your development process will need to transform or change to accommodate any offshore outsourcing. Assumptions will no longer be valid as time and distance come into play. Leave nothing to assumption instead start redesigning your processes afresh:

- \* Create a Software Engineering Process Group
- \* Map all Software Processes and standards as they exist
- \* Identify all stages in this process
- \* Define inputs and outputs at all stages
- \* Identify the interfaces between stages
- \* Identify all participants in each stage
- \* Identify criteria for moving from one stage to another stage
- \* Identify checks and balances performed at each stage
- \* Identify all standards and infrastructure processes that are used – coding standards, check in and check out process for defects, Configuration Management, Change Management, Acceptance, integration and build etc.
- \* Identify dependencies on other functions- budget allocation, sanction, procurement, systems and network administration, HR, Finance and Accounts



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Once you map the as is process you start designing the process to what they will be. The interfaces are important as interactions and handovers take place at the interfaces. How will these be impacted when you have a remote team? What would be needed to facilitate these interfaces to ensure that work gets checked in appropriately? Your focus is to track your parameters of importance:

- \* Time
- \* Cost
- \* Scope
- \* Performance

while you leave people management to your outsourcer.

Involving other functions can be extremely critical. One Company engaged an offshore service provider for a major Software development program. The OSP (Offshore Service Provider) was given the go ahead to hire 30 consultants and start the first phase of the project. The Program Manager could not get a commitment from its own Procurement Agency and it took 30 days for equipment to finally be sanctioned and ordered. Worse the Program Manager was unaware that certain legal clearances were required before the equipment could be shipped overseas. That took another 15 days. Finally he failed to get his Sys Admin in the loop early on so when the overseas team wanted to get into the network they were denied access. It took some time before the Admins could ensure the proper type of access could be provided. This resulted in a delay of over 60 days a period in which the team was practically idle.

Once internal processes have been mapped they have to be re-engineered to accommodate the overseas team. Some interfaces would be added and most stages would be redefined. The entry and exit criteria at each stage would change suitably to involve formal acceptance procedures. The participants would also change.

The check in and check out, configurations Management and other processes would have to be suitably modified.

The next stage would be to identify the work to be outsourced. The best job that can be outsourced initially is one which has the least variability. Projects such as Testing, Quality Assurance, Maintenance, Porting, and Internationalization of code are ideal for remote outsourcing. Variability will require frequent changes and close communication and if both companies are new to each other and distant this will stress the work to the point of instability or being entirely dysfunctional.

A leading Company outsourced a piece of work to a CMM certified organization and nine months down were ready to pull the plug as the program seemingly did not work. Wiser counsel prevailed and after a careful analysis the Company stepped back and changed the type of work that was being outsourced. The result was a dramatic turnaround.

It is important to understand that when you outsource the OSP has no experience on your job. They themselves will go through a learning curve. Make a provision for that learning curve.

Make a presumption that your OSP is inexperienced. Therefore, first identify projects that would match that inexperience, then as the OSP gets more experienced with your work and environment identify projects that are more complex.



## Whitepaper Offshore Outsourcing - Gather Data (Part 6)

*Surendra Saxena*

No outsourcing can work unless you can nail down requirements. Just as important is how well you can measure how these requirements can be met. In essence:

- \* Get complete requirements
- \* Identify acceptance and performance criteria
- \* Put measurements in place

The more fine grained the requirements the better will be the results. Vagueness will result in deliverables that just may not meet the needs of the users. Time and distance will add to the unpredictability of the output if the requirements are vague.

The foundation to a successful relationship is to understand your own responsibilities. There are some things that you just have to do before you plan to outsource applications development:

- \* Formulating Requirements
- \* System Analysis including use case scenarios
- \* Overall System Design
- \* Infrastructure specifications and design. This should be owned by you. Infrastructure includes hardware, operating systems, network, tools, contractual and billing implications (especially in Web services architectures), application servers, databases, eai technologies etc.
- \* Performance specifications
- \* Service levels desired
- \* Standards to be followed for development, testing and documentation
- \* Standards for release/ packaging
- \* Acceptance criteria

To be fair to your OSP have your acceptance criteria ready before you outsource. Your OSP should be clear from the beginning on the basis of acceptance. Thus define every thing that is required for you to accept the software. This could include Functional acceptance, Usability acceptance, maintainability acceptance, and performance acceptance. Define documentation expected and standards to be followed for documenting the code.

What cannot be measured cannot be improved, put measurements in place. Look at your existing operations and establish

- \* Performance measures
- \* Fiscal measures



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Typical performance measures for a Maintenance project could be modules by type and complexity, productivity of a team and individual for complex, average and simple bugs, average trouble tickets fixed by complexity, percentage of trouble tickets to existing trouble tickets (Release change ratio), defect density, detection efficiency, removal efficiency, average fix per period, average time to repeat simple, medium or complex bug, average time lost due to improper fix.

Cost measures could be current cost per fix by complexity, existing cost of operations.

When you outsource a piece of work the expectation is that your OSP will significantly beat your performance in cost and performance. This will not happen at the outset but progressively they will.

Therefore when you gather data you are actually looking at your current service level. This will establish a desired service level for your OSP:

\* For volume of work to be done

\* By value at which that work needs to be done

This is your baseline, now as the OSP gets more and more experienced with your work improve the baseline. Incentivize and reward your OSP as he better his performance.

When you outsource new applications development the process can be even more challenging. If you lack the rigor of formal processes or are unwilling to set formal processes there is an increasing likelihood of failure. Checks and balances are required not for micromanaging the service provider but to ensure that you are getting what you want. Be prepared for iterative approaches to building your solutions prototyping and testing at every stage of the process to ensure conformance to requirements. Set your team to be able to test incremental releases.

## Computer Week

### Don't be blinded by offshore savings claims

*Tuesday 13 January 2004*

The business case for moving some IT operations offshore is, on paper, compelling for organisations of a certain size.

Amid eye-grabbing claims that exporting IT development and infrastructure can save in excess of 50% of their total cost, it is understandable that consideration of such a move is high on the agenda of many IT directors.

As we report this week on page 24, however, the promised savings often fail to take account of a number of real but hidden charges such as additional security and the cost of management and governance.

A decision that seemed open and shut at a 50% cost saving rate can be much more finely balanced at 20%, given the risks and the initial investment required.



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It is critical that the IT director acts as a voice of reasoned restraint within the business to ensure that return on investment projections factor in all of the costs involved, even though there may be difficulties in assessing a value to some of the intangible costs.

Failing to conduct a thorough consideration of all the costs risks the outsourcing decision being considered a failure, even though it still provides a positive financial return, because it did not achieve savings that were unrealistic from the start. In particular, the more complex the work being outsourced, the greater the hidden charges and the more carefully they have to be considered.

This is not to suggest that offshore outsourcing is not a useful tool, nor that cost is always the primary consideration when exporting IT functions. But it risks being regarded as a panacea, a silver bullet that will cut costs and free up resources for investment in other parts of the business.

Importantly, the high level of savings claimed for offshore outsourcing risks blinding the business to other options that may be more efficient.

The full range of criteria used to determine whether a function is suitable for outsourcing should be considered when making a decision about moving it offshore.

Offshore outsourcing is still in its infancy and new issues are constantly emerging. Ultimately, your appetite for risk may be the deciding factor in how tightly you are willing to embrace it.

## Managing offshore outsourcing contracts

*Tuesday 11 November 2003 by Julia Vowler*

Although IT directors are being tempted by offers of savings from offshore outsourcing, will the added complexities of managing a remote contract prove too costly?

The trend for UK companies to outsource IT and business functions gained renewed momentum last month when high street banks HSBC and Lloyds TSB announced offshore deals to India.

Analyst firm Gartner has predicted that the European market for offshore IT outsourcing will grow by more than 40% in 2003, and UK companies are lining up to take advantage of cheaper labour costs in countries such as India and Vietnam.

Estimates of the savings that offshore outsourcing can offer vary, but some experts believe offshore deals could cut costs by up to 40%.

Despite the obvious benefits, outsourcing experts have warned IT directors to consider the challenges of managing a contract from thousands of miles away in a different time zone.

The most dramatic risk to an offshore contract is geopolitical - potential military, political or economic instability could affect the country where the supplier is doing business.

The recent Iraqi war, for instance, sent shivers through the outsourcing business community even though most offshore outsourcing centres were relatively far away. Flare-ups in tension between India and Pakistan have also raised concerns.



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Bob Aylott, principal consultant at outsourcing advisory company Orbys Consulting, said one way to manage geopolitical risk is to follow the example of manufacturing companies such as motor manufacturer BMW, which has factories in South Africa and South America. Outsourcing to different countries spreads the risk among suppliers, in the same way that companies in the UK often have more than one telecom supplier. "Having just one supplier is pretty unsafe," Aylott said.

## Hidden increased costs

Another factor for companies to consider is the cost of managing the contract. The average offshore contract will cost significantly more to manage than the same contract in the UK.

Richard Sykes, chairman of outsourcing consultant Morgan Chambers, said that although companies could usually expect to spend between 3% and 5% of a contract's value on a UK-based outsourcing deal, the figure could rise to between 8% and 11% for an overseas contract over time. However, the cost of managing offshore deals should fall.

Other advisers, such as the National Outsourcing Association, believe the hidden cost of offshore deals could be far higher. It estimated that overseas telecom links, the need to have more managers to scrutinise the deal along with travel costs could reduce any savings, above that of employing someone in the UK, by up to 40%.

Ensuring that a less experienced overseas supplier is familiar with your business will also require a more prescriptive contract, which will take longer to draft and absorb more staff time.

"You cannot take any kind of tacit knowledge about your business or sector for granted," said Aylott. "In the UK, for example, everyone knows about the Bacs clearing system or the impact of Christmas on planning cycles - but not necessarily in the rest of the world." Experts also advise users to have a senior employee from the outsourcing provider stationed in the UK.

Regular travel to the offshore site, ideally every few months, will be another inevitable extra cost. Experts advise trips to check up on suppliers every two to three months.

"If you do not go every three months it is not enough," said Aylott. "Otherwise you are not seeing the people who are doing your work, only the front-end salespeople."

However much time and money is invested in managing a contract, there will inevitably be situations where a user wants to bring a service back in-house. One reason may be unhappiness with the supplier's performance, or the needs of the user could change, for example, following a merger. Bringing a contract back in-house can also be made more difficult if the staff who ran the service were transferred to the outsourcing supplier, as they may be reluctant to return to their original employer.

Some outsourcing advisers believe the logistical challenges of negotiating with managers thousands of miles away effectively makes reclaiming an offshore service impractical. To date, there have been few, if any, examples of a company bringing an offshore deal back in-house.

But for all the extra challenges of managing offshore outsourcing, there is no shortage of takers in the UK. The strong growth in the market is predicted to continue, at least for the next few years.

Offshore contract management team Contract management needs to consist of three layers, said Stratos Sarissamlis, vice-president international at analyst firm Meta Group.



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The lowest layer, comprising a small team of IT staff, monitors service levels to check they are being met. The team should meet twice weekly: once at the beginning to agree the week's work schedule, and at the end to sign off performance and delivery. It can identify areas for improvement or where there is need to update technology.

The second layer of staff should monitor finances, produce monthly reports, apply bonuses and penalties and assess any recommendations from layer one.

The third layer of staff should meet quarterly. Their focus is on business risk and resolving disputes and they should have the power to review and restructure the contract and approve recommendations for change.

## Making an outsourcing contract work

Enter the offshore market slowly. Test out suppliers with non-critical projects and add more work gradually. One-off development is very different from ongoing maintenance and support.

Spread your risk among more than one supplier, preferably in more than one country, or with a supplier that can operate globally.

There is a huge variety of experience and maturity among offshore suppliers, not just in systems development but in knowledge of how UK businesses work. Less experienced suppliers, although they may be cheaper, will require more management effort.

You will need to invest more in contract management, around 10% to 11% of contract value, compared with only 3% to 5% for UK outsourcing. Over time this percentage should halve.

The IT boom is creating a high churn among offshore IT professionals. Although you cannot bind your outsourcer's team contractually, encourage loyalty and belonging by making them feel part of your company and culture.

Travel is inevitable. However good your UK-based account manager, you must visit your offshore team at least several times a year.

## Overseas outsourcing brings privacy risks

*Monday 23 February 2004*

Outsourcing jobs overseas can sharply increase data privacy risks and the complexity of managing that risk, experts at the Fourth Annual Privacy and Data Security Summit in Washington DC have warned.

As a result, companies need to ensure that overseas suppliers are contractually tied to specific conditions regarding how data is transmitted, accessed, used, stored and shared. Those challenges include regulatory compliance, data protection and access issues, as well as monitoring and auditing issues.

"The risks are enormous to business strategy," said Richard Purcell, founder of consultancy Corporate Privacy Group and former chief privacy officer at Microsoft.

For instance, security breaches at offshore locations can be harder to detect - and deal with - from a regulatory compliance standpoint. Under California law, for example, companies are required to notify customers of any database breach that may have compromised the customers' personal data as soon as the breach is discovered.



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With overseas suppliers, it is much harder to know whether, and exactly when, a material breach may have occurred, Purcell said.

When data is sent overseas for processing, companies often make little attempt at categorising it, said David Medine, an attorney at William Cutler Pickering in Washington. Personal data covered by privacy laws might be combined in one database with data protected under HIPAA rules or other laws. That makes it much harder to provide adequate levels of protection for different classes of data.

"Not all data is the same. There are different sources of data, different types of data and different rule sets," said Ken DeJarnette, an analyst at Deloitte & Touche in San Francisco. "Without knowing what your data is, you won't know what protection you need."

Companies need to understand their own legal obligations and the measures their supplier has in place to meet these obligations, said Deloitte analyst Rena Mears.

India, which is the biggest outsourcing destination for many companies, has no formal data privacy law, although one is in the works.

Amy Yates, general counsel at Hewitt Associates, a human resources outsourcer, said shipping work to a third party does not absolve the original company of responsibility for protecting that data. Offshore suppliers are not obliged to comply with the same privacy regulations their customers must meet as owners of the data.

That means spelling out what a supplier is expected to do and maintaining the right to audit it for compliance. "You can't expect your vendor to fulfill your legal obligations for you. They are obligated only to their contract with you. So you need to tell them what to do," Yates said.

Marc Lowenthal, chief privacy officer at New Century Financial, said an incident response plan needs to be in place to deal with security or privacy breaches. Lowenthal's company has set up a team comprising the privacy officer, chief security officer, IT representatives and staff from legal audit and compliance teams.

Once a breach has occurred, "it really is about how you minimise your damage", he added.

*Jaikumar Vijayan writes for Computerworld*

## How to choose the right offshore IT model

*Tuesday 3 February 2004 , by Tim Pullen*

**offshore IT The risks and benefits of five business models for taking your IT offshore.**

A growing number of UK companies are moving IT systems and business functions overseas to lower-cost countries such as India in a bid reduce costs.

However, there are various types of offshore outsourcing and it is crucial for an IT director to make sure they choose the right one for their organisation before negotiating a contract with a supplier. There are five main models for offshore IT, each with their advantages and potential risks.



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## Offshore outsourcing

This is when a company moves IT systems or business overseas and the supplier runs the service. The main advantage with this model is that the supplier will usually guarantee savings in IT-related costs under detailed service level agreements in the contract. On the downside, this option normally results in job losses for UK IT staff and can often attract negative media coverage.

If the decision is taken to outsource, the natural reaction is to find a credible "local" service provider and enter into an outsourcing agreement with them.

## Onshore outsourcing

A similar but alternative approach is to use a UK-based service provider and enter into an outsourcing agreement. The service provider then uses its overseas operations (sub-contractors) to provide the services from the foreign destination. This means that although the customer can use a known service provider, the overall cost of the project will increase.

## Do it yourself

The alternative to outsourcing is for an organisation to establish its own operations overseas. This removes the need to pay a service provider's margins and gives more flexibility as to how the overseas operations are used.

Whether this is carried out by means of a branch, subsidiary, etc, this will be influenced by many factors, particularly tax rules.

## Build, operate and transfer

The build, operate and transfer model is for those companies which want to test the water before establishing their own operation. A service provider is used to build and operate the business for a period of time, after which the customer can, if they want, acquire the operations.

For the commercial model to work, no infrastructure or set-up costs should be paid up front. The service provider pays for building the operation and if the customer decides to exit, the service provider has to find a new customer to recover the costs.

## Joint ventures

Apart from tax reasons, joint ventures should only be used for outsourcing when there is genuine potential for collaborative exploitation between companies.

Keeping the distinction of customer/supplier (rather than venture partners) is very important. As an example, if you are a joint venture partner which also receives outsourced services from the joint venture, you are partly responsible if there are problems with the outsourced service.

On the other hand, if your supplier does not fulfil the outsourcing agreement, it is clear where the responsibility lies.

*Tim Pullan is a senior lawyer in technology and outsourcing at law firm Tite & Lewis*



# Business Wire

## CDC Software Completes Acquisition of Pivotal

*/High-Tech Writers Feb 25, 2004*

HONG KONG & VANCOUVER, British Columbia--(BUSINESS WIRE)--Feb. 25, 2004--CDC Software Corporation ("CDC Software"), a software unit of chinadotcom corporation (NASDAQ:CHINA) (Website: [www.corp.china.com](http://www.corp.china.com)) today announced that it has completed the acquisition of Pivotal Corporation ("Pivotal") (Nasdaq:PVTL) (TSX:PVT) following (a) the affirmative vote by Pivotal shareholders and optionholders on February 23, 2004 in favor of the proposed arrangement (the "Arrangement") under Section 252 of the Company Act (British Columbia) involving Pivotal, Pivotal shareholders and optionholders and CDC Software, (b) the issuance of a final order approving the Arrangement by the Supreme Court of British Columbia following an application made on February 24, 2004 and (c) the satisfaction of all other conditions on February 25, 2004. As a result, CDC Software has purchased approximately 27.0 million shares, or 100% of the outstanding shares of Pivotal, in consideration of US\$35.9 million in cash and US\$20.7 million in chinadotcom shares at an issue price of US\$11.22 per share, reflecting the 10 day average trading price through February 23, 2004. The company will issue 1,846,429 of chinadotcom's common shares resulting in an approximate 2% increase in chinadotcom's common shares outstanding to approximately 103.4 million. chinadotcom is a leading integrated enterprise software and mobile applications company in China and internationally.

"The acquisition of Pivotal marks a milestone in the history of chinadotcom. Pivotal's leading market position in the CRM (customer relationship management) industry and its broad suite of marketing, sales, service and partner management capabilities will complement our existing software product offerings. In addition, Pivotal's seasoned management team, with its in-depth market knowledge and experience in the software sector, will further strengthen the competence of our software team globally," commented Peter Yip, CEO of chinadotcom corporation.

Bo Manning, CEO of Pivotal Corporation, said, "We are excited about the closing of the acquisition. In addition to the financing provided by chinadotcom for our further expansion in product and business development, we believe the combination of the two companies will allow us to increase our scale, enhance our products and services, and broaden our geographic reach by leveraging the chinadotcom group's software development capabilities and its global distribution platform, which is particularly strong in the fast growing China market."

Highlights of the transaction:

- Pivotal's broad suite of marketing, sales, service and partner management capabilities will complement CDC Software's existing Enterprise Resources Planning ("ERP"), Supply Chain Management ("SCM") and Human Resources and Payroll ("HRP") product offerings, which currently have limited CRM functionality.
- Pivotal adds an additional 1,700 customers to chinadotcom's customer-base which totals 3,200 accounts worldwide (inclusive of chinadotcom's pending acquisition of Ross). This large, global customer base provides a solid platform for cross-selling synergies within the group.
- The transaction further expands Pivotal's Asian business by leveraging



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offshore capabilities in India by providing access to chinadotcom's cost-effective India and China-based offshore resources. -- As part of CDC Software, Pivotal will continue to broaden and enhance its CRM products and services as well as build integration with other CDC Software products. -- After the completion of the transaction, the Pivotal management team will continue to focus on execution of the company's strategy and operations.

The whole article is published by Business Wire or: --30--JB/na\* CONTACT: chinadotcom Corporation Media Relations: Jane Cheng, (852) 2961 2750 Fax: (852) 2571 0410 jane.cheng@hk.china.com or Investor

## Business News Americas

### Progress aims for CMM5 center by end-2004 - Argentina

*Feb 25, 2004*

US company Progress Software (Nasdaq: PRGS) is setting up an offshore software development center in Argentina, for which it aims to obtain capability maturity model (CMM) level 5 certification by the end of this year, application partners VP Chris Claubaugh told BNamericas. Progress sees the Argentine operation along with centers in Eastern Europe and India as forming the core of the company's global outsourcing business, said Claubaugh, who was speaking from Buenos Aires. The centers aim to outsource elements of software development carried out by Progress' partners in the United States and other high-wage countries, he said. To date India's Tata Consultancy Services (TCS) is the only company operating a CMM level 5 center in South America. Claubaugh said Progress sees the high-level certification as a way of differentiating its offshore centers from those of other corporate software vendors. Progress' business is supplying software products and consulting, education and technical support services for developing and integrating custom e-business applications, he said. According to Claubaugh, the approach differs from other corporate software vendors such as SAP and Oracle in that it frees partners to develop unique applications tailored to specific customers or markets. The high potential for customization means that some partners end up developing high value-added applications that have international export potential, and in these cases Progress works to help its partners sell in foreign markets, he said. Consequently, Progress' partners reap a significantly larger margin for their software than do the partners of these other vendors, Claubaugh said. Globally the partner base includes more than 2,000 companies that supply more than US\$5bn in Progress-based applications and services annually, according to the company's website. Worldwide the company billed US\$309mn last year. About 7% of that billing came from Latin America, where the company has had a presence for about 10 years and works with around 100 local partners, the executive said. Progress increased Latin American revenues 15-20% last year, and expects to repeat that figure in 2004, he added. This year the company's top priority in the region is to continue growing its partner base, Claubaugh said. To that end, Progress has a direct presence through offices in Argentina, Brazil and Mexico, and through representatives in other parts of the region, he said. Progress will also be working to deploy its new on-demand business model for interested partners, Claubaugh said. Progress's version of the model calls for billing in the local currency and revenue sharing with the partner, making the model a very low-risk option for partners, he said. - (BNamericas.com)



# Business Week

## The Hidden Costs of IT Outsourcing

While moving software development and tech support offshore is all the rage, many companies find the overall savings aren't that great

*By Olga Kharif in Portland, Ore.  
Edited by Thane Peterson*

Keith Franklin, president of Empowered Software Solutions in Burr Ridge, Ill., loves offshore outsourcing. It means more work for his 40-person company. Just last year, ESS, which specializes in developing applications for Microsoft's .Net platform for Web services, earned \$500,000 in revenues from fixing buggy software written in India. It took ESS five months to repair a glitch-filled application for a Web portal. Most pages on the site weren't connected, turning updating into a nightmare. Some code was missing.

The shoddy work didn't come cheap, either: The Indian outsourcer went \$1 million overbudget. Franklin says he could have done the project for less than \$900,000 -- right here in the U.S.

Indeed, offshoring -- sending work overseas -- isn't always all it's made out to be. Particularly with information technology, which can be a lot more complicated than moving traditional manufacturing operations overseas. IT quality is much more difficult to gauge, says Atul Vashistha, chairman and CEO of info-tech offshoring consultancy neoIT in San Ramon, Calif. And since IT is an integral part of every business process, it requires more communication and management.

Offshore IT outsourcing started to soar during the economic downturn. With their companies' sales squeezed and shareholders screaming bloody murder, many CEOs began mandating that some IT work be sent overseas. They were following the lead of big companies, including chipmaker Intel ([INTC](#)) and software giant Microsoft ([MSFT](#)), that already do considerable software development in India and Russia. With the trend gaining momentum, more than 40% of U.S. companies will develop software or test it, offer tech support, or provide storage functions overseas by 2004, according to market consultancy Gartner (see BW, 10/27/03, "[All The World's A Call Center](#)").

"DIRTY LITTLE SECRET." On paper, it looks extremely attractive. A Russian programmer charges 80% less than an American. But when you parse it all out, the total cost of offshoring a given IT job is generally comparable to getting the work done domestically, says Tom Weakland, a partner at management consultancy DiamondCluster. It's just that few companies are aware of these real costs. "Most companies can't accurately measure their productivity and costs prior to and after outsourcing," says Weakland. "Most look just at wages."

A few companies have learned the lesson the hard way. A year ago, 100% of neoIT's business came from consulting companies wishing to go offshore. Today, about 25% to 30% of its business relates to fixing problems, says Vashistha. Most companies don't want to advertise the problems they've run into, of course. "It's a dirty little secret," says Michael Mah, managing partner at software consultancy QSM Associates, based in Pittsfield, Mass. "There could be more crashed projects in the next 6 to 12 months."



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One weakness of moving support functions overseas is that it leaves no one on-site to help customers. Take publishing-software maker Quark. For the last year it has based its English-speaking tech-support staff -- people you call if your app keeps crashing -- in India. Kamar Aulakh, Quark's president, claims that the move hasn't affected service quality or caused any customers to flee. He says his support staff is able to resolve problems over the phone. But the trend leaves some customers worried.

**BACKWARD PRIORITIES.** As Empowered Software has discovered, programs developed by offshore outsourcers are also often buggier than software programmed domestically -- usually 35% to 40% more so, estimates Mah. "If a company makes software for flying airplanes, I wouldn't want [it] to be created with the priority of the deadline coming first and quality coming second," he says.

And if a financial application used by, say, a bank distorts crucial information such as trading data, a customer could sue or withdraw its business. Should such problems arise, the U.S. company can't easily turn around and sue its applications-development outsourcer overseas.

Fixing even small bugs can cost up to 10 times more after the software is written than at the design stages, Mah says. And some offshore-outsourcing companies charge extra for fixing bugs after delivery. In a worst-case scenario, a company could end up feeling like it's in that old *Dilbert* cartoon in which the pointy-haired boss promises \$10 for every bug fix -- and a programmer decides to code himself a new minivan.

**MIDNIGHT OIL.** Costs add up even when offshoring is done right. Many companies tend to send expatriates to set up their operations abroad -- and their wages usually run high. Then there's the price of additional executive travel. And, ideally, offshore employees are also brought into the U.S. for several months for extensive training in language and culture.

More important is the cost and inconvenience of managing offshore crews. When privately held software maker Elance outsourced some of its development to India last October, its domestic engineers had to work past 10 p.m. every day to communicate with the Indian team. Even now, they have to work late a couple of nights a week, says Fabio Rosati, Elance's president and CEO.

Some companies also have to change their internal processes to accommodate offshore partners. Some decide to open branches abroad, where they have more control over how work is done. And others are diversifying their offshore outsourcing. Last November, Electronic Data Systems ([EDS](#)) unveiled its Best Shore Initiative, designed to help clients pick the best offshore location. The locations have to pass tough guidelines for quality of work, infrastructure, and low cost.

One reason for the initiative, says Dan Zadorozny, EDS's vice-president for application-services delivery, is that labor costs in traditional outsourcing powerhouses such as India are escalating. Already, an entry-level programmer costs more there than in Argentina, he says -- which is where he's increasingly sending clients.

**DOMESTIC SOURCES.** Software companies that facilitate communication between customers and their offshore vendors are also prospering. Elance's software, already used by shipping giant FedEx ([FDX](#)), General Electric ([GE](#)), and cell-phone maker Motorola ([MOT](#)), allows companies to track specifications, compile an audit trail of what was communicated to whom, and measure performance against hundreds of pages of contracts. The company declines to disclose its annual sales, but Rosati says they're doubling every year.

Other companies hope to lure disillusioned outsourcing customers back home to the U.S. In October, RTTS, a privately held test-automation consultant, unveiled a testing service that works just like one offshore -- only it's delivered out of New York. By doing the testing remotely, as Indian outfits do, rather than on-site, RTTS can match the price of Indian companies.



"It's the same model as India, but there are no time-zone and language issues to deal with," explains Bill Hayduk, director of professional services for RTTS, whose customers range from pharmaceutical to insurance companies. "Customers going offshore aren't happy with the quality they're getting. So we think there's a big opportunity for us."

The outsourcing trend is unlikely to reverse any time soon, however. Pressured by lower-cost competitors, U.S. companies like the instant gratification of savings on wages. But as the real costs of IT outsourcing become apparent over time, many companies may come to realize that it's no panacea.

## VCs Turn Their Gaze Offshore

FEBRUARY 2, 2004 *VENTURE CAPITAL* By Gabor Garai

**International outsourcing has been a way to cut costs. Now, investors are recognizing that it can also generate hefty profits**

Outsourcing isn't just for the big boys any more. Venture capital firms are getting in on the act with the small companies they back. One major American venture capital firm, for example, is understood to insist, as a condition of investment, that any company it invests in outsource its computer programming tasks to the greatest extent possible.

In another, even more vivid situation, several American and European investors recently put up several million dollars to back a Hungarian clinical research outfit whose main line is obtaining outsourcing business from American pharmaceutical companies.

**EXACTING FORMULA.** What makes this business noteworthy, both as a business and as an indication of future direction for venture investors, is that the Hungarian company, Goodwill Research, isn't just handling repetitive or mundane tasks, like software service calls or data-entry work. Rather, it is a highly sophisticated medical-services company that specializes in conducting clinical trials for pharmaceutical companies -- at one-fourth to one-third the cost of the going rates in the U.S.

Clinical testing is one of the most daunting tasks facing any pharmaceutical company. Completing it efficiently and effectively is key to obtaining approval from the U.S. Food & Drug Administration (FDA) for new drugs, which is required before any drug can be marketed in the U.S.

Clinical trials present hurdles on a number of fronts. It can be difficult to recruit enough patients because of the requirement that studies be double-blind. Patients in the grip of a worsening disease often resist the notion that they may be consuming a placebo instead of the new drug being tested. If patients drop out during a study, the results may become questionable. In addition, studies may extend longer than expected, and costs increase beyond budgets.

Moreover, laboratories must be highly reliable. The data must be expertly recorded and maintained.

**CAPITAL WITH BORDERS.** Hungary has a highly sophisticated scientific community with much experience in many aspects of medicine and medical research. Even more significant from a business perspective, Hungary's personnel and facilities costs are a fraction of America's. In addition, it is easier in Hungary to obtain volunteers for double-blind studies, and they tend to stick with the studies, reducing time and money expenditures further compared to the U.S. Already, Goodwill Research is working with a number of sizeable American pharmaceutical companies, lowering their costs for conducting clinical trials.



This kind of situation tells us several things about the outsourcing phenomenon, especially as it affects venture investing:

- Outsourcing offers smaller companies significant business opportunities, no matter where they are located. Not only can smaller American businesses benefit from outsourcing tasks, but smaller overseas companies can benefit by positioning themselves to seek out companies that need to outsource tasks.
- Outsourcing is moving up the so-called "value chain." The tasks being outsourced are increasingly sophisticated, and thus less subject to commoditization down the road. . In Hungary, a number of small software development companies are beginning to focus on the outsourcing opportunity, serving as innovators rather than simply programmers.
- As a result of the first two items, companies that make effective use of outsourcing will increasingly attract the attention of venture investors. They seek out companies with sustainable competitive advantages, intellectual property, and other key indices of long-term and appreciating value.

All this means that outsourcing will increasingly be viewed by venture capitalists as not just a way to save money, but to make money. If done right, outsourcing is a way for small companies to speed development and focus on their core competencies by leveraging cash. A small company's ability to attract venture capital won't be limited to its location, but increasingly to its ability to make the best use of its assets -- both physical and intellectual. If done right, outsourcing can help smaller companies attract venture capital.

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