

Successful Offshore Outsourcing for Small to Mid-size Businesses

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Executive Summary

The mounting cost of IT services puts considerable pressure on the scarce financial and staff resources of Small to Mid-size Businesses (SMBs). This suggests that offshore outsourcing, with its promise of cost reduction, would strongly appeal to SMBs. But less than one in five SMBs currently has an offshore outsourcing strategy in place.

The reason for this is that smaller companies must overcome unique strategic and operational challenges in order to make offshore outsourcing work. These include limited expertise, a shorter planning horizon, and concerns around choosing the right mid-tier vendor. To maximize business benefits, SMBs must not only develop an outsourcing strategy and choose an appropriate vendor, but also build the right management skills, create effective communication channels, and then persevere in the process in order to learn and improve over time. Unfortunately, best practice advice and consulting expertise are largely skewed towards Fortune 1000 companies and often do not apply to smaller firms.

This paper discusses the reasons why mid-size companies have been slow to embrace offshore outsourcing. Intended for those who have decided to pursue offshore outsourcing, it explores ways in which smaller firms can effectively plan and implement an offshore outsourcing strategy to reap the same competitive advantages as their larger counterparts, including reduced IT costs, improved process management, and greater business agility.

Introduction

As the technology prerequisites for doing business become more complex and expensive, mid-tier companies struggle to meet basic IT needs. While Fortune 1000 enterprises can amortize the mounting cost of IT services across a large user base, Small to Mid-size Businesses (SMBs) must provide many of the same capabilities - from e-mail to high-speed Internet access to a dynamic Website - with a fraction of the resources. Specialized requirements like e-business services or mobile applications make the challenge greater still.

How can SMBs provide enterprise-scale technology on a mid-size budget? Offshore outsourcing seems like an appealing solution, offering technology expertise and superior process management at a lower cost. Yet the great majority of SMBs have not yet considered offshore outsourcing as part of their business strategy. As of January 2005, only 19% of smaller companies reported having an offshore outsourcing strategy in place, as compared to 95% of the Fortune 1000.¹

Outsourcing Challenges for SMBs

Offshore outsourcing presents SMBs with strategic and operational challenges that are easier for large organizations to overcome.

Strategic Challenges

Strategic issues are those that relate to planning and long-term time horizons. The principal strategic problems that small and mid-size companies face with respect to offshore outsourcing are limited expertise and a shorter planning horizon.

Lack of Expertise

Fortune 1000 companies have large IT organizations and a great number of project managers and administrators dedicated to planning an outsourcing strategy. Drawing on best practices and their own in house experience, they carefully consider what projects to outsource, how to leverage distributed development models, and how to build a business case.

By comparison, IT departments in SMBs are skeletal and intently focused on immediate, day-to-day IT concerns. Often there is little bandwidth left over to develop an offshore outsourcing strategy. In fact, capacity constraint due to a lack of resources is what prompts many companies to look at outsourcing as a solution.

¹ Ventoro (www.ventoro.com), "Offshore 2005 Research: Preliminary Findings and Conclusions."

Another problem in planning offshore outsourcing is the lack of advice specific to smaller firms. The trade press focuses on outsourcing almost exclusively from the standpoint of engagements among larger enterprises. However, advice that works for large organizations with dedicated, expert teams may be of little value to the streamlined staff at a small organization. Too often, SMBs are left to fend for themselves through ad hoc research and recommendations from colleagues. This leads to uncertainty and reinforces the impression that offshore outsourcing is “only for big companies.”

One way to prepare effectively for a new outsourcing relationship is by inducting someone with outsourcing experience to spearhead the initiative. Another approach is to tap external expertise by contracting with an independent outsourcing consultant. This consultant can be a valuable resource in the initial structuring of an outsourcing engagement and in facilitating critical knowledge transfer.

A Shorter Planning Horizon

With their smaller management teams and shorter-term perspective, SMBs find it inherently more difficult to take a future-oriented approach to running their business. Many SMBs do not operate with the multi year strategic plans that are typical of Fortune 1000 companies. However, up-front preparation is perhaps the single most critical factor in successful offshore outsourcing. A recent study found the lack of preparation and planning on the part of the client to be the primary reason for the failure of offshore initiatives.²

All too frequently, SMBs fall into offshore outsourcing engagements out of tactical necessity. Perhaps a competitor has introduced a new, customer-facing system that gives them an advantage. Or a key member of the IT staff has left the company. In the face of such unexpected events, many companies choose to connect hastily with an outsourcing vendor. However, the reactive introduction to offshore outsourcing presents inherent risks. A company can arrive at a more pragmatic plan for leveraging offshore outsourcing by looking at the total picture of its IT activity, ideally during the budgeting process for the upcoming year. By understanding that outsourcing is a medium- to long-term process, small and mid-size companies will be able to avoid costly mistakes that are often the result of a purely tactical approach.

Operational Challenges

Even for SMBs that address offshore outsourcing strategically, the decision to begin is only the first step. The challenge remains for the operational side of the business to execute the strategy. When it comes to getting the work of offshore outsourcing done, SMBs may again confront a shortage of staff and expertise. There may be no one in house with direct experience in outsourcing: to scope out the work to be done;

² Ibid.

model the stages of the project; negotiate pricing and contractual safeguards; manage communication, knowledge transfer and project execution processes; and address the numerous other details that come into play as the engagement unfolds.

Choosing Projects for Outsourcing

When outsourcing is a reactionary move, companies often outsource projects with which they are experiencing difficulties, such as a shortage of skills or time. However, those projects may not be the best choice for outsourcing, especially at the beginning of an outsourcing relationship. When considering what type of work to send offshore, SMBs should consider handling new development work in-house, or at least locally, and planning their outsourcing activities by going through a methodical process. They may find that the right projects for an initial offshore outsourcing relationship may well be those that they already handle competently in house. Such projects are more likely to embody process documentation and other forms of readily transferable knowledge and can therefore be more effectively managed remotely.

It is important to remember that outsourcing providers have learning curves, too, and that a well-delineated and well-managed project allows both teams to come together without drawing too heavily on the client’s expertise. The matrix in Table 1 provides guidance on the selection of activities or projects for outsourcing offshore.

	High Domain Expertise Required	Low Domain Expertise Required
Highly Mission Critical	Not suitable for outsourcing.	Suitable for outsourcing, but requires safeguards to reduce the risk of project disruption.
Less Mission Critical	Suitable for outsourcing, but requires a strong knowledge transfer mechanism.	Suitable for outsourcing.

Table 1: Criteria for selecting work suitable for offshore outsourcing.

Provided that appropriate safeguards and knowledge transfer processes have been established, SMBs can outsource a wider range of projects offshore without incurring unacceptable risk. Additional safeguards can help mitigate risks, such as building in redundancies for mission critical work and contractually ensuring the close supervision of the vendor. Similarly, documentation and codification, along with in-house training of the partner staff, can facilitate knowledge transfer.

Choosing a Partner

Having decided that offshore outsourcing is the right approach, a business must find the right partner to

support the effort. There are hundreds of competent, mid-sized outsourcing firms in India alone. The difficulty lies in selecting a subset of companies that are most likely to fit the bill and then evaluating them individually.

A mid-size company naturally seeks a mid-size supplier. Unfortunately, these suppliers lack the visibility of their larger counterparts. Each presents potential customers with an appealing Web site touting its team talent, vast engineering resources, years of experience, state-of-the art facility, and glowing client testimonials. The vast majority of these firms are well staffed, experienced, and highly competent to undertake a wide range of projects. Their pricing structures are equally comparable, due to the intensely competitive nature of their business.

The difference between offshore outsourcing vendors from a prospective client's point of view lies in their specific domain expertise, corporate culture, and consulting style. Some suppliers will focus mainly on solving technical problems. Others are better set up to devote time to understanding the client's business process and strategy. Some have broad industry knowledge, while others target niche markets.

Applying the Right Evaluation Criteria

Given the similarities among mid-size outsourcing suppliers, it is difficult for SMBs to develop a short list of potential partners. A useful starting point is to specify the right evaluation criteria (see sidebar).

Most of these criteria are applicable to enterprises as well as smaller businesses. In addition to these well-publicized criteria, SMBs must consider two other factors:

- ❑ The duration of key client relationships. Prospective clients should request references, call them and determine the amount of repeat business they have given the vendor. Long-term partnerships indicate not only that the client is satisfied with the vendor, but also that the vendor can successfully work and learn collaboratively over time to maximize the business value of the partnership.

Criteria for Evaluating Outsourcing Vendors

- ✓ In what core businesses does the vendor specialize?
- ✓ Does the vendor focus on developing reusable software modules, knowledge management systems and SOA frameworks to bring down implementation costs?
- ✓ Does the vendor abide by industry standards like CMMI, Six Sigma and ISO 9001 Quality Management System certification?
- ✓ What are the vendor's security practices and data privacy safeguards?
- ✓ Does the vendor have onshore staff to assist with project management and communication?
- ✓ How much attention can the vendor's top management team give to the proposed project(s)?

- ❑ Stability of supplier's management team. While high turnover of technical staff is a ubiquitous problem of the outsourcing industry, a more important concern for the SMB is the stability of a vendor's management team. These are the people who will address significant problems and maintain continuity of contact between the organizations.

By applying these additional criteria, SMBs can gain a strong sense of a mid-tier vendor's stability and reliability over the long haul.

Making Offshore Outsourcing Work

For small-to-mid-size firms that have successfully met the challenges of developing an outsourcing strategy, identified an appropriate partner and negotiated a contract, a final challenge remains: making the arrangement work in a way that maximizes business benefits. Key factors include:

- ❑ Persistence
- ❑ Taking responsibility for results
- ❑ Developing key management skills
- ❑ Leveraging the partnership

Persistence

It takes time to establish efficient communication, exchange useful information and gain real value from the relationship. Too many mid-size companies fail to realize that the most beneficial offshore outsourcing engagements are not one-time events. The ability to improve the process in the long run is a major element in the successful offshoring initiatives of many Fortune 1000 firms. Businesses, like individuals, need time to make mistakes and learn from them. "Lessons learned" can come from any number of places. The key is to stay the course long enough to make use of the lessons, generally for a period well beyond one fiscal year. By building experience over time, each organization can refine its unique set of offshore outsourcing best practices that can be leveraged for ongoing value.

Once senior management has decided on offshore outsourcing as a business strategy, it is essential to stay committed and align the support of key decision-makers. This ensures that the strategy is embraced consistently at all operational levels. If the outgoing CTO was committed to outsourcing and the new CTO strongly believes otherwise, time and money may well be wasted.

Taking Responsibility for Results

Outsourcing a problem does not automatically solve it. Instead, outsourced resources must be managed as carefully as in-house resources. Regardless of the size of the company, a successful offshore

outsourcing engagement requires clients to communicate complete information about goals and requirements. No amount of technical expertise on the part of the vendor can make up for poor requirements definitions or weak communication links. Simply “throwing the problem over the wall” to the outsourcer is likely to result in disappointment. In such instances, the client company underestimates the scope and corresponding effort that its own responsibilities entail. For example, software engineers in the vendor’s organization are not in a position to make decisions about features and requirements that are usually made by the client’s business analyst. The disappointment caused by implicit assumptions very often results in high levels of dissatisfaction with outsourcing itself.

Developing Key Management Skills

Besides specifying requirements, SMBs also need to hone the management competencies that are relevant to outsourcing relationships. This can be difficult for even the largest and most sophisticated organizations.

Fundamentally, outsourcing is a form of delegation that revolves around identifying clear goals and measuring progress toward them effectively. Training in how to delegate is especially important for outsourcing project managers. A formal training program can help these managers develop cultural sensitivity and other “soft” skills required for successful outsourcing.

There is also a wide range of other factors, such as logistical and time zone differences, which can impact the management of offshore relationships. The key to addressing these factors successfully is a policy of open, ongoing communication and interaction between client and vendor. Building personal relationships, such as through periodic visits between facilities, further promotes mutual understanding and success.

Leveraging the Partnership

Establishing a long-term partnership with a suitable provider is the best way to realize maximum benefit from offshore outsourcing. When the offshore team works as an extension of the in-house staff, it has time to capitalize on lessons learned and adjust to the client’s style of working. This improves communication and promotes rapid, more effective problem solving. Each team needs to have realistic expectations about the information, skills, and responsiveness that they can expect from the other.

A partnership approach will also help the outsourcing vendor provide better value than is otherwise possible. Outsourcing vendors are frequently asked by prospects what guarantees they can make about the technical talent available for a project. Yet it is often the potential client—not the vendor’s HR policies or wage scale—that is the most critical factor in attracting talent to the vendor’s organization. The best people want to know what they will be working on. If clients are committed to long-term relationships and vendors

know specifically what technical expertise they need to provide, they can more easily attract the right people to do the work. The result is better quality work from the vendor and better value for the client.

Summary

Small-to-mid-size businesses face unique challenges in their effort to leverage offshore IT outsourcing. At the strategic level, the highest hurdles include a shortage of resources, a lack of expertise, and a tendency to act tactically rather than strategically. Specific operational challenges that SMBs face in implementing an offshore outsourcing strategy include choosing appropriate projects to outsource and identifying the right vendor to help with the effort. By approaching offshore outsourcing in a strategic manner as long-term relationships rather than “one-shot deals,” small to mid-size companies can meet their goals of reduced IT costs, improved process management, and greater business agility in a competitive marketplace.

About the Author

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Dr. K. Kumar has over twenty years of experience as an executive, academic and entrepreneur. As CEO of Trigent Software Ltd., Bangalore, he was responsible for setting up and growing Trigent’s development center in India. His background includes leading the marketing efforts for a line of power equipment at Crompton Greaves Ltd., developing business solutions at Computer Point (I) Ltd., and assisting clients with developing business strategies for the global marketplace at Tata Consultancy Services in Bangalore. His entrepreneurial work includes the successful co-promotion of ventures in the service and consumer products sectors.

Before joining Trigent, Dr. Kumar was a visiting professor of strategy and entrepreneurship at the Indian Institute of Management, Bangalore. He has researched and published on topics related to the strategic management of new ventures in entrepreneurial and large corporate settings, and on strategic issues impacting growth and consolidation in information technology and related industries. Dr. Kumar holds a Bachelor's Degree in Electronics and Electrical Engineering from Madurai University and a Master's Degree in Business Management from the Indian Institute of Management, Bangalore. He is a Fellow of IIMB (equivalent of a Ph.D).

About Trigent Software Inc.

Trigent is a privately held, professional IT services company and a Microsoft Gold Partner with its U.S. headquarters in the greater Boston area and its Indian headquarters in Bangalore. We provide consulting services in various technologies including Microsoft Solutions. Our operating model is to conduct sales, customer relationships and front-end consulting (e.g., business case, requirements, architecture) onsite with our clients and perform the detail design, development, integration, testing and quality assurance offshore at our world class development and support center in Bangalore. We are a SEI CMM Level 4 company and is ISO 9001:2000 TickIT certified organization.

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