Handbook and Tips:

How to Design & Manage a Strategic Outsourcing Program and Avoid Common Mistakes

Abstract: *Independent Software Vendors and Application Service Providers have become increasingly pressured by external market conditions in developing an offshore sourcing strategy, yet few succeed in designing a strategic, not just tactical cost-savings approach.*

Software Product Lifecycle Management Series

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1. Executive Summary

According to McKinsey research, in 2005 only 4-8% of worldwide large offshore software engineering market is related to packaged software R&D, and most of that has occurred only in the last 4-5 years.

Independent Software Vendors (ISVs) and Application Service Providers (ASPs) are challenged to innovate faster then its competition and deliver their products to market first, supplement their development teams and re-balance their development priorities in order to accelerate revenue generation. Management and investors want to lower total cost of ownership and increase shareholder value. Due to the standardization of software engineering processes, pricing pressure and margin compression, evolving enterprise customer expectations, software companies are forced with the task of delivering more complex product development with limited and decreasingly time frames.

Regardless of size and maturity, offshore outsourcing is on the agenda of early staged, mid-sized and large software companies for many different reasons. Having the right strategic offshore roadmap and governance model is critical.

Accelerating consolidation activity is a symptom of increasing competitive pressure, which is in turn driven by fundamental changes in customers' purchasing behavior.

To overcome all or some of the above problems more and more software companies turn to Product Outsourcing i.e. hiring external vendors to develop a product for the company.

Regardless of size and maturity, offshore outsourcing is on the agenda of early staged, mid-sized and large software companies for many different reasons. Cost reduction is typically the basis for offshore outsourcing, but the big picture for ISVs and ASPs is to build, retain and maintain its customer base by constant innovation. Global outsourcing is an option vendors are exploring to remain cost competitive as operational difficulties associated with global outsourcing are gradually removed.

Having the right strategic offshore roadmap and governance model is critical.

2. State of Software Industry

2.1. Market Trends and Challenges

Profit margins are shrinking while sales and marketing costs often reach 30-60% of gross revenue at many software organizations. Vendor consolidation continues to be a major trend in the sector, having picked up pace after 2000.

The software industry is a subset of the larger computer industry and is considered the third-largest U.S. manufacturing business, after automobiles and electronics. During 1999-2004, software industry had faced increasing pressures on a number of fronts (Exhibit 2.1).

Exhibit 2.1

Major Trends:

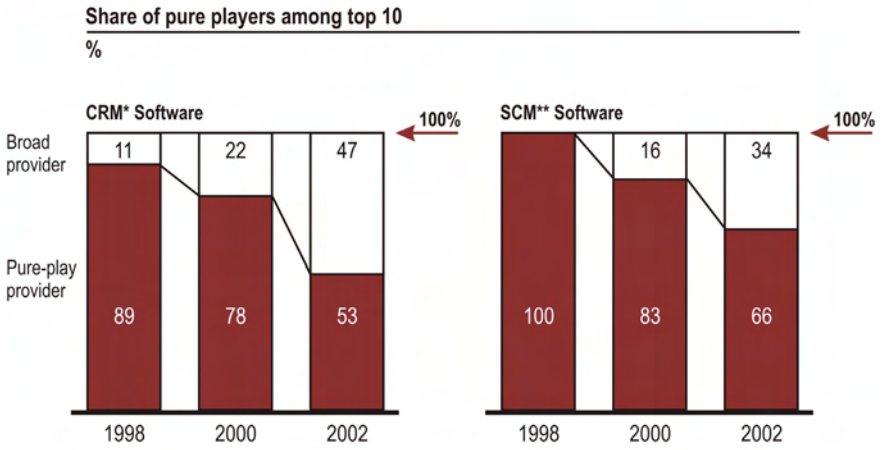
- Profit margins are shrinking while sales and marketing costs often reach 30-60% of gross revenue at many software organizations. Enterprise ISVs are under pressure to control and reduce R&D budgets in order to improve margins and manage long sales cycles. At the same time, their development teams are being asked to handle more work, while accelerating product releases and implementation cycles.
- Days of implementation cycles up to 18-24 months in the past, today this is no longer possible given the faster time-to-market and return-on-investment demands of ISVs' shareholders and clients, namely the IT organizations of sector companies. As a result, these cycles cannot run longer than six months, and often need to be even shorter, like 3-4 months.
- Vendor consolidation continues to be a major trend in the sector, having picked up pace after 2000. Competition in the enterprise software market is stronger then ever. The

software industry will see a tremendous consolidation wave and downsizing during the next 5 years. In 1999, there were about 3 00 public software companies, versus about 130 in 2005. According to Goldman Sachs, only half of these will be around in two years. Oracle's merger with Peoplesoft in December 2004, closely followed by Symantec merging with Veritas, Ora cle's merger with Siebel in September 2005 provide prominent examples. The application software segment seems to b e further ahead in this respect, while the other segmen ts leave room fo r future M&A activity. As fewer players are competing, large vendors are broadening their scope, which has led to th e collapse of niche software markets and further consolidation (Exhibit 2.2).

Packaged software vendors heavily depend on short product lifecycles. They are forced continuously to provide new product versions with new features to spur demand.
Open source software puts an enormous pressure onto small and mid-size software vendors across the stack.

Exhibit 2.2

THE COLLAPSE OF SOFTWARE NICHE MARKETS HAS LED TO FURTHER VENDOR CONSULIDATION PARTLY ESTIMATES



* Customer relationship managment
** Supply chain management

Source: IDC

This illustrates how packaged software vendors heavily depend on short product lifecycles. They are forced continuously to provide new product versions with new features to spur demand. As the sheer size of the software packages is risin g as a result of bundling with complementary products, it has be come increasingly difficult to keep prod uct lifecycles short and provide timely updates.

Last but n ot least, custom er demand has led to th e broad adoption of open-source software in system infrastructure and middleware product segments. Open source application

software vendors like SugarCRM and CompiereERP are early players in the application software segment.

Open source software puts an enormous pressure onto small and mid-size software vendors across the stack.

These drivers result in an increasing competitiveness in the sector as margins are shrinking. It raises the need to adjust go-to-market approaches and asserts cost pressure on vendors' R&D budgets. Most likely, the latter will lead to more industrialized, more tightly controlled software product development, relying on standardized, reusable components to reduce lifecycle costs. As time and cost seem to be the key, global outsourcing has emerged as one cost-and time-saving option made possible by the abundance of low-cost broadband capacity and the emergence of sophisticated distributed development tools.

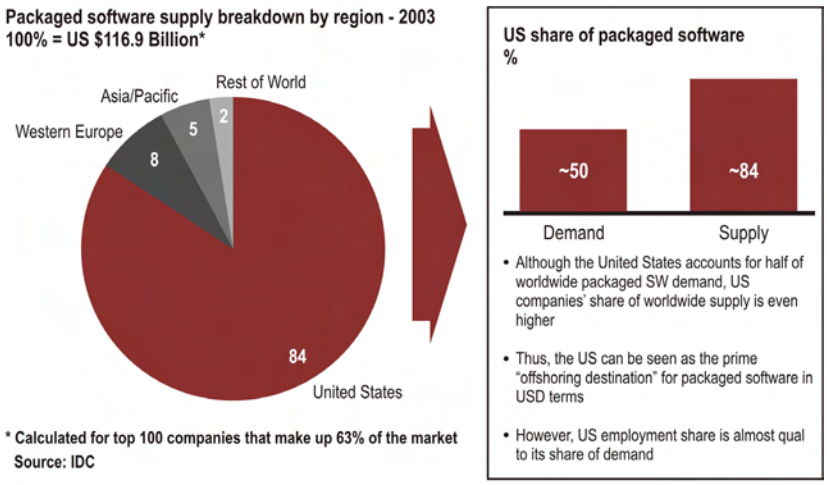
There is a mismatch between US share of software sector demand and supply. From the demand perspective, of the $185.5 billion market in 2003, the United States alone accounted for almost 50 percent of worldwide demand.

2.2. Packaged Software Industry and Global Outsourcing

According to IDC's software forecaster, there is a mismatch between US share of software sector demand and supply. From the demand perspective, of the $185.5 billion market in 2003, the United States alone accounted for almost 50 percent of worldwide demand. From the supply perspective, US vendors provided roughly 84 percent of global packaged software supply in 2003 (Exhibit 2.3).

Exhibit 2.3

SECTOR SUPPLY IS EVEN MORE CONCENTRATED WITH 84% OF PACKAGED SOFTWARE BEING SUPPLIED BY US VENDORS



This makes the United States the prime "offshoring destination" for packaged software in dollar terms. Most of worldwide packaged software R&D employment is "offshored" to the United States as of today. According to IDC, out of the top 20 vendors that together held 47 percent of the market share, 17 were US-based companies.

Today, only 4-8% of worldwide large offshore market is related to R&D, and most of that has occurred only in the last 4-5 years. The difficult job of enterprise software product engineers is to innovate by creating solutions for complex business problems in the sector or domain market. For innovation work there is no market precedent; hence to succeed, ISVs need high-caliber talent who can think innovatively "beyond tomorrow" and adjust to fluid R&D roadmap requirements.

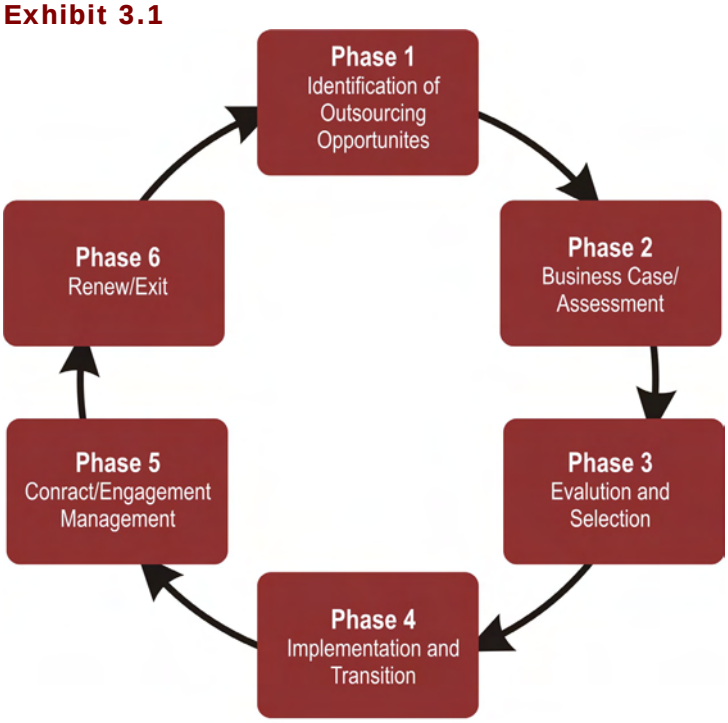
Furthermore, software companies are driven by the desire to reduce product lifecycles and to provide more timely updates. The 24-hour/7 day development promised by global outsourcing supports them in reducing the cost of additional features and updates. However, even as competitive pressure intensifies for many, comfortable margins still prevail for some larger companies, which therefore seem to adopt outsourcing at a slower pace.

Offshore outsourcing creates more options for software vendors while they need to shorten development and integration cycles. It reduces development expenses, since offshore labor can cost one- to two- thirds of onshore alternatives. As a result, ISVs can achieve maximum bandwidth by leveraging an extended labor force while keeping costs under control.

3. Outsourcing Lifecycle

The life cycle of an outsourcing engagement for software company usually consists of six distinct phases. The diagram below illustrates their chronological order and the way they build on each other (Exhibit 3.1):

Exhibit 3.1



Challenges faced by software companies driving them to re-balance their cost structures, re-think their product roadmaps, corporate strategies and market positioning, while continuing innovate in order to address demands of enterprise customers.

3.1.1. Phase 1: Identify Outsourcing Opportunities.

Challenges faced by software companies driving them to re-balance their cost structures, re-think their product roadmaps, corporate strategies and market positioning, while continuing innovate in order to address demands of enterprise customers.

A diagram below illustrates major drivers that influence software vendors and make them consider offshore outsourcing:

Table 3.1

Cost pressure	The intensifying cost pressure resulting from previously described changes in customer purchasing behavior, a stron ger demand for open-source products, the collapse o f niche segments, and the decline in license revenues is a key d river for the adoption of offshoring. Custom er demand also require s more m odular, reusable components, which increases the need for cost reductions, especially in R&D.
Cost differential (perceived or real)	Even as wage inflation in many popular offshoring destinations prevails at rates of nearly 20 percent each year, one of the strongest motivating factors driving adoption still seems to b e the cost reduction potential, especially for functions not considered mission critical. This i s amplified by the fact that approximately 80 percen t of the sector employment is located in developed—and therefore high-wage—countries.
Availability (perceived or real) of quality vendors	The abundance of mature, external IT services vendors in low-wage regions is fostering a rapid pace of adoption.
Availability (perceived or real) of suitable labor.	The lack of qualified talent in developed labor markets during the high-tech bubble in the late 1990s initially spurred company interest in global outsourcing. Although the supply situation in developed labor markets seems to have improved since then, skill shortages continue. Studies reveal that "US com panies' continue to experien ce a shortage o f specially qualified personnel; both the highly skilled and entry level jobs.

Choosing the processes that software companies want to outsource is a critical component of their outsourcing initiatives and can have a tremendous impact on its success. Major strategic and tactical opportunities available for software vendors lay in the categories below:

Table 3.2

Cost	Organizational change
Reduction of burn rate Better value for investment Control/stability/predictability Transparency	Core/strategic focus Customer focus Work practices Decoupling innovation and engineering Reduce/Share risk/reward
Service and Resources	**Tactical**
Match increasing customer demands Staff/skill shortage Improved service levels Recourse for failure	Cash infusion Staff reduction Increased resources
Capital Skills	Innovation Industry development

3.2. Phase 2: Assessment / Business Case

With industry analyst firm Gartner Inc. stating that more than 50% of outsourcing fails, the approach and execution of your outsourcing decisions are critical. Software vendors are challenged with how be able to effectively make decisions on what applications should be outsourced offshore, what should be kept in-house, upgraded or retired. To forge a successful outsourcing strategy, independent software vendors and application service providers should conduct an offshore outsourcing "readiness" assessment. The assessment should be equally applied to software vendors considering outsourcing for the first time, or to clients who wish to improve an existing outsource supply as it helps align the strategic corporate and R&D goals and tactical objectives of an outsourcing engagement.

The results of the assessment will provide a software organization with much of the information required to make key decisions and to focus management effort.

The assessment can help examine the ability of a software development organization to outsource, looking at procedures and processes maturity, experience, management tools and ROI objectives. The assessment may cover four segments of organizational readiness, each providing a discrete evaluation of part of the organization and its processes and expectations:

1. Business Objectives Readiness
2. Software Development Processes Maturity Readiness
3. Cultural Readiness
4. Financial Expectations (Desired vs. feasible ROI)

The assessment may apply maturity models based on SEI CMM and ITIL principles.

Data for assessment may be gathered from:

1. Questionnaires
2. Interviews
3. Discussion with product managers and application owners
4. Study of product roadmaps, maintenance plans and application/code base inventory

Deliverables may include:

1. Outsourcing Readiness Report
2. ROI analysis
3. Application/Project Sequencing Plan
4. Engagement Roadmap

When reviewing product roadmaps, maintenance plans and application/code base inventory, the following criteria are recommended to assess readiness of specific applications/processes:

1. Skill alignment with current/future technology direction
2. Current cost of operation
3. Application maturity
4. Alignment to business (core, context, utility)
5. Business value
6. Business satisfaction
7. Functional completeness
8. Technical completeness
9. Rate of change
10. Technology platform
11. Associated cluster

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12. Perceived risk profile

Table 3.3

Tactical View (Project-by-project)	Strategic View (Long Term Partnership)
• Short term project- based view • Focus on head-count based cost reduction • Significant overhead may outweigh cost savings • Not sustainable in the long run	• Long term strategic ROI view • Focus on Innovation, TTM, Cost • Benefits far outweigh costs • Sustainable time and cost efficiencies

However, regardless of business model, sustainable time and cost efficiencies of outsourcing and whether it can be successful or not depends on how it is designed, implemented and managed. Software companies often hire contractors for particular types of work and have formed long-term relationships with firms whose capabilities complement or supplement their own. That is why sometimes strategic outsourcing is mistaken with tactical subcontracting. The difference between subcontracting and outsourcing is that the latter involves the most efficient reconstructing of particular business activities by utilizing external partnerships. Software vendors should carefully evaluate available business models before making a selection.

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3.3. Phase 3: Evaluation and Selection

3.3.1. Choosing a Vendor

According to the Everest Group (2002), successful shopping for offshore services requires from the customer to research the following vendor characteristics:

1. Information technology resources (to eliminate the need for customer investment)
2. Process expertise (to streamline the process and to make it cost effective; to focus internal management on core competencies; to take advantage of the vendor's former experience)
3. Economies of scale (to facilitate scalability, globalization, and networks)

4. Access to resources otherwise unavailable to the buyer (equipment, applications, capital, people, lower-cost raw materials)

Given these demands, software companies should look for an offshore partner that answers a number of key criteria.

1. The partner should have a deep understanding of R&D and product culture, it should understand the difference in between enterprise application maintenance and software product engineering, it should have proven track record in all stages of the product development lifecycle.

2. Most offshore outsourcers companies talk about quality certification – this is important, but not enough. What's even more important is guided or structured flexibility in development processes and procedures that is in tune with innovation fluidity and culture.

3. Next, talent has to be a notch above what's typically needed within sector companies' IT divisions – innovative talent capable of creating, rather than following, a roadmap. A major reason why leading ISVs are successful is that they follow a passion, and we believe ISVs sense our own passion to innovate and partner with them to solve problems.

It is recommended that decision-makers visit prospective vendors and proposed locations in order to meet with staff and to inquire about past projects. It is also preferable to choose a vendor that has proven effective Recruitment and HR practices, as this are key resource software companies may utilize during ramp-up process.

3.3.2. Choosing a Country

Industry analysts recommend that customers consider the following criteria when determining the best fit between an ODC and a host country:

Cost

- Cost of labor
- Cost of management and infrastructure
- Tax and treasury impact
- Long term resource availability (number of graduates in IT for

example)

Environment

1. Economic and political risks
2. Country infrastructure
3. Cultural compatibility
4. Geographic proximity
5. Security and intellectual property

People

1. IT market maturity
2. Size of labor market
3. Education level of work force
4. Language barriers and literacy rates
5. Employee retention

The Exhibit 3.3 lists the major IT outsourcing destinations in the world according to Ernst &Young data. It also compares their strengths and weaknesses in some of the categories listed above.

Exhibit 3.2

	India	Ireland	Russia	Israel	Mexico	China	Philippines	Hungary	Malaysia
Labor Cost	A	D	A	D	B	A	A	B	B
Cultural Fit (including language)	B	A	B	A	C	B	C	C	C
Infrastructure (including tax & legal)	A	A	B	A	B	C	B	C	B
Skills & Training	A	B	A+	A	C	B	C	C	C
Intellectual Property Protection	B	A	C	A	B	D	C	B	C
Political Stability	C	A	B	D	A	B	B	A	B
Process Maturity	A+	A	B	A	B	C	C	C	C
Overall	+4	+3	+2	+1	-1	-3	-3	-3	-4

3.4. Phase 4: Implementation and Transition

This phase compromises of the decisions required so that the outsourcing process is well established. The goal of the Implementation and Transition is to implement the actions, policies, and procedures charted in the Preparation Phase. Active personnel recruitment is underway and stable business relationships are established based on tangible work interactions. One or more pilot projects are executed in order to transfer knowledge and to provide the core team with subject expertise. This is an opportunity for the staff to master the customer's domain, business processes, and technologies through actual experience.

An effective governance model should include metrics, payment models, the change in the relationship management, the pricing structure and fees, the intellectual properties, the termination options, the rights and restrictions of both outsourcer and company and the liabilities.

This phase is characterized by:

1. Predictable and steady workflow
2. Established expertise and knowledge transfer
3. Management based on performance metrics and established procedures
4. Production of acceptable deliverable
5. Continuous development and improvement

3.4.1. Establish Governance Model

A rewarding outsou rcing relationship begins with clearly defined expectations that can be easily understo od from both the compan y and the outsourcer and allow a more shift and smooth outsourcing management process.

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They also must include Service Level Agreements (SLA's) whenever this is feasib le. It is ver y important that al l outsourcing contracts have t erms for both termination of cause and termination of convenience. So me exit considerations may be centered on p eople, equipment and intellectual properties.

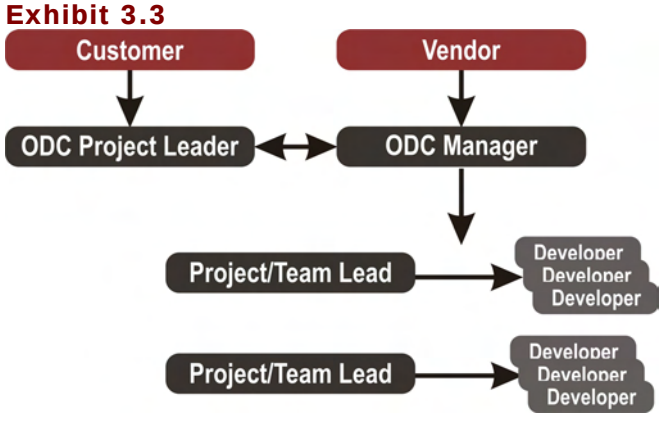
Table 3.4

Contracts	Service Level Agreements (SLAs)
Define legal terms: • Obligations, rights & Responsibilities • Guarantees • Liability • Termination **Usually stay:** Air tight and very dusty **Written for:** Service failure. Short term project-based view	**Define service:** • Definitions • Requirements & • Expectations • Metrics (like KPIs) • Relationships **Usually stay:** in use and under change **Written for:** Service Success

3.4.2. Defining organizational structure

A typical organizational structure of an offshore outsourcing engagement for a software company is roughly illustrated in the diagram below (Exhibit 3.4):

Exhibit 3.3



3.4.3. Team ramp-up

Customer and outsourcing provider usually assign a person or a team to manage evaluation and selection process. Then the customer and the provider work together to conceptualize and to re-confirm the scope of work, the goals, and the activities of the outsourcing engagement:

1. Project identification
2. Deployment plan, including milestones, schedules of knowledge transfer, sequence of project launching, etc.
3. Offshore development team organizational structure and governance
4. Team roles and responsibilities
5. Recruitment process
6. Software development process, methodology and metrics
7. Communications, reporting, and escalation procedures
8. Dedicated IT infrastructure (set-up and maintenance)
9. Office infrastructure, location, and security, including communication Equipment
10. IP rights protection

Outsourcing providers should be included in planning. A provider can be very helpful in project planning once he knows what the company strategy is and where the company is headed. Incentives should be used to increase benefits. If the providers are motivated, they can be stretched even further to meat outsourcing objectives and thus more benefits for the company.

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3.4.4. Establish Communication Plan

In order to manage the established offshore team effectively, the outsourcing provider and the customer continue to communicate and to work together on all organizational levels. They select managerial team and define their duties. Forrester Research (2003) suggests the following communication schedule for different levels of participants:

Table 3.5

Software Vendor	Outsourcing Supplier	Agenda	Frequency / Location
Steering Committee	Senior	• Escalation issues	• Quarterly
VP of Engineering	Management	• Customer satisfaction	• User goes offshore once per year
		• Resource allocation	
		• Process	• Vendor goes onsite
		• Savings and	once per year
		productivity gains	
Offshore Program Office	Account Manager/ Program Manager	• Consistent issues across program management teams	• Monthly (1-2 hrs) • User goes offshore twice per year
		• SLAs	
		• Best practices	
		• Escalation issues	
		• Future innovations	
Project Management Team	Project Delivery Team	• Planned vs. executed progress	• Weekly (1-2 hrs)
		• Communications	
		• Frequency of	
		questions	
		• SLAs	
		• Outstanding issues	
		• Dependencies	
		• Project Context review	

3.5. Phase 5: Sourcing Management

It is very important to constantly evaluate the outsourcer's performance against evaluation criteria on a regular basis.

The essence of product outsourcing is that it shifts a company's focus from managing resources in managing results. So outsourcing demands a more advanced approach to performance management, one that ensures that the desired results are defined clearly and reflect the company's true requirements. Also an outsourcing management approach makes certain that the outsourcing results are reported regularly and quickly adjusted as needed. It is very important to constantly evaluate the outsourcer's performance against evaluation criteria on a regular basis.

3.5.1. Metrics-based performance management

As software development companies move to measuring performance of their outsourcing initiatives and SLA-based outsourcing relationships, metrics assume critical importance. Proper selection of metrics is a key to motivating the right expectations and establishing success criteria for a successful relationship in order to maintain R&D quality and monitor the support and maintenance activities.

Some of the metrics which can be used are:

1. Number of problem requests (PR) per day/week/month
2. Mean time / Average time / Average resources required to resolve a PR
3. Number of code fixes per day/week/month
4. Average number of lines of code affected per PR
5. Average time spent for PR that requires code modification
6. Response time

The above are only a few of the metrics that can be collected to track and measure performance. Similar metrics should be collected in a reas like testing, release management, customer satisfaction etc.

In cases that the outsourcing process or end-result is complicated, sub-categories or criteria should be set.

Table 3.6 Criteria and Sub criteria of Outsourcing Evaluation

CRITERIA OF OUTSOURCING QUALITY EVALUATION	SUB CRITERIA
Experience	Specialized knowledge and skill-set of a team.
Communication	Detailed and frequent reporting. Fast response.
Contract uphold	On - time delivery. Contract terms uphold.
Efficiency	Projects delivered on time and on budget. High quality end-product. Goal achievement.

Source: Avlonitis G.

Therefore software companies need consider the following guidelines when choosing metrics for offshore outsourcing performance management:

1. Select metrics that correspond to factors within control of each party
2. Select metrics that motivate both parties to improve the relationship
3. Seek to collect a manageable amount of information.
4. Set baseline and target values.

Although it is easy to overwhelm the outsourcing relationship with performance management standards, Independent Software Vendors need to consider maturity of their software engineering processes and choose metrics that are objective.

Although it is easy to overwhelm the outsourcing relationship with performance management standards, Independent Software Vendors need to consider maturity of their software engineering processes and choose metrics that are objective, produce a reasonable volume of data, and are easy to collect at minimal expense. The objective in metrics-based performance management is to be able to measure and adjust performance, gradually build a successful and strategic relationship between client and provider.

3.6. Phase 6: Sourcing Transition (Renew/Exit)

Just as organizations have a disaster recovery plans that they create yearly, so should software companies have an exit plan for any outsourcing relationship. It might be disaster recover or even BOT (Build-Operate-Transfer) – a business model leveraged by companies that are seeking to establish a R&D initiative but are not ready to invest and take responsibilities and manage risks before realizing the benefits of a dedicated or captive engineering facility offshore. The model allows companies to set up operations with minimal investment while leveraging a localized partner who executes both a comprehensive build and operate program and implements IT best practices subsequently transferring the operation to client ownership.

During this phase, a software company should evaluate the outcomes of current outsourcing engagement, compare its initial goals a nd expectations against outsourcer's performance and make a qualified decision on how to evolve the relationship with outsourcing service provider in order to achieve strategic objectives.

4. Common Risks and Mitigation Strategies

Gartner and Forrester recommend some of the following risk mitigation strategies when engaging IT offshore services:

4.1. Risks and their mitigation during "Assessment/Business Case" Phase

Internal Readiness (the internal structure of the enterprise)

1. Executive level support
2. Planned Human Capital Management
3. Communication plan for all stakeholders
4. HR redeployment plan based on Portfolio sequencing and review
5. Risk management subgroup as part of the offshore steering committee to focus on compliance, data, security, and privacy

Portfolio Management (determining which application/functions are best developed/ supported offshore versus onshore and the appropriate resource mix for various projects)

1. Methodology for determining what goes where
2. Guidelines for production support, maintenance, new development

IP Security (establishing an environment of trust with the selected vendor while executing the necessary legal protections)

1. Make sure protections are in place in the event of turnover at the offshore vendor.
2. Consider outsourcing development work that will have little impact on your business if it is "appropriated." Groundbreaking research may be better held internally, while engineering on established products can be outsourced offshore.

The risk of data and IP protection is inherently raised when working in international business. Determine up front who owns the technology and/or the intellectual property that results from the software research and development. What should the offshore third party be prevented from doing with respect to developed or accessed intellectual property — sharing with others? Disclosing to others?

4.2. Risks and their mitigation during Evaluation and Selection Phase

Geopolitical (border unrest, religious strife, war, terrorism, political process, etc.)

1. Geographic dispersion of sites
2. Onshore, offshore, near-shore strategy
3. Scenario planning for different levels/probabilities of risk
4. Detailed business continuity plans for vendor and user

Country (government support, political stability, labor characteristics, etc.)

1. Scenario planning for different levels/probabilities of risk by country
2. Sources of country information (INS, World Bank, IMF)
3. Multi-region sourcing
4. U.S.-based corporations with multiple overse as locations

Vendor (reliability, commitment to security, qualifications)

1. Site visits
2. Interview with the head of quality and delivery
3. Vendor due diligence plan based on technologies and skills
4. Audit of the CMM paper trail of an actual project
5. Defined SLA that reflect goals of offshore strategy, such as helping the client improve its CMM capabilities
6. Comprehensive Master Agreement (covering labor rates, IP ownership, disaster recovery , security, staffing rotation schedules, etc).

4.3. Risks and their mitigation during Implementation and Transition phase

Language and Communications (different proficiency and comprehension levels, day-to-day misunderstandings, etc.)

1. Common process and methodology
2. Language training
3. Effective handoffs/overlapping shifts and other communication plans
4. Work on security and telecom issues as s oon as

possible
5. Collaborative technologies
6. Acceptance criteria defined upfront (including sign off by business and IT, documenting required functions, system performance, and test case scripts)

Culture Difference

1. Embed a project manager who has cross-cultural experience
2. Provide cultural sensitivity training to team members on both sides

It is critical to implement an ongoing program that stresses global and cross-cultural awareness, creating a comfortable multicultural workplace.

Human Capital (getting the right skills, high turnover rates, etc.)

1. Fixed fee contracts (possibly at higher rates)
2. Awareness that you get what you pay for
3. Choosing vendors with low turnover and high CMM certification
4. Matching country versus needed skill sets
5. Background checks and third party references

Knowledge Transfer (offshore employees failing to acquire quickly sufficient knowledge of the systems, the corporate culture, the industry, etc.)

1. Controlled transition process
2. Weekly meetings for transition team to review milestones
3. Right mix of offshore/onsite resources; controlled handoffs
4. Web-based knowledge/task management and other collaborative systems
5. Established process for transferring knowledge and resources back in-house
6. Updated tool and application licenses to support multiple sites

Knowledge transfer is an extremely important aspect of any outsourcing program management, particularly if documentation is lacking. The time and effort to transfer

knowledge and subject-matter information to the service provider is a cost rarely accounted for by IT executives. Both parties must establish a communication framework to transfer knowledge on objectives, issues, updates and results of an outsourcing engagement.

4.4. Risks and their mitigation during Sourcing Management phase

Change Management (transition, organization, communication, governance, etc.)

1. Developed change-management program
2. Proactive communication of objectives, benefits, staff redeployment plans
3. Teambuilding exercises for the "retained organization"
4. Compensation for transition leaders

Business Continuity Risks and Mitigation Strategies

1. Detailed business continuity, recovery and resumption, crisis management and disaster recovery plans for both vendor and customer Database on the offshore staff with their subject matter expertise and visa status
2. Scenario planning for different levels and probabilities of risk
3. Project specific plans and prioritization
4. Additional emphasis on human capital contingencies
5. Analysis of BCP measure versus added costs

4.5. Risks and their mitigation during Sourcing Transition (Renew/Exit) Phase

Exit Planning

1. Exit parameters identified in advance
2. Transition plan for physical infrastructure, knowledge, data, people
3. All relevant documentation is always available with the "retained" organization

5. Common outsourcing mistakes

5.1. Outsourcer/Vendor mistakes

5.1.1. Ignoring the importance of leverage

One of the biggest advantages of outsourcing is the ability

to use "leverage". "Leverage" is when the outsourcer creates value for the company - client and thus becomes needed. For an outsourcing company this means: access to scare materials, the ability to substitute expensive resources by cheaper ones, the possession of expertise and access to capital. So a client feels most satisfied and regards the outsourcing company valuable when the outsourcer can provide all or some of the above.

5.1.2. Avoiding accountability for the outsourcing process

An outsourcer must always be responsible and accountable for its outsourcing process. Not always this is the case. Outsourcers tend to avoid accountability since it can result in greater risks. Greater risks simply mean that the outsourcers are responsible for everything that can go wrong in an outsourcing process. So they do whatever they can so that they can legally remove the risk. But by doing so the risk moves to the client, which now has the ability and the right to intervene to an outsourcing process, something that always leads to disaster.

5.1.3. Using someone else to manage the outsourcing deal

Outsourcing as mentioned before is like a marriage. So the relationship between the outsourcer and the company - client is very intimate. One cannot manage such a relationship by using a third party. Usually a managerial team, different from the outsourcing team and sometimes hired to do this job, takes over the outsourcing relationship as soon as the outsourcing deal is signed. This results in dissatisfaction and disappointment of the customer since he cannot get in touch with the outsourcing team.

6. Company/Client mistakes

6.1.1. Inadequate readiness assessment of current state, desired future state and required roadmap

Software companies often make decisions on what and how to outsource too quickly without detailed expert assessment of their current state, desired future state and required path on how to get there. It is critical to plan

outsourcing strategy considering company's current software engineering processes maturity, in-house team size, available documentation, and experience with distributed software development, cultural fit and executive and staff support. It is recommended to access applications, source code base and business processes and lay out a matrix of how and in what sequence applications and processes can and/or should be outsourced, kept in-house or retired.

6.1.2. Unrealistic Cost Expectations

Cost Expectations determining savings that organization can leverage as a result of outsourcing often can be over-estimated. Although they can be based on ROI projections, software vendors should consider learning curve for offshore team to become productive. For several years now, the business press has been claiming that IT work costing $40-$80 an hour in the United States can be done for $15-$25 an hour in India or Russia. If those figures sound too good to be true, that's because often they're not. An offshore team often will not become productive (by on shore standards) for at least three to four months, or even longer for more complex projects. IT executives should expect to pay an additional 5 percent to 15 percent on managing an off shore outsourcing program, at least during the first year. The transition phase will add costs, too — planned expenses should cover due diligence, transfer of knowledge and extensive program management.

6.1.3. Relying too much on executive contact

Once a company has decided to outsource, usually hurry's up to get the outsourcing deal done and put the transaction on a fast track. To do that, executives from the company and the outsourcer, meet, agree and let the next level of management to sort out all the details of such a relationship. Since an outsourcing process is a complicated one, it sis advisable that various elements of a company must be involved in the original meetings and have a say to the agreement. Top-level executives are rarely enough to review such a process.

6.1.4. Not letting the outsourcer lead the process

The essence of outsourcing is that a company transfers the process of product making to the outsourcer and then buys the results of that process. The quickest and most certain way to destroy an outsourcing process is to let the company - client dictate how this process is done. When a company tells the outsourcer what to do, removes from the outsourcer the ability to add value to the process and produce a cheap product.

6.1.5. Interfering with the process

Many companies willingly do not transfer the ownership of the outsourcing process to the outsourcer and keep the process under control. When the company assigns someone to look over the process this person becomes overwhelmed and incompetent to manage something that has very little knowledge about. As a result the outsourcing process fails.

6.1.6. Signing an outsourcing deal with too long a term

The longer your contract terms, the more deep you get in it. Software companies should construct a contract that will last a long time but will allow the service terms agreements to change during short periods of time. it is preferable for a company to develop a close relationship with an outsourcing company, but sign short term contracts that can be easily negotiated and if necessary renegotiated or even broken.

6.1.7. Improper process management

Companies new to the outsourcing process often do not assign the right people to manage the process. They often assume that since all the details of an outsourcing contract are discussed and the contract is signed, that do not have to worry about the outsourcing process any longer. The right person for the job should be someone that understands the process and be able to focus and interpret the results in terms of the best interest of the company. He should have a different way of thinking in respect to most business managers and the oversight to recognize any problems or mishaps before those are surfaced.

6.1.8. Treating the outsourcer as an outsider

Far too often the company forgets that the outsourcer is a business asset and must be treated as such. Team members across the globe are vital parts of a successful and prosperous business. If the outsourcer is treated differently, for example like one of many suppliers or one of many customers, then the one thing that the outsourcer adds to a company will be lost.

7. Benchmarking outsourcing: when and why

Most companies when they decide to outsource a product are confident enough that this action will save them money in respect that is cheaper than producing the product themselves. The most common mistake in this line of thinking is that the company is usually under the impression, that it's receiving a fair deal , simply because the outsourcers cost's are lower that their own. Typically outsourcers propose 15-20% less than a company's current cost. But many times this difference in costs results in poor quality products. So benchmarking is required to provide a baseline of costs and service levels. A company can use it to compare results delivered by the outsourcer against the same or similar results throughout the industry or market and consequently negotiate or renegotiate the outsourcing deal.

During negotiations benchmarking knowledge is critical to setting the right expectations for cost, performance and service levels. Any negotiation position is reinforced by external validation of one's requirements. Also when a company has decided to outsource, with very little investigation, and wants to move fast through the negotiation process, can use benchmarking data as a guide.

When an outsourcing deal is signed and the process has been set in motion, benchmarking can be used for contract refinement. Most of outsourcing deals are renegotiated within two years of being. Usually dissatisfaction over pricing and service levels are the

main drivers for renegotiation. Benchmarking plays a key role in re negotiations since the compa ny -client need access to industry performanc e parameters in order to make a case with the outsourcer.

Usually the requirement for benchmarking should and sometimes is, drafted into the final terms of an outsourcing agreement.

8. About the Author

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9. Appendix A - Outsourcing strategy checklist

BACKGROUND INFORMATION	
Why outsourcing is needed?	
How can outsourcing by used as a strategic tool?	
What are the expectations from outsourcing?	
DECISION MAKING	
Who will decide what to outsource?	
Who will select the outsourcer?	
Who will approve variations to the outsourcing agreement?	
Who will approve budgets, timelines and deliverables?	
COMMUNICATION	
With whom should the company communicate?	
What will the outsourcer want to know and when?	
What is the best way to conduct communications?	
ENSURING A SUCCESSFUL OUTSOURCING PROCESS	
What are the critical success factors?	
What are the risks?	
How does one overcome risks or problems?	
What are the assumptions to be made before proceeding?	
RESPONSIBILITIES	
What are the company's responsibilities?	
What are the outsourcers?	
What knowledge - skills are required?	
ASSETS - STAFF AND LICENSES	
What assets, staff or licenses need to be acquired?	
What assets, staff or licenses need to be transferred?	
What assets, staff or licenses need to be redeployed?	
What assets, staff or licenses need to be disposed of?	
OBLIGATIONS - LEGAL MATTERS	
Are there copies of all arrangements and agreements?	
Is there any consent to be obtained from third parties?	
Are there any obligations after the outsourcing process begins?	

10. Appendix B – Do's and Don't's for successful outsourcing

Five do's of successful outsourcing

- One must outsource the "bottlenecks", the things that are really keeping the company from growing profitably.
- One must pick great partners, check them out and speak to their customers.
- Once outsourcing is done, the outsourcer must be regarded as part of the company and treated as such.
- One must demand excellence, since outsourcing is what the outsourcer does for a living.
- Outsourcing might scare employees. One must communicate honestly with them.

Four inhibitors to outsourcing

- Fear of loss of control.
- Work viewed as too strategic.
- Company's unique culture.
- Measuring the value.

Source: Corbet M. F.

11. Appendix C: Lexicon of Acronyms and Abbreviations

ASP – Application Service Provider
BCP – Business Continuity Planning
BOT – Build-Operate-Transfer
CMM - Capability Maturity Model for Software
SLA – Service Level Agreement
ISV – Independent Software Vendors

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