ventoro

Offshore 2005 Research

Preliminary Findings and Conclusions

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Letter from the President

October 11, 2004

Early 1848, General John A. Sutter found gold in Coloma, California while building a sawmill. Although General Sutter successfully kept the secret quiet for a while, rumors surrounding the find soon leaked out to the world. By the spring of 1849, the largest gold rush in history was on.

Thousands, swayed by the erroneous belief gold was lying on the ground for their easy take, left their existing lives and rushed to California. While it is true a few made vast fortunes during the height of the Gold Rush, most prospectors never even saw a fraction of the fortune they dreamt about.

The *real* story of the Gold Rush is not of wealth and riches, but of those who jumped at the idea of easy fortunes without knowledge of how to find gold, how to mine, or even how to survive in a wild, unsettled country. To make the challenge worse, these ‘49ers faced a constant barrage from swindlers claiming to offer “*the* secret” to success, preferred mining sites, near-magic tools, or an expedited journey to California. More often than not, these shady individuals had little or no more experience than the prospectors they preyed upon.

It is my strong belief the Offshore Outsourcing market is an example of history repeating itself. It is true companies can achieve significant bottom-line savings, however, most do not. Just as in the times of the Gold Rush, failure to achieve the end objective is most often caused by a significant underestimation of what it takes to be a success, compounded by distractions along the way. Companies naively launch offshore outsourcing strategies without an understanding of what it will take to be a success and, once they find out, millions have been spent, key employees are gone, and the Executive is left trying to figure out how to salvage the initiative. Following a similar pattern to the Gold Rush of ’49, the Offshore Outsourcing market is also flooded by those claiming to be able to help you through the process of moving offshore only to find out they do not have the experience or content to help.

All of this may sound as if I frown upon moving offshore but nothing can be further from the truth. Moving existing business functions offshore is one of the most powerful tools an Executive can use to improve both bottom-line and even top-line numbers. However, it must be done ***after*** establishing a sound business case and with a full understanding of the effort and planning it takes to be a success.

In early 2004, we launched an aggressive research project to get to the heart of what it takes to be an offshore success story. We chose to focus this research project on those "practical and tactical" items you will need to know in order to:

- Set a sound strategy tailored to your specific needs;
- Define a realistic plan taking you to offshore success in the most direct and risk-free means possible;
- Steer clear of the potholes along the way; and
- Measure the performance and fine-tune your existing offshore strategies.

A brief summary of our findings is outlined in this "Preliminary Findings and Conclusions" (October 11, 2004) Report. Although it is impossible for a single report to address or even solve all of your specific needs, this "Preliminary Findings and Conclusions" Report will help you get in the right mindset and will, help you weed out those companies only interested in selling you a shoddy shovel.

We hope you gain value from our work and encourage you to offer your comments, stories or advice for future reports.

Best regards,

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Special Recognition

This report could not have been done without the help of thousands of people around the world. We would like to offer special recognition to the following individuals who went out of their way to offer help - in order to make this "Preliminary Findings and Conclusions Report" a reality:

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About Ventoro

Ventoro was founded by seasoned Executives from the Offshore Outsourcing world who recognized the challenges U.S. and European customers face when planning, implementing and managing successful offshore outsourcing or offshoring initiatives. With the sincere desire to offer our customers the best possible value, Ventoro combines thorough research, extensive education and practical experience to help our customers achieve the greatest possible results.

We currently help the following groups:

U.S. and European Executives Implementing or Managing an Offshore Strategy
We help “onshore” firms wade through the entire lifecycle of an offshore strategy. Beginning with initial strategy sessions to long-term management, Ventoro has a vast collection of tools, methodologies, research, training and services to help businesses achieve the greatest possible return on their offshore investment.

Higher Education Institutions and Educators
We strongly support higher education and believe education must help prepare companies to succeed with global fulfillment models. Ventoro partners with educators and various institutes of high education around the world in preparing and delivering courses related to Offshore Outsourcing, Offshoring and Global Market Penetration.

Government Agencies and NGOs
More than 500 Non-Government Organizations (NGOs) and Government Agencies in dozens of countries are now aggressively working to attract outsourcing business for their constituents. Our research supports the strong demand for outsourcing services regardless of geographic location and we work with such organizations to understand the outsourcing market and build strategies tailored to each organization’s unique assets.

Outsourcing Service Providers
The outsourcing market is rapidly maturing and now has more than 10,000 firms around the globe competing for business. We work with outsourcing vendors to understand the current market and specifically position their services for success in the global market.

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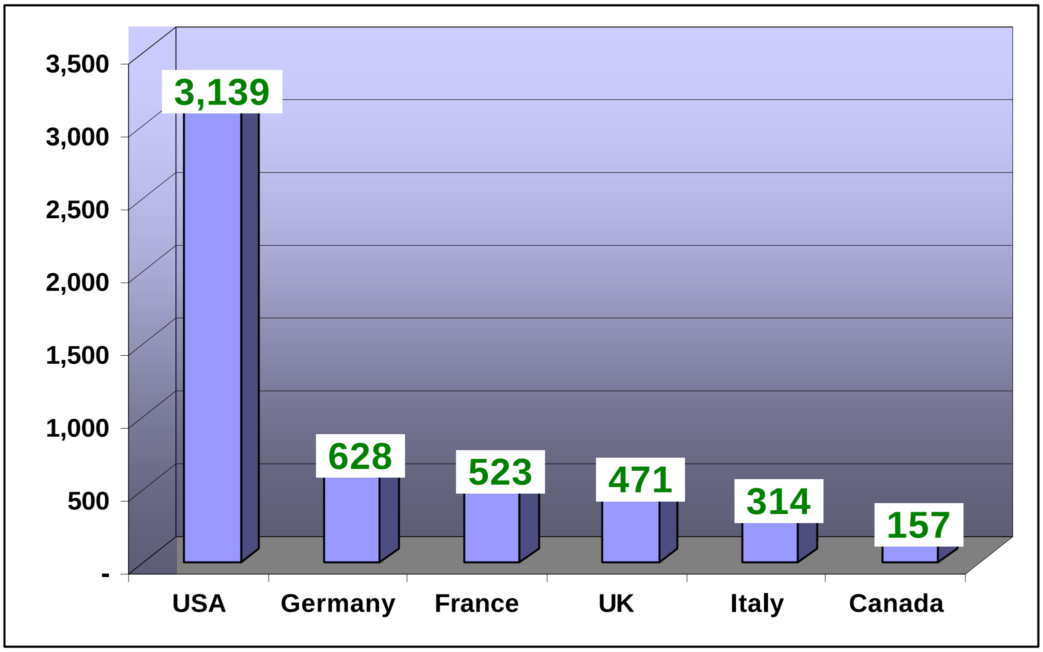
Introduction

Research Information

For this research project, we polled 5,231 Executives across North American and Europe who would generally be considered buyers of offshore outsourcing services. A breakdown of the number of Executives polled from each country is as follows:



For our research, we also polled 303 Offshore Outsourcing vendors from 12 countries. While we do not include their statistics in our graphs throughout this report, we did consider their collective wisdom in creating this report.

Definition of Success

Throughout this report, you will find reference to “success.” As a general rule, we use the polled individual’s opinion of their offshore strategy to determine success. For those statistics where we make judgment on the success or failure of an offshore strategy, we will clearly state so and offer our criteria for defining success.

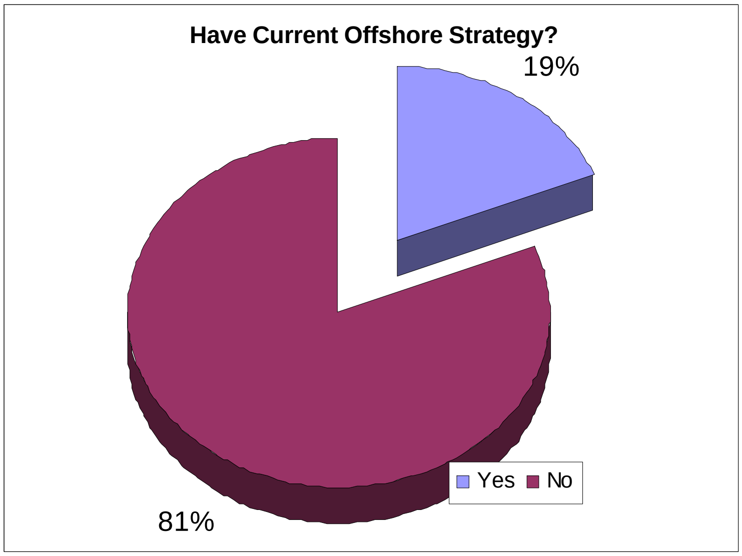
Cause and Effect

Offshoring or offshore outsourcing initiatives do not succeed or fail based on a single indicator. The total success or failure of any offshore strategy will rest on a combination of multiple variables. Throughout this report, we endeavor to highlight trends noticed in our research by stating success rates. There is no implication that by adopting a single recommended item you can/will expect the same probability of success.

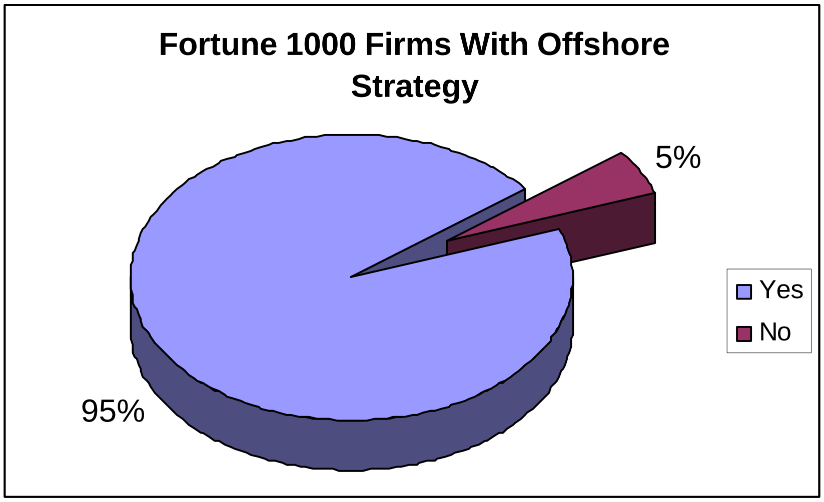
Offshore Market Statistics

How Big is the Market?

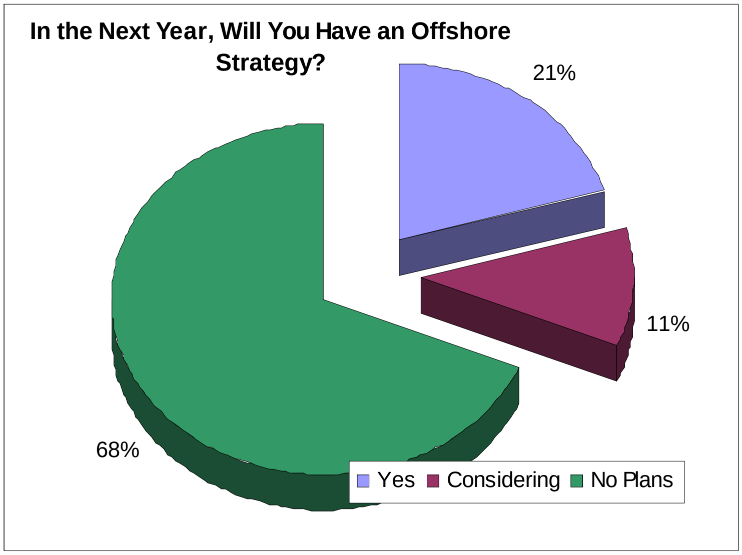
Offshore Outsourcing and Offshoring are occurring at a much lower rate than perceived by the public. In our poll, we found that slightly over 19% of all companies have a current offshore strategy.



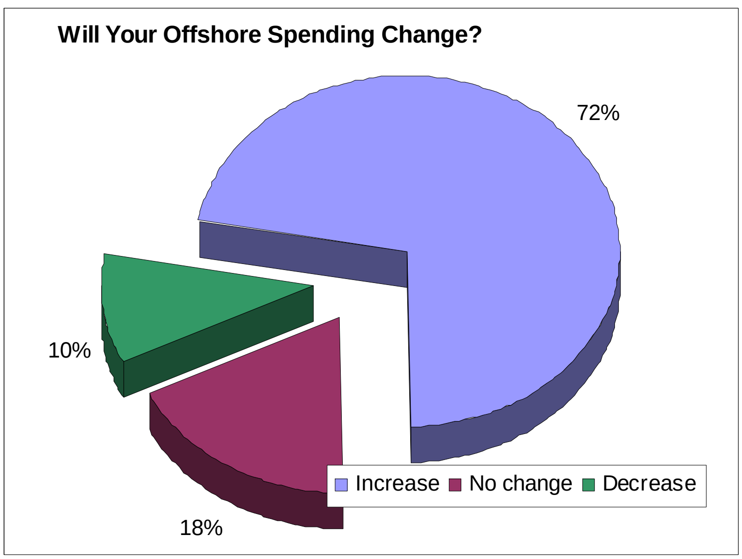
If we consider only firms considered to be Fortune 1000 firms, the number of firms using an offshore strategy jumps significantly to 95%.



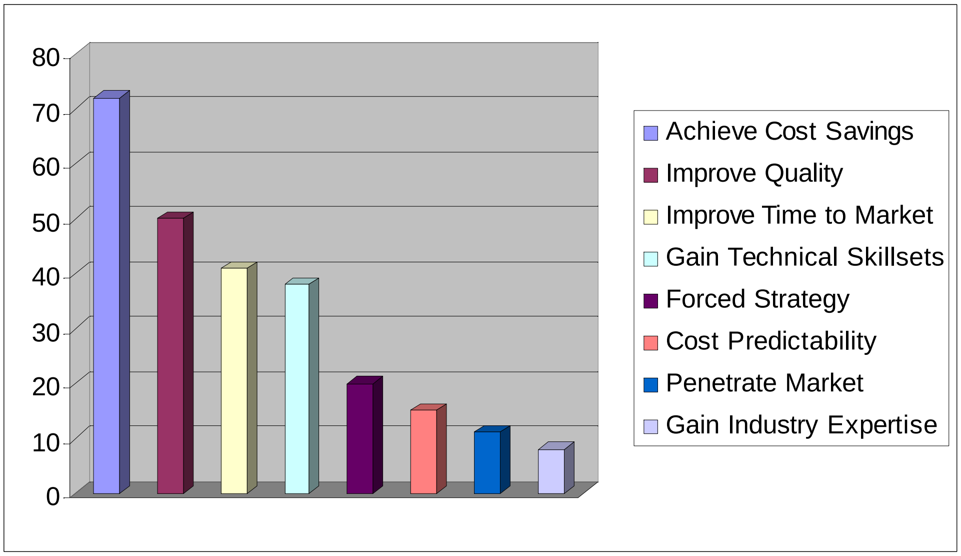
When polled about future offshore plans, only 32% of participating Executives are either planning or are considering an offshore strategy within the next year.



For those with an offshore strategy, it does appear spending will increase with 68% of all Executives managing existing offshore strategies planning on increasing their offshore presence.



Why Move Offshore?

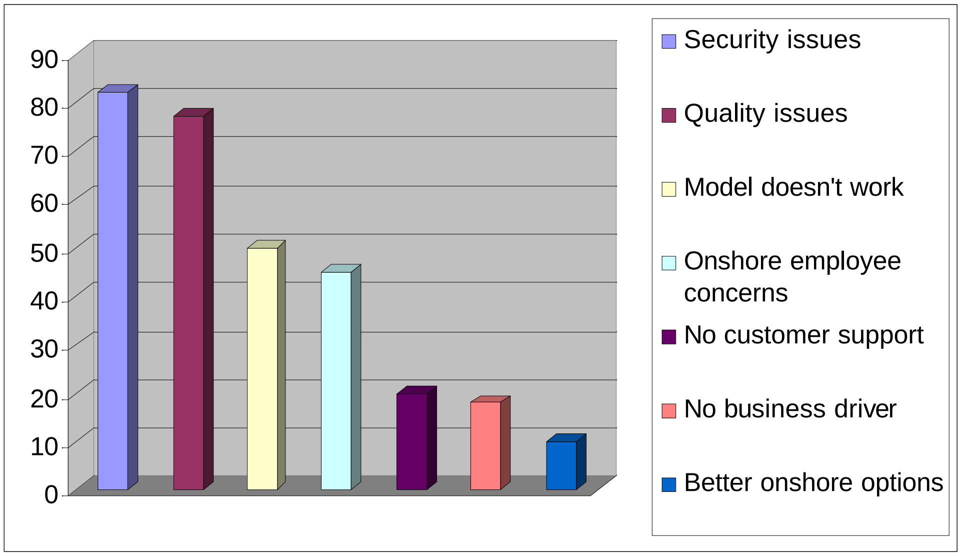


When asked "Why move offshore?" cost savings still outpaced all other drivers. Of special note:

1. **"Forced"**
   Almost 1 in 5 Executives polled stated they pursued an offshore strategy due to significant pressure from Shareholders, the Board of Directors, "C" level executives or other authority. We do not believe this to be a sound driver and strongly encourage all to choose an offshore strategy only *after* proving it is the best business solution.

2. **"Gain Industry Expertise"**
   Almost 8% of all Executives polled claimed they chose an offshore strategy to gain specific industry expertise. This is a strong indicator that offshore outsourcing vendors are maturing and we are now seeing the best firms from India, Russia and other offshore outsourcing hotspots, competing with the traditional onshore business strategy firms.

Why Stay Onshore?



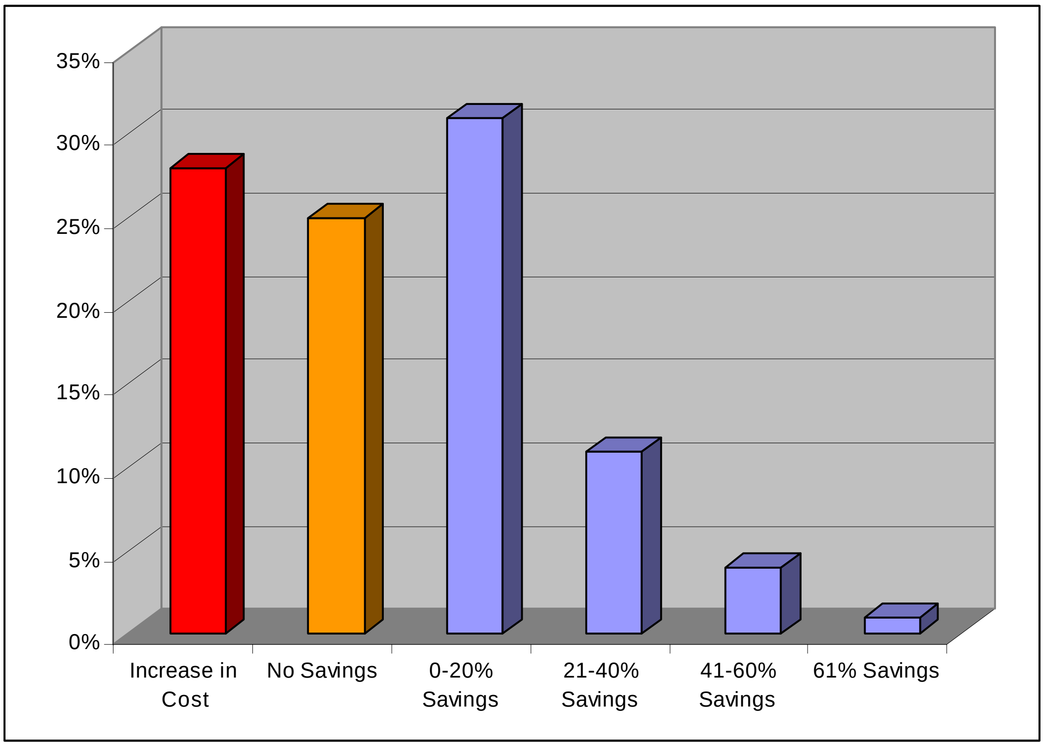
When polling those Executives that have opted not to pursue an offshore strategy, the primary reasons cited related to security (including IP theft and fraud) and quality issues. When pushed further, only 1 in 3 of these Executives admitted they would be willing to reconsider an offshore strategy if both security and quality issues could be satisfactorily mitigated.

How Well is it Working?

When reviewing all offshore outsourcing and Offshoring engagements, we found the average cost savings to be slightly below 10%. This number may seem low but we considered all engagements we reviewed including the following:

1. Those that increased cost (nearly 28%)
2. Those that did not generate any material savings (25%)

If we remove all those engagements deemed to be a failure by the polled executives, and those engagements that had no prior baseline to compare cost savings, we calculate an average savings of 19%.



Unrealistic Targets

In our research, we found nearly 5% of those polled achieved a cost savings exceeding 50%. Upon further investigation, most of these firms had unusual circumstances related to their offshore outsourcing strategy (such as replacing $400 per hour onshore resources with $50 per hour offshore resources of the same caliber). When we remove these from the equation, we found only two firms out of all we researched that achieved such a significant savings. If you are anticipating an offshore outsourcing or Offshoring savings of 50% or more, you are not being realistic.

Realistic Target

When reviewing those firms that followed the basic advice we outline in this report, we found a cost savings of 30% is realistic and recommend this number as a target for our clients.

Success

Regardless of how much an Executive may actually save with their offshore strategy, over 45% of those polled indicated their offshore strategy was a "success" with only 36% claiming their offshore strategy had failed.

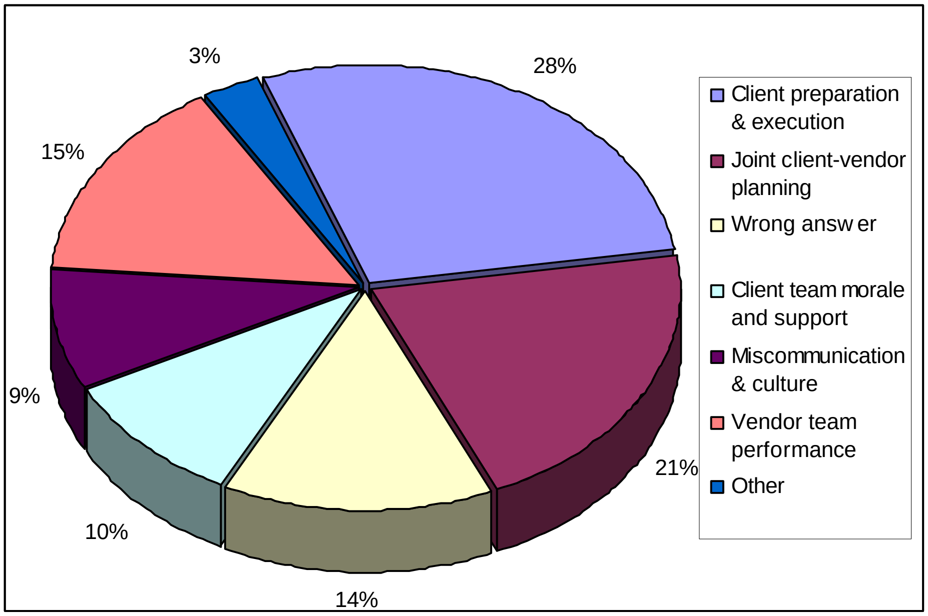
Onshoring

Over 1 in 3 Executives reported they have had to "onshore" (moving work from their offshore team back to their onshore team) work due to performance problems with their offshore strategy. Of those that have "onshored" work, 73% will continue to establish a long-term offshore strategy, 10% are not sure if they will continue with their offshore plans, and 17% have no current plans to pursue an offshore strategy in the future.

Why Do Offshore Strategies Fail?

The ultimate success or failure of any offshore strategy hinges on the performance of the implementing Executive. Even in cases where an Executive retains an offshore vendor, engagements that do not succeed are tripped up 52% of the time by problems exclusive to the client.

Offshore Outsourcing Root Failure



A break down of the top 7 root failure causes is as follows:

1. **Client Preparation and Execution**
   The leading cause of offshore strategy failure is the lack of preparation or execution by the client team (28%). Prior to moving offshore, you need to do your homework and prepare your organization. Once you begin the process, you (the managing Executive) need to set the high standard in performance and detail. You need to ensure that if you engage an offshore outsourcing vendor, you verify every detail is recorded, reviewed and planned. As a rule of thumb, you should be the one pushing for greater clarity throughout the entire engagement and not wait for the vendor to ask for you to step up.

2. **Joint Client-Vendor Planning**
   The second leading cause of failure in offshore outsourcing engagements are problems relating to the extent and quality of the client-vendor planning sessions prior to commencing the engagement (21%). Often, offshore outsourcing vendors steamroll the initial engagement process, trying to get signed contracts as fast as possible, and the client does not demand clarity in roles, responsibilities, expectations, joint operations, deliverables, short-term team plans, performance metrics, etc. In the end, the two parties have not formed an effective team and fight on misperceptions and missed expectations. Prior to signing contracts, mandate a complete and comprehensive plan outlining the first six months of your engagement. In this comprehensive plan, specifically cover roles, responsibilities, deliverables, how you and the vendor will work together, expectations and standards.

3. "Offshore" is the Wrong Answer

14% of the time offshore outsourcing engagements fail, "offshore outsourcing" simply was not the best answer to the business problem. We routinely found instances where the Executive stated a sound business objective but failed when prescribing "offshore outsourcing" as the solution, specifically when:

- There are better options
- Moving the item offshore simply will not solve the root problem

In each case reviewed, the company spent a significant amount of money offshore and never achieved their end objective ROI. Prior to moving offshore, take time to identify the root of your problem and establish if an offshore solution is the best *solution*.

4. Client Employee Morale and Support

There is a significant issue with maintaining the support of your internal team during your offshore outsourcing engagement. It is a fact offshore strategies are difficult and will require your employees to be active participants willing to help address issues as you implement the offshore strategy. If your employees do not support the move and you can't maintain their morale, you will not be able to get your organization to successfully adopt the offshore fulfillment model.

5. Miscommunication and Cultural Issues

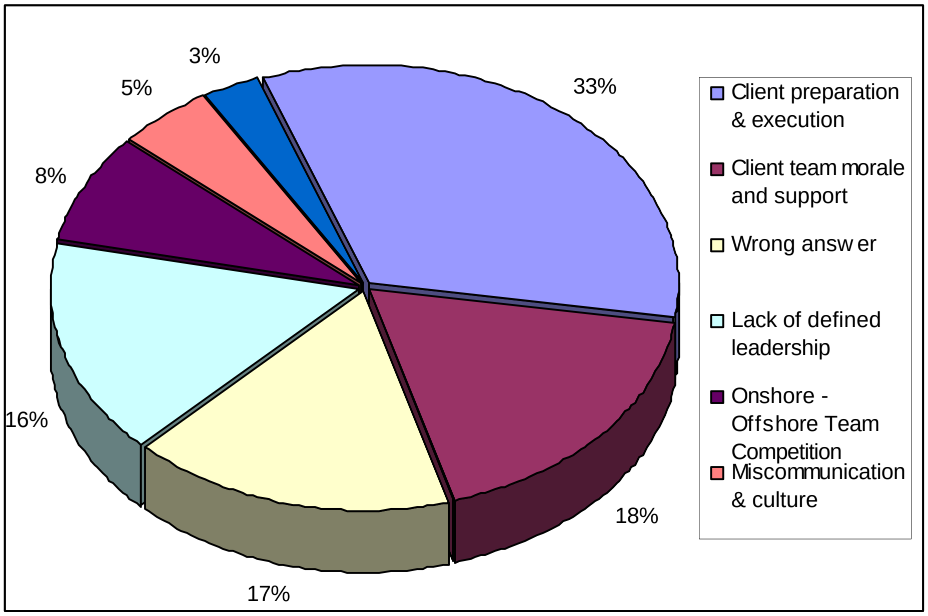
Contrary to the marketing efforts of a few offshore outsourcing vendors, communication and cultural issues still have an impact on the overall success of offshore strategies. We found 9% of the time an offshore strategy fails, it is directly due to cultural or communication issues between the onshore and offshore teams.

6. Vendor Team Performance

Slightly over 15% of the time offshore outsourcing engagements fail, the fault falls squarely on the shoulders of the offshore vendor. We routinely found issues such as:

- Failure to execute as planned
- Non-compliance with SLA, SOW or MSA

Offshoring Root Failure



Those companies building their own offshore team had similar root causes for offshore strategy failure. Of critical note specific to those building their own offshore team:

1. **Lack of Defined Leadership**
   U.S. and European business culture allows for (and, in some instances, even encourages) employees to perform duties or take on leadership responsibilities beyond what may be officially outlined in an organizational chart. In most countries considered to be an offshore outsourcing hotspot, this simply does not happen. Prior to moving offshore, prepare the following:

   - Organizational chart reflecting reality. If a person has higher leadership position in the team, make sure it is correctly reflected on paper.
   - Detailed job description for each onshore and offshore position inside your team

   If you want your offshore team to follow the lead of your onshore team, make sure your onshore team members hold a higher position on the organizational chart than your offshore team. Although it may seem comical, do not assume your offshore team will grasp the concept they are fulfilling products or services for a customer unless you have put the customer on the organizational chart.

2. **Preparation and Execution**
   It appears when U.S. and European Executives build their own offshore team, they are not as diligent in their preparation or execution when compared to those Executives that retain offshore outsourcing vendors. As a result, we found offshoring engagements have a higher occurrence of problems associated with this issue (preparation and execution) when compared to offshore outsourcing engagements.

3. **Onshore-Offshore Competition**
   In all offshoring initiatives, we have found varying degrees of competition between the onshore and offshore teams. The onshore team is trying to prove you still need them and the offshore team will posture for greater responsibilities. Unless you take an active approach to mitigating this problem, you will have a dysfunctional global team incapable of delivering any product.

4. Take Responsibility

Ultimately, the success or failure of your offshore initiative is up to you. In our research, we came across an alarming number of Executives that would not consider their role in any failed offshore strategy (even when they built their own offshore team!). Our philosophical belief is that each Executive moving offshore must step up and take the responsibility for the outcome of the offshore strategy. With this in mind, we interpret comments such as:

"In the end, there were too many gray areas and our vendor wouldn't work with us to get this done."

To mean:

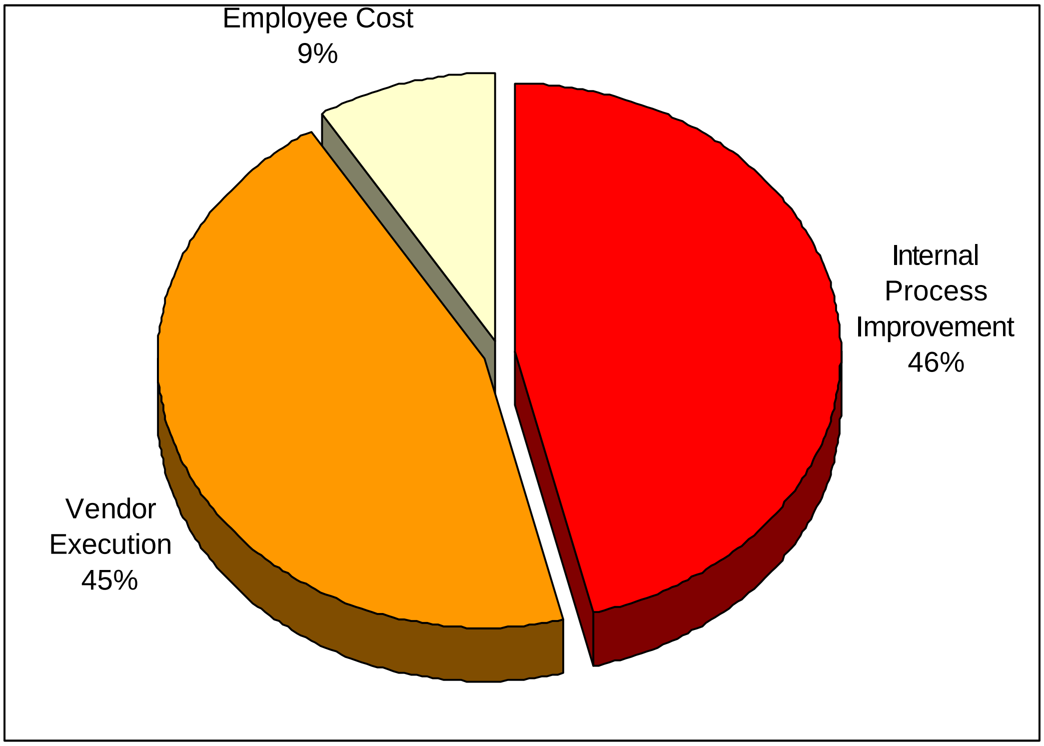
"I failed to adequately explain what we expected and what we needed prior to signing contracts."

Throughout this report, we will use the above philosophy and will not get into dissecting the excuses of those Executives that failed to deliver.

"Be very clear about what your goals and objectives for the effort are. Talk with a LOT of people who've done this before you so your eyes are completely wide open to the issues and challenges you face. Go THERE first. Establish some checkpoints along the way to make sure you are on track and it still makes sense to proceed. You should always be prepared to pull the plug if the execution or results veer way off course. Be PATIENT. A successful effort is measured in years of deployment not months. We are 5 quarters in to a full-time (jump in with both feet deployment). This followed a 4-quarter pilot effort. So, we have a total of 9 quarters of effort thus far and I see at least another 5 quarters before we realize the full potential of the initial objective."

-U.S. Executive

Where are the Savings?



In our research, we found the leading driver for cost savings in an offshore outsourcing engagement to be process improvement not the vendor resource costs. As such, we heavily recommend finding a vendor:

1. Capable of working with you to improve processes; and
2. Demonstrates sincere interest in helping you improve and is not seeking just a quick dollar.

We do not recommend adopting a strategy of selecting those vendors offering rock-bottom resource costs without any material intrinsic processes unless you have the capability and are willing to incur the cost of implementing such processes for the vendor. In the end, you will pay significantly more by selecting these vendors.

Conclusion

There is a clear trend among those firms that have higher success rates and the majority of this report is dedicated to calling out those items. There are a few rules we want to highlight here that will serve as a general theme of this "Preliminary Findings and Conclusions" report:

1. Take time to identify a quantifiable business problem and establish that an offshore solution is the best solution.

2. The success or failure of your offshore strategy is largely up to you (not a vendor) and you must carefully plan and execute in order to achieve an offshore ROI.

3. Realize an offshore ROI is a long and difficult process. Executives that are successful prepare and work hard.

4. The success of your offshore strategy has everything to do with the quality of both your onshore and offshore team. If you do not have the best employees and do not give them the tools (and skills) needed, you will not be a success.


Making the Offshore Decision

Should I Move Offshore?

The decision to move offshore or stay onshore is an incredibly charged question in today's market and should be made carefully. Through experience, we have found this decision must be made by answering the following three questions:

1. **Is your company ready?**
   In most cases, simply improving core processes will yield significant results. As an example, most companies have developers capable of writing great code but the organization fails to define sound requirements and fails to manage scope during software projects causing cost to skyrocket. Unless the company can shore up requirements and effectively manage the entire project lifecycle, an offshore strategy will not yield an ROI. When considering an offshore solution, carefully audit the performance of your onshore team and honestly assess how mature your organization is. If your problems are primarily caused by a lack of execution or discipline, an offshore strategy will not pay out as well as simply fixing the problems with your onshore team.

2. **Do you have a sound business case?**
   We do not believe in blanket offshore strategies based on artificial drivers (please see **"Organic Vs. Forced "**). We have found firms that identify a quantifiable problem and have clearly established a specific offshore solution as the best option are the most likely to succeed. When making the decision to move offshore:

   - Take time to identify specific items for consideration;
   - Take time to identify root problems; and
   - Prove a specific offshore solution to be the best option.

   Unless you can build this clear business case, you do not have a reason to move offshore and should not take such steps.

3. **What do my customers say?**
   Prior to moving offshore, you must poll your customers and understand their thoughts and concerns. Although you will find opposition to the idea of moving offshore, you should not kill your offshore plans just yet … take time to fully understand what your customers are saying and prioritize their issues. You will find their concerns fall into two categories:

   A. **Philosophical**
   There is a growing philosophical objection to moving jobs or fulfillment to offshore teams. Although there may or may not be merit to these arguments, you must listen to them carefully and ask your customers a simple question: "Are you willing to pay a premium for a solution developed locally?" If the answer is "yes!", reconsider moving offshore.

   However, our research indicates this is not likely to occur. When polling Executives that have presented this question to their customers, over 92% responded customers are putting aside their philosophical issues with offshore outsourcing to buy a lower cost product. While customers are passionate about the offshore debate, their purchasing patterns do not indicate they are serious about the issue.

   B. **Practical**
   There are many practical issues your customers will identify when presenting a potential offshore model and you must pay close attention when moving any function offshore that traditionally has involved a great deal of customer interaction.

> If you are moving a highly customer interactive function offshore, we strongly recommend conducting a focus group trial of the offshore experience. At the end of the trial, you will find moving the function offshore will cost you a minimum 2% of your customer base. Take this loss and factor it into your anticipated savings. If you find the loss of your customer base to be too great, reconsider moving offshore.

If you can state …

1. "My organization is ready."
2. "My problem can best be solved by a specific offshore solution." and
3. "I know the impact moving offshore will have on my customers and I am willing to move forward."

…you have made the decision.

"Gaining support from management was fairly simple. Once they understood the opportunities for improving quality and saving money, they were supportive. Customers and peers are another story. When we first thought about moving the development team to India, I was skeptical. It was only after we had tried a project or two that I began to see what was possible. The same pattern seems to happen with our customers and peers. They are skeptical at first. Once we show them the results, they warm up and even embrace the idea. It's those first few projects that are difficult."

-US Executive

What Should I Move Offshore?

The question of what to move offshore is more complex than many people understand. To add challenge to making this decision, there is a great deal of poor advice in the market.

Common Market Advice: Fact and Fiction

1. **Move the simple, tedious, maintenance or support functions offshore**
   We often come across firms that have opted to move their tedious, mundane, maintenance or simple support functions offshore while keeping those new, exciting or complex functions onshore. While this approach may work for some firms, invariably we have found this approach to shoot the turnover rate inside the offshore team through the roof. In fact, firms that move such functions offshore will experience among the highest offshore team turnover rates adding significant cost to the initiative. Simply put: If you onshore team doesn't want to do it, your offshore team won't either. If you are planning on moving such functions offshore, do not underestimate the impact of the high turnover rate.

2. **Move the non-core items offshore**
   We often encounter firms that move all non-core functions offshore and keep all items considered to be their core business onshore. As a generalization, this has proven to be a sound approach. However, we must note that many offshore vendors have invested heavily to gain a niche expertise and we have worked with many clients who have used offshore vendors to improve their core business. If you are considering retaining an offshore vendor, we do recommend giving some consideration as to how the leading offshore vendors can act as a catalyst for your business.

3. **Move non-customer facing functions offshore**
   Companies often move non-customer facing functions offshore while keeping highly customer interfacing functions onshore. We found this model to be relatively sound with an average success rate above the mean.

4. **Move stand-alone functions offshore**
   Another common metric used for determining what to move offshore is the degree the function must interact with other functions, applications or processes. Similar to above, we found this strategy to be relatively sound but caution against making the decision of what to move offshore solely upon this metric.

5. **Move support offshore and keep build onshore**
   In this model, companies use their onshore team to build new tools or implement new process processes and then send the support for the established item to the offshore team. We have found this to be a surprisingly poor model. In our research we found supporting applications typically requires a high degree of customer interaction and often requires a tiger-team resolution concept that has proven to be difficult to implement in many offshore hotspots. (Please see **"Mind Drain"** later in this report.)

6. **Move implementation offshore and keep innovation onshore**
   We have found this model to be a sound option. In most cases studied, companies using this model to determine what to move offshore have been a success assuming the company can build a successful transition mechanism between the two functions (and teams).

So, what do we recommend?

A brief summary of what we recommend to our customers (and what we found to be the most reliable through our research) is as follows:

1. **Set Performance Goals**
   Begin the process by recording quantifiable performance goals you want to achieve through your offshore strategy.

2. **Identify Candidates**
   After you have recorded specific performance goals, identify all potential candidates (functions, projects, products, teams or other) for moving offshore. With each, record baseline performance metrics and list all potential issues preventing the candidate item from achieving the defined long-term goals.

   You will find many of the items you may consider moving offshore have fundamental internal team execution issues that may not be resolved by an offshore strategy. Honestly assess candidates and if an offshore strategy will not help you achieve your performance goals, remove the item from the list.

   Similarly, you will find many of the items listed as candidates for moving offshore are already performing relatively well. If moving the item offshore will not have a material impact to the overall performance, we also recommend removing the item from the list.

3. **Qualify**
   For each candidate item on your list, complete a scorecard type assessment consisting of the following items (minimum):

   - Risk
   - Customer opinion
   - Peer support
   - Employee impact
   - Customer interaction
   - Complexity
   - Interdependency
   - Level of “business” understanding needed
   - Maturity and preparedness of the item

   Once you have completed your scorecard, make an honest judgment call for each item.

4. **Compare**
   Once you have completed a scorecard for all items you are considering moving offshore, research all potential alternative solutions. For example, if you are considering moving your medical data entry to an offshore team, investigate options such as:

   - Optical character recognition
   - Onshore data entry team optimization
   - Electronic capture devices for doctors

Review each option and if at the end of the assessment, you can demonstrate an offshore solution is the best business solution, proceed.

Scope

The question of how extensive your offshore initiative should be is an extremely complex question and must be addressed on a case-by-case basis. That stated, there are a few points that must be noted:

1. When starting out with a new vendor or new business model, pick a small, independent item to move offshore. Regardless if you are working with an offshore vendor or not, your organization will go through a fairly sizable learning curve during the first few projects. If this is your first offshore engagement, take this advice into special consideration.

2. Over time, you will find your onshore and offshore teams will settle into a fairly consistent working relationship and larger or more complex tasks can be moved offshore. You will find if you can move a series of interrelated items to your offshore team, you will gain additional cost savings and will likely to see a higher quality product from your offshore team.

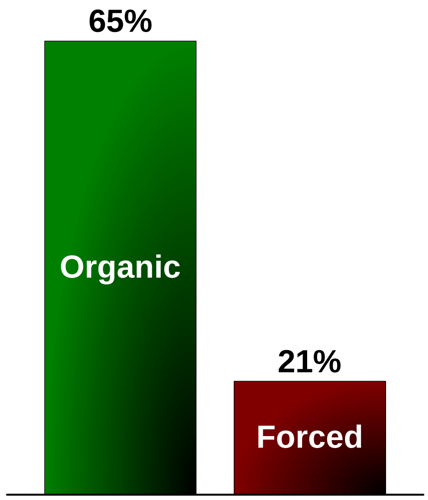
3. We are now seeing the outsourcing of vast business functions with varying degrees of success. While we have found that moving an entire business process, function or product line offshore produces the highest ROI numbers, it is also one of the riskiest items a firm can undertake. In our research, we found less than 1 in 3 firms undertaking such a widespread offshore strategy will generate a material ROI at the 3-year mark.

Organic or Forced

Almost 20% of the U.S. and European executives we polled stated they were effectively forced into an offshore strategy by senior management, the board of directors, or by shareholders. These executives also stated they were not allowed to investigate other potential solutions and we noticed an extremely high rate of failure among this group. To help us further understand this pressure, we studied two groups:

1. **Forced**
   This group was forced into some form of an offshore engagement by some authority. This group was not given an opportunity to adequately research all possible solutions to their identified problem. Often, these executives felt as if they were being told to "make the offshore solution fit your problem."

2. **Organic**
   This group of executives took time to define a specific problem, investigate many potential solutions, and then determined moving offshore was the best possible option.



In our study, we found the Organic Group three times as likely to achieve a successful offshore strategy as the Forced Group.

Upon further investigation, we found three leading problems with forced offshore strategies:

1. **Offshore is the wrong answer**
   Simply put, offshore strategies are not the single answer to every problem. Many times, executives being forced to implement an offshore solution are facing a problem that is not appropriately handled by an offshore team.

2. **No employee support**
   Executives being forced to implement an offshore strategy most likely will not support the initiative. Although they may execute exactly and exude a high degree of professionalism, we have found the morale of the Executive to suffer and the effect trickles down through the ranks. Fact is, if you do not have the sound support of your implementation management team and supporting employees, you will not be a success offshore.

3. **Public Opinion**
   Often, companies with a forced offshore strategy find themselves making up excuses for why they are moving offshore. In almost 80% of the companies we researched with a forced offshore strategy, Executives complained about the constant Public Opinion battle they fought with both internal and external entities.

After reviewing our research, we strongly caution U.S. and European firms against implementing any form of a forced offshore strategy; you are not likely to succeed.

Economies of Scale

In speaking with those that wrote blanket offshore policies forcing their organization into an offshore strategy, "Economies of Scale" was often referenced. In our research, we found the increased difficulties you will incur by attempting to implement a successful offshore strategy with a disassociated team will far outweigh any potential cost savings you may experience from a blanket offshore engagement.

The Balance

The large firms we found to have the best success with their offshore strategies implemented a balanced offering. In this model, such firms will either build a facility offshore or retain an offshore outsourcing vendor with some level of exclusivity. When a manager identifies a problem needing resolution, the manager is then encouraged to research all potential solutions (including the common offshore team). At the end of the research phase, the manager then has the ability to select the best solution for their business based on real metrics used to assess various options.

Through this model, our research demonstrates companies can achieve some form of additional cost savings through implementing an enterprise-wide offshore fulfillment mechanism while allowing the Executive to select the best solution for the business.

Build or Buy

With recent headlines bringing into light extreme violations of security and fraud by offshore outsourcing vendors, U.S. and European firms are swaying toward building their own offshore team. We believe this change to be an unwise, knee-jerk reaction and strongly believe too many firms are building their own facility when they should have engaged an outsourcing vendor.

Arguments for "Buy"

1. **Offshore Resources**
   Our experience has shown the best and brightest employees in the market want to work with the major local vendors. Across India, Russia and other offshore hotspots, the top seasoned pros (those you need) want to work for Luxoft, Wipro, Infosys, etc., not U.S. or European multinationals. While it is possible to mitigate this, it is an expensive, frustrating, and time-consuming process.

2. **Additional Value Add**
   Offshore outsourcing vendors truly are some of the best companies in the world. Every year, these vendors invest millions to develop new methodologies, collect IP, and develop additional catalysts you can use to gain a significant jump in value. The elite group of offshore vendors brings these intangibles to almost every engagement and you would spend millions simply trying to catch up.

3. **Performance**
   Breaking it down into true statistics, offshore engagements that have used offshore vendors reach a positive ROI faster, have a lower failure rate, generate a better ROI, and have the highest satisfaction rates. If you do it all on your own, you are likely to spend almost twice the amount of money compared to the amount you would spend when working with a vendor.

4. **True Risk and Mitigation**
   It is true there are problems with SLA compliance. A few simple rules can help you mitigate most of the problems recently revealed:
   - Take time to find a vendor known for their character and integrity;
   - Implement a mechanism rewarding the vendor for identifying ways to improve the performance of the offshore engagements; and
   - Implement a basic audit and compliance monitoring function.

5. **Cost**
   There is incredible overhead associated with managing remote teams and offshore vendors have two advantages:
   - **Economies of Scale**
     Offshore vendors already have an infrastructure built to facilitate management of various teams around the world and by utilizing this built-in infrastructure, the cost is shared across all their accounts.
   - **Catalysts**
     Offshore vendors have invested a phenomenal amount in solving the remote team management issue. They are now leaders in this space and can manage remote teams more cost-effectively than anyone else, as per our research.

When to Build

For a few companies, we do recommend building their own offshore team and use the following criteria for making the call:

1. **You have experience**
   We typically look for experience in both working in the selected country and in building remote teams. If you have built offshore teams before and have a great deal of experience working with teams in your selected offshore country, check number 2 below.

2. **You can get the resources**
   When you begin looking for resources, honestly assess both the management team you are attracting and the junior employees applying for jobs. If you are not getting the cream of the crop for both groups, do not build your own offshore team. Too often companies build their offshore team and then cycle through employees for years without generating results. (By all indicators, this an incredibly expensive proposition.)

3. **Overhead no big deal**
   Managing teams in multiple locations is a tough task. When building and running an offshore team, you take on a sizable overhead simply trying to keep multiple sites operational. If you do not have experience managing the activities of two or more teams in multiple locations, do not attempt to build your offshore team yourself.

4. **Does it pencil**
   Finally, does building your own offshore team without the support from an offshore vendor present a more cost compelling story when compared to using a vendor? If, at the end of your analysis, it is cheaper to build your own without vendor support, proceed. However, we must note we rarely find instances where an onshore firm can build an offshore team for a lower rate than a vendor assisted option.

Sensitive Materials

Occasionally, we come across companies opting to build their own offshore team referencing the argument the item they are moving offshore is of such a sensitive or valuable nature that if it fell into the wrong hands, the company would experience significant detriment and damage. In our research we found moving such items offshore does increase the probability of IP theft, but the primary driver for such theft will be your disgruntled onshore team. Building your own offshore team or retaining a vendor will not mitigate this risk and, as a result, we recommend you seriously reconsider moving such items offshore.

What Model?

So, you have made the decision to move offshore and you know what you will move offshore … what model should you choose?

Buy Models

1. **Offshore Staff Augmentation**
   The offshore staff augmentation model functions similar to onshore staff augmentation. In this model, your onshore team will provide daily oversight of an offshore resource (or team of resources). This model forces a great deal of communication between your onshore and offshore teams and we have yet to find any instance of such a model that incurred a positive ROI when factoring in the incredible overhead effort required. As a result, we strongly recommend firms avoid the offshore staff augmentation model.

2. **Project Outsourcing**
   In this model, the customer identifies a specific project needing completion and prepares all necessary project-related materials. The customer then retains an offshore vendor to deliver the project. At the completion of the project, the engagement ends. If you have a project lasting 3 months or more, and do not have a consistent forecast beyond the initial project, this is an appropriate model to choose.

3. **Offshore Dedicated Center (ODC)**
   In the dedicated center, the vendor assigns a set number of resources to the client for an ongoing series of projects. In this model, the client is responsible for a fully burdened resource cost and will be responsible for downtime between projects. The upside to this model is that if you have a series of related projects, you will keep the same resources on each project eliminating the ramp time and will not end up paying for additional team ramp costs. If you have a long-term forecasted need for a specific series of related projects, it is strongly encouraged you explore an Offshore Dedicated Center model.

4. **Functional Outsourcing**
   In this model, the vendor will outsource a complete function or application. While pay models occasionally are structured on a time and materials basis, most functional outsourcing engagements heavily leverage a risk-reward model. Also, these engagements typically encourage the vendor to bring tools, methods, resources and knowledge to the engagement in order to achieve a greater performing engagement. With the high-caliber offerings now being developed by outsourcing vendors around the world, this model is now proving to generate the best possible value for customers.

Build Models

1. **Do It Yourself (DIY)**
   The Do It Yourself model is what it implies: You, the client, do everything from finding an offshore office, obtaining all local licenses and permits, hiring all employees and managing the daily activities of each employee once the team is assembled. Of all the potential options for building your own offshore team, this is proving to be the most expensive and least successful with a success rate of less than 35% and average cost exceeding $5 million.

2. **Build Operate Transfer**
   In the Build-Operate-Transfer model you hire a local offshore outsourcing vendor to completely build your offshore team. Once the offshore facility is up and successfully running, the customer will then buy out the offshore facility under pre-defined terms.

Of all the build models, we found this model to generate the greatest results. Please consider the following:

- This is an incredibly low risk model. If, at the end of the ramp period of time, your business needs change, you are not stuck with a long-term offshore obligation. Depending on how you structure your contract, you can simply hand the vendor the keys and walk away without future liability.

- Statistically, this is lower cost and higher performing than doing it yourself. Having a firm that specializes in building outsourcing teams build your offshore team will cut the cost and time required to generate a positive ROI by 30%!

3. M&A

Becoming more fashionable, firms wanting to build an offshore team are turning to Mergers and Acquisitions (M&A) strategies. We found this approach to be sound and buying or merging with a mature offshore team has given several onshore companies a lightening-fast method for launching an offshore strategy. If you are going to be in the offshore market to stay, the M&A approach is an extremely sound option and should be seriously considered.

Vendors

The incredible success of the Indian Offshore Outsourcing market over the past five years has proven that regardless of your location, you can sell world-class services to the biggest companies around the globe. As a result, we are seeing a boom in the vendor market and believe there to be more than 10,000 firms in over 175 countries claiming to offer some form of offshore outsourcing service. While most of these firms are not worth considering, we are seeing an important metamorphosis in the vendor market that should improve the performance of your future offshore initiatives.

Vendor Maturity

One absolute fact is that Offshore Outsourcing Vendors have been incredibly nimble in adjusting to ever changing market demands.

The Offshore Outsourcing market really took root in the late '90s as global firms struggled to find enough engineers to staff their Internet and Y2K projects and offshore vendors merely had to have people.

When the technology market imploded in 2001 – 2002, the offshore outsourcing market effectively retooled from being a body shop to offering low-cost alternatives to onshore tech resources.

Anticipating a change on the horizon, offshore outsourcing firms invested heavily in such processes and certifications as CMM, ISO, Six Sigma, etc. When the market transitioned away from low resource cost models to a more sophisticated project delivery model, they were positioned and ready.

We are seeing yet another major change where onshore firms are demanding material and tangible results. As with every other shift in the past, offshore outsourcing vendors saw this coming and invested heavily to position themselves in this new market.

Close examination of the marketing materials from major offshore outsourcing vendors reveals no one brags about their low rates. All highlight their ability to transform your organization utilizing their significant investment in gaining domain and technical expertise. In our experience, this is not merely a marketing pitch. Offshore Outsourcing Vendors are now the thought leaders in many industries and technologies. Now it is relatively common to have traditional business consulting firms (such as Accenture, BearingPoint, McKinsey and others) replaced by offshore outsourcing vendors. If you ask the Executive making the switch, the decision is most often based on the ability of the offshore vendor to generate results and cost is not usually a driver.

From our view, this heightened global competition is good news. We have already seen onshore service vendors significantly step up the quality (and value) of their work and anticipate the intense competition among the global services firms will generate better, more "results centric" and affordable offerings for buyers in the years to come.

Vendor Selection

One of the most hotly debated issues with Offshore Outsourcing is how to find the best vendor. We have read more than 50 whitepapers on the subject and interviewed dozens of so-called experts. Interestingly, there are many conflicting opinions and we wanted to find the method most likely to generate the best results. A breakdown of each method we researched is as follows:

1. **Pick the Country First**
   The mantra "Pick the Country First!" is perhaps the most widely known and commonly used method for selecting an offshore vendor. In this model, the buyer uses some form of a "scorecard" approach to select the country most appropriate for their purposes. After selecting the country, the buyer then selects the vendor(s) most likely to be able to handle their needs out of the top vendors from the selected country. The arguments for this model usually are as follows:

   - Some countries do not adequately protect your IP;
   - Some countries offer greater financial exposure;
   - Some countries are not as stable as others; and
   - Some countries have been involved with outsourcing longer than others and this experience translates into a higher probability for success.

   In our research, we found companies using this model to select a vendor run a success rate a little below the mean success rate of 45%. The relatively poor performance of this method caught us off-guard and we decided to dive into the details. After researching this model closely, we believe this model has a significant fault: we found no instances where the criteria generally recommended in selecting the country caused any outsourcing engagement to fail. As an example, IP Law is commonly used in selecting the country, yet we find no instances where lacking IP Law caused an outsourcing engagement to fail. As a result, using such criteria as the top item in selecting an offshore vendor seems misguided.

   Of special note: We did find instances where selecting the country(ies) first were a sound option due to significant cultural, language or legal issues. We encourage you to use your common sense.

2. **Friend Recommendation**
   Either formally or informal, we found a relatively large percentage of customers buying upon the advice of their friends. In this model, a buyer will poll their counterpart in other business groups (or other companies) and will use the information gathered to select the vendor. If the buyer merely hires the vendor with the best recommendation, success rates are low (below 35%). However, if the buyer uses a strong recommendation from peers as the entry criteria in an RFP process and thoroughly investigates each recommended vendor aggressively, the success rate jumps to 59%.

3. **Domain & Technical Filtering**
   There is a growing trend in the market where buyers will use specific industry domain and technical skills as the entry criteria for an RFP process. In this model, buyers will identify the combination of specific industry knowledge with their technical needs and will search (usually regardless of country) for all appropriate vendors. Of all the models listed above, we found this to be the best method for selecting a vendor, with companies using this model achieving an offshore success rate of 65%.

What do we recommend?

In selecting an offshore vendor, we recommend the following approach:

1. **Find all vendors with your industry expertise and technical skills**
   Fact is, for 90% of all readers of this document, there are offshore outsourcing vendors with sound experience with both your industry domain and your core technologies. Find these vendors, regardless of their country, and do not be persuaded by those firms claiming that a lack of industry expertise or technical skills not to be an issue.

2. **RFI – RFP process**
   Once you have a comprehensive list of all vendors with the appropriate industry and technical skills, issue an RFI stating your business problem and let the vendors respond with their potential solution. We recommend you do not include a "solution" in your RFI and that you use the process as an opportunity to see how each vendor would approach and solve the problem. Read each RFI response carefully and filter out those firms you do not believe to have taken the RFI seriously or fail to offer any insight into how they would approach your specific problem. Once you have filtered out the pretenders, issue an RFP asking for bids on a defined implementation.

3. **Research and Recommendations**
   Once have received the RFP proposals, conduct an aggressive research campaign for each vendor. Of special note:

   A. <u>Find customers</u>
      For each vendor, find their customers (independent of the contacts the vendor's sales team provides) and assess the following:
      - Vendor's ability to execute
      - Vendor's integrity
      - Vendor's level or professionalism
      - Vendor's ability to solve problems
      - How "customer centric" the vendor is

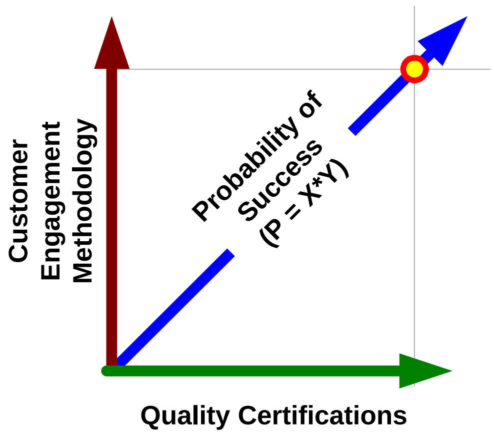
   B. <u>Site visits</u>
      For vendors you are seriously considering, conduct an offshore site visit, touring their major fulfillment locations. Make sure the facility matches the description given by the sales team and the employees appear to be enthusiastic.

   C. <u>Employee interviews</u>
      For many offshore outsourcing engagements, key resources will be identified during the RFI, RFP process(es). Take time to digest their resumes and, when conducting site visits, ask to interview these employees. Make sure:
      - The person(s) exist
      - Each are current employees of the vendor
      - The experience levels match the resumes
      - The academic and professional credentials are legitimate

Once you have completed your research, we recommend performing a limited pilot with the top two firms you have selected. This pilot should be 3-6 months in length and, while not opening your firm up to risk, should be significant enough to push both your firm and the vendor. At the conclusion of the pilot, choose the best performing vendor for your long-term projects.

The Value of Certifications

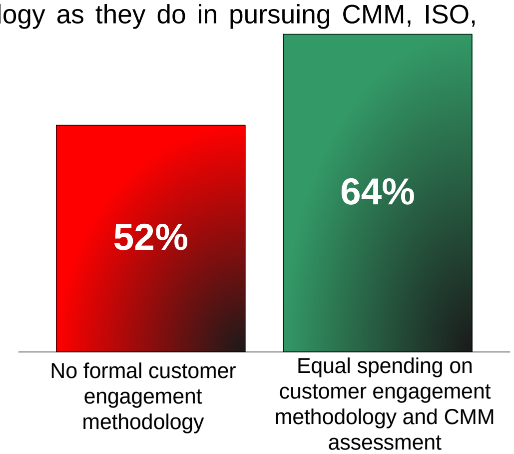
When reviewing the Offshore Outsourcing Vendor market, you will notice almost all vendors display an incredible list of certifications. We found there is significant value in these certifications and encourage you to find a vendor with the top certifications.



Further, we recommend you support your selected vendor in pursuing and maintaining such certifications. We believe this effort will pay dividends over time.

However, these certifications are not the answer to all problems. These certifications typically do nothing to directly facilitate the working relationship between you and the vendor but help the vendor improve their internal operations. When selecting a vendor, take time to find a company that has heavily invested in developing a formal customer engagement methodology in addition to chasing certifications.

In our research, we found when vendors invest as much money in developing a comprehensive customer engagement methodology as they do in pursuing CMM, ISO, etc., the probability of success for each engagement substantially improves. To highlight our findings, we compared a sampling of SEI CMM Level 5 assessed firms, without a formal customer engagement methodology, to those firms SEI CMM Level 5 firms claiming to invest as heavily in their customer engagement methodology as they do with their CMM type assessment.



Managing the Vendor

Many companies make the one or two critical mistakes after selecting an Offshore Outsourcing Vendor:

1. **Over-Management or Adversarial Role**
   Many buyers instantly turn into militants after retaining an offshore vendor demanding all actions taken by the offshore vendor be reviewed and governed by the buyer. In some cases, we have seen this go so far as the buyer demanding to see daily productivity reports outlining the specific tasks each member of the offshore team completed. When companies make this mistake, the relationship between the buyer and vendor will never mature to a team state and the engagement will not succeed. If you are the buyer, give your vendor some space and offer some trust.

2. **No Management**
   On the opposite end of the spectrum, buyers make the mistake of assuming that once the vendor has been selected, there is no need for vendor management. When buyers make this mistake, life seems easy until the first deliverable where significant miscommunications, misunderstandings or even errant shortcuts are instantly revealed. As with above, buyers making the mistake of not actively managing the vendor relationship will never completely develop a team and the offshore strategy is not likely to be a success.

Once you have retained an offshore vendor, we advice the following rules:

1. **Don't Micromanage**
   Give your vendor the ability to operate the team as they see fit and only require the vendor to comply with those rules you deem to be of a critical nature. For example, if you are outsourcing software development, the time the developers must be at their desk is not likely to be important. As a result, do not mandate your vendor enforce an absolute 8:00 – 5:00 workday.

2. **Be Explicit**
   Be incredibly thorough and explicit in your communications with the offshore vendor. Do not assume you will get what you want if you have not clearly articulated the details.

Question: What is the best advice you can offer companies when working with an offshore vendor?

Answer: “Start with small project and don't expect a fast cost downsizing at beginning. Get the quality assured and get familiar with the offshore vendor first.”

Gordon Zhou
Manager of Consulting Services
Forlink Software Corporation
www.forlink.com

3. **Be Consistent**
   We find buyers make two fundamental mistakes:
   - They hold their onshore and offshore teams to completely difference standards; and
   - They do not enforce the boundaries defined with the offshore vendor consistently.

   When this occurs, you loose credibility with the vendor and start heading down a slippery slope.

4. **Lead by Example**
   Related to above … lead by example. If you set a high performance standard for both onshore and offshore teams, set the same standard for yourself and live by it. If you demand attendance in meetings yet fail to make meetings yourself, your offshore team will follow suit.

5. **Offer Trust**
   Give your vendor a little credit and, as the relationship grows, offer increased trust. Many buyers have a constant and consuming distrust of their offshore vendors that is preventing them from ever seeing an offshore win. To realize the most out of your offshore strategy, you must establish a true "team" relationship with your offshore vendor.

6. **Encourage Optimization**
   Simply through the nature of business, your vendor will attempt to squeeze the greatest possible margin out of your engagement. How you channel that initiative can determine whether you will achieve a greater performing offshore team or you will not receive what you anticipated from the vendor. We recommend establishing a means for the offshore vendor to present ways to improve the operations of your offshore engagement. Reward the vendor for presenting ideas and let the vendor share in financial gain.

7. **Define Clear Roles, Responsibilities, Working Relationship(s) and Expectations**
   Prior to starting your offshore engagement (and prior to signing contracts), clearly state roles, responsibilities, expectations, and a clear guide as to how you and the vendor will conduct business together. This sound strategy will pay great dividends long term and, if done correctly, will eliminate many of the headaches companies experience when working with an offshore vendor.

8. **Conduct "State of the Union" Interviews**
   On a quarterly basis, meet with the Vendor's senior executive team to review progress and future plans. Clearly identify concerns and issues that must be addressed and craft a plan with the Vendor to resolve any issues.

9. **Audit and Monitor**
   You must implement some form of control regarding the performance metrics you have defined. At a minimum, create a team consisting of both vendor and buyer employees chartered with measuring the performance of the engagement. If your contracts contain any form of risk/reward payment models based on performance, we strongly recommend you retain a neutral third party to monitor and audit the performance of the offshore engagement.

Payment Models

We found *how* you structure payment impacts the success rate of the outsourcing engagement. Those firms retaining a vendor on a pure time and materials basis will experience the highest failure and fraud rates, while those firms implementing aggressive risk-reward models have a higher probability of success..

From our research, we recommend the following:

1. **For business function outsourcing (non-project driven)**
   If you are outsourcing call centers, data entry or other service(s) where you are trying to gain an advantage over a defined period of time, implement a risk-reward payment model including the following components:
   - Employee retention, training and education
   - Performance
   - Process optimization

2. **For application development or other project driven outsourcing**
   If you are outsourcing the development of a product or project with a defined start, end and objectives, we encourage our customers to implement a risk-reward payment model on the following:
   - Milestones
   - Performance
   - Features
   - Process optimization

The Fixed Fee Bid Twist

The new standard in the industry is to offer fixed fee project bids. We believe such a payment model is a great opportunity for the vendor to cover rising offshore costs while containing your financial risk. We encourage you to consider fixed fee bids for your projects. That stated, we do need to offer a firm word of caution: If your organization is not mature enough to develop clear and detailed documentation on the exact item you want, you should not enter into fixed fee contracts with your offshore vendor. Unless every aspect of what you want is spelled out in mind-numbing detail, you must assume you will not get it. If you are not able to break projects down to this level, you are not likely to win in a fixed fee project model.

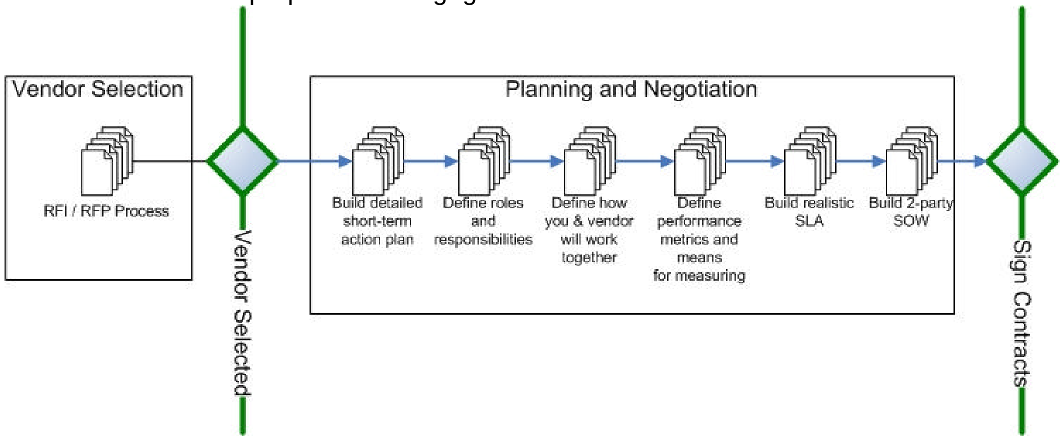
Question: What is the greatest mistake Customers make when engaging an offshore outsourcing vendor?

Answer: “The same [mistake they make] when engaging an onshore company: lack of requirements, lack of understanding that software is a complex area with multiple mistake possibilities, lack of validation, lack of understanding for structuring tasks like requirement validation, formal software validation plans, need for communication processes ...”

Walter Wartenweiler
Keats Software Ltd.
www.keats-software.com

Vendor Engagement Model

Select a vendor that proposes an engagement model similar to:



Be careful and look for the following:

1. Vendor wants to drive clarity in plans, roles, responsibilities, expectations, performance metrics and standards prior to signing contracts. If the vendor wants to steamroll through the planning process, forsaking details in order to get you to sign the contract, it is an indication the vendor does not have your best interest(s) in mind and you should not continue with the vendor.

2. The best vendors will have a carefully crafted methodology taking you through this process in the most efficient and pain-free manner possible. The best vendors in the world will distinguish themselves during this phase by helping you understand the intricacies of the outsourcing process and will carefully walk you through the entire decision process.

"It is important that the customer and vendor work together when starting a new relationship to build a tailored engagement model. Every customer has different strengths, weaknesses and maturity level. We found that when we work with each customer to personalize how we work together, the engagements work better and customers are happy. The best vendors have a formal mechanism for tailoring each engagement and customers should search for a vendor that believes this is [an] important step."

-Dmitry Loschinin
CEO
Luxoft
www.luxoft.com

The Role of the Onshore Vendor

Over the past few years, we have seen many onshore service vendors establish relationships with offshore outsourcing vendors with the intent of providing you the service of an offshore firm with the cost benefits of the offshore outsourcing model. We believe this model to have some (but diminishing) merit.

Offshore Outsourcing Vendors have invested heavily in developing robust onshore service teams. The best offshore vendors now have the ability to provide you an onshore interface that rivals the best of the existing onshore services firms. We are finding when you introduce an additional party into the relationship, the increase in overhead hassles is simply not worth the potential gain in user experience.

What to look for

Although the above may indicate little value for interfacing with an onshore vendor for your offshore services, we find the model to still be of some value. Our research indicates when the onshore vendor and offshore outsourcing vendor have built an effective team, the probability of client project success improves.

If you are considering retaining an onshore vendor to handle your offshore services, we recommend you look for the following:

1. Make sure the experience is seamless and the onshore vendor is not merely a sales agent for the offshore firm. If the onshore vendor does not serve as your primary interface for each project, the onshore vendor is not providing you any value.

2. Look for an onshore vendor that brings more to the table than just the onshore interface. Many onshore firms have collected a significant amount of industry IP and have significant value.

3. Look for an established relationship between the onshore and offshore vendors. If the two have not been actively working together for some time, look elsewhere. We know of many cases where the onshore and offshore vendors have not actively worked together before and the client ultimately pays for the two service providers to iron out their differences.

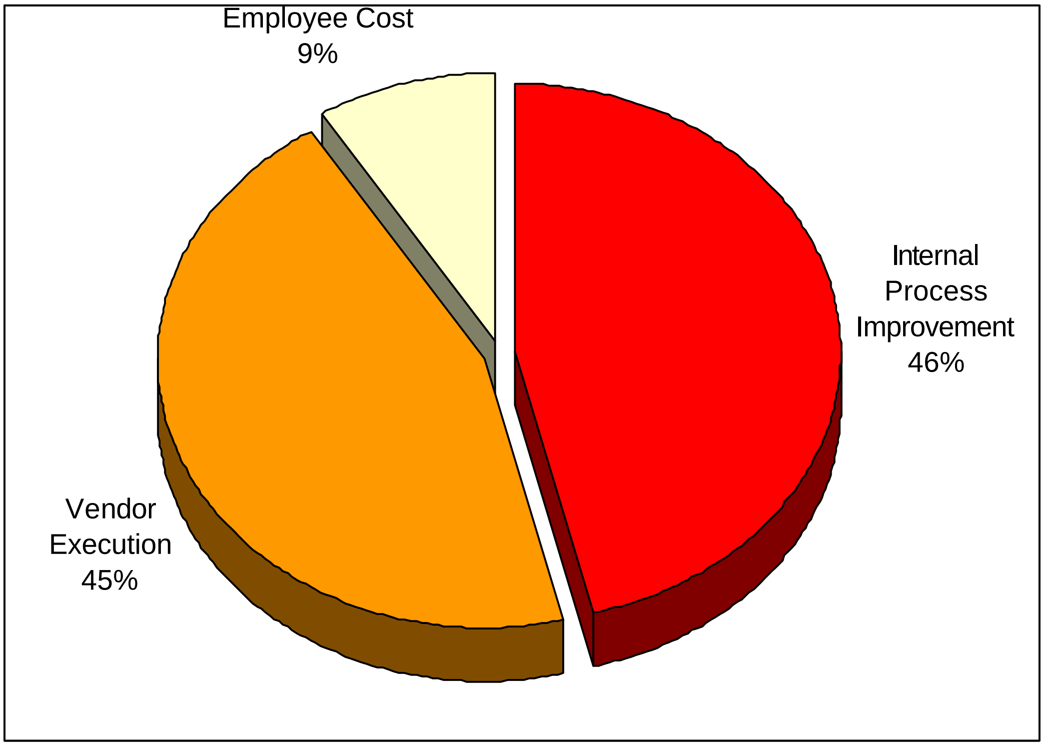
Warning to onshore service firms

We have seen a common cycle in the market where onshore vendors, feeling the heat from the offshore outsourcing trend, rush to establish a relationship with a major offshore outsourcing vendor. The offshore outsourcing vendor accepts the onshore firm with open arms and uses the onshore firm to market offshore services to all existing clients of the onshore firm. After the offshore vendor has penetrated all the accounts of the onshore firm, the offshore outsourcing vendor finds another onshore firm with which to partner.

If you are establishing a relationship with an offshore outsourcing vendor, make sure the relationship is a *true* partnership where both parties work together to chase business outside your existing client base.

Business Transformation

Our research indicates you will achieve your greatest offshore outsourcing cost savings through improving processes (not hiring low cost employees).



Regardless if you are retaining an offshore outsourcing vendor to specifically assist with some form of transformation or not, we encourage you to embrace the offshore outsourcing process as an opportunity to make improvements. If you work with the vendor to better understand how you can improve your project delivery, you will realize a better end result.

Stubborn Client Syndrome

We often find onshore clients that aggressively muscle their selected offshore vendor and refuse to consider the offshore vendor may have some value beyond simply providing employees. Further, the onshore client will often refuse to listen to common sense suggestions from the vendor that would make the specific engagement better. If you are working with an offshore vendor, encourage your vendor to offer suggestions as to how to improve the specific engagement and your operations as a whole. You will find by doing so, you will make dramatic improvement in the performance of your offshore strategy.

"The biggest mistake companies make when they move offshore is that they tend to think of cost benefit more than process implementation. They overlook the process and concentrate on 'How to get more out of less, 'as a result quality goes for toss. I think [buyer executives] need to understand that offshoring is not the key to success; it's just a way to keep your overhead expenditure down. The key to success will always be process through which one delivers quality."

-Deepak Dwivedi, CEO
U&D Square
www.udsquare.com

Fox In the Hen House

When you select a vendor, you must take into consideration the ethics of the vendor. We came across many instances where the client had little trust (for good reason) of the offshore vendor but continued to work with them. We believe this to be a grave mistake. Make sure if you open your organization up to suggestions from the offshore vendor, the advice you receive is geared toward your success and not the vendor's future sales. If you find you are working with a vendor of questionable ethics, fire them. The cost is simply too high to work with such firms.

Advice for Offshore Outsourcing Vendors

The Offshore Outsourcing Vendor market is booming and you are now facing competition from almost 10,000 vendors in over 175 countries. You can no-longer sit back and expect customers to come to you.

To be competitive in the next 10 years, you must:

1. **Build an organization centered on character and integrity**
   U.S. firms hold dear an ideal business relationship that can best be described as "Norman Rockwellesque". U.S. companies want a vendor that interacts with them honestly and with intent to build a better future together. A major complaint when working with Offshore Outsourcing Vendors is the integrity and ethics U.S. firms demand does not exist in many foreign businesses. Although this may not have impacted offshore outsourcing business significantly yet, it will soon. Do not be one of the firms suffering from a character or integrity issue in the next few years. You will not be a long-term success.

2. **Demonstrate tangible results on each engagements**
   Offshore outsourcing has a significant problem proving results. There is an incredible, ongoing public opinion debate in both the U.S. and Europe centered on the fact most firms moving offshore do not realize a material gain. We are already seeing offshore vendors establishing mechanisms to prove results on each engagement and anticipate this trend will continue into the foreseeable future. If you want to be a success, make sure you demonstrate value for each customer with tangible results.

3. **Sell your superior value**
   U.S. firms are no longer seeking the lowest cost vendor. They are seeking the offshore outsourcing vendor most likely to achieve a specific goal. Using software development outsourcing as an example, U.S. and European companies are now seeking vendors that will take them through requirements to final implementation with the greatest success. Vendors growing in today's market are those firms that:
   - Demonstrate real industry niche expertise
   - Demonstrate sound technical and delivery capabilities
   - Strongly encourage customers to sign contracts rewarding the vendor for achieving results

   Vendors that fail to step up their value proposition will not achieve success in the years to come.

Advice for Onshore Service Firms

The current outsourcing market bodes extremely well for onshore service providers. Long gone are the tedious hourly rate debates with U.S. and European companies now hunting for results. This transition has opened the door for many onshore firms and we are starting to see U.S. and European Service Providers winning significant contracts by demonstrating their ability to achieve a better final result when compared to offshore options.

If you are an onshore service provider, we recommend:

1. **Carve out a niche**
   It is nearly impossible to be everything to everyone in today's market. Throw out the idea you can do anything and focus on those potential niche areas where you have a real story and proven expertise.

2. **Invest in technologies and tools**
   If you will rely on your employee efforts alone, you will have an incredibly difficult time competing. You must find technologies or tools that will allow you to shift your delivery paradigm allowing you to compete. Onshore service companies that are winning deals today are now hybrid application service providers / consulting firms using proprietary tools or other technologies to gain a significant competitive edge.

3. **Sell your total value**
   When competing in the global market, stay far away from discussing your cost model and your hourly rates. Highlight your ability to achieve a final objective better than any other firm in the world. Further, break down this total value into tangible examples your prospects can easily see and understand. If you can get them to see that “a reduction of the total product cost” is more important than “hourly rate for a C# developer” and can prove you generate the best end results, you have a real shot at the deal.

Countries

“What country?” is a question we are often asked. To separate myth from fact, we targeted the real country issues to help you make the best choice. A summary of our findings can be summarized in two statements:

1. The Geo-Political element of the “what country?” question has less of an impact than most Executives anticipate

2. The cultural element of the “what country?” question has a significantly greater impact than most Executives anticipate.

Statistics

We will give credit to India for defining Offshore Outsourcing over the past decade. Under the aggressive leadership of several Indian companies, the world has adopted a global fulfillment model for many traditionally "white collar" functions and proved the model can work.

Eyeing the success of the Indian offshore market, thousands of firms have come to the realization they, too, can compete in the global economy regardless of their location.

Today, we believe the following:

1. There are more than 10,000 vendors offering some form of outsourcing.

2. There are offshore outsourcing vendors in over 175 countries.

3. We aware of more than 500 government agencies, trade groups or NGOs actively campaigning to grab a larger share of the global outsourcing market.

The net impact of this booming global growth is as follows:

1. Buyers of outsourcing services will have many more options from which to choose.

2. The quality of service delivered by outsourcing firms should improve greatly over the next decade.

3. Onshore fulfillment or outsourcing firms will have to greatly improve their value proposition in order to stay in business. The common crutches onshore service firms use now to generate business are likely to cease.

Common Sense Approach

In this report, we will assume a certain degree of common sense and will not use those companies that disregard practicality in regards to choosing a country.

There are many instances when the "country decision" heavily suggests a certain country (or group of countries) and the Executive chartered with implementing the offshore strategy looks past the obvious. As an example:

> Company "X" runs an inside sales team selling home financing products and services to a largely Spanish speaking population. Prior to moving offshore, the call center was run by a vendor in southern California and costs were relatively high. Company "X" challenged their new Director of Operations to find a way to reduce the cost per call and the suggestion to move offshore was instantly made.
>
> In a previous company, this new Director of Operations hired an Indian vendor to run an inside sales call center and achieved a certain degree of success. With the charter of implementing the same type solution for Company "X", this Director of Operations promptly retained the same Indian firm to build a call center in Mumbai without considering options in Mexico, Chile or other native Spanish speaking locations.
>
> After three months of searching, the Indian firm could not find enough Spanish-speaking employees to staff the center as planned. Both the Vendor and Company "X" finally came to their senses canceling the contract.

Geo-Political Country Impact

We are aware of several major reports arguing the importance of such items as:

- Market Stability
- IP Law
- Civil Law
- Education
- Government Sponsorship

We found the impact of such items to be mixed and must segregate “Offshoring” from “Offshore Outsourcing” to better understand the impact you can expect.

1. **Offshore Outsourcing**
   In our research, we failed to find a single instance where geo-political issues had any direct impact on the overall success of an offshore outsourcing engagement. Offshore Outsourcing engagements succeed when customers:
   - Prepare adequately
   - Hire a great vendor
   - Take steps to work effectively with the vendor

   Statistically, Offshore Outsourcing engagements do not fail due to geo-political country issues.

   If you are considering an offshore outsourcing strategy, we strongly recommend you push aside the “country” question (assuming you do not forsake common sense) and focus on finding the vendor most likely to help solve your problem.

2. **Offshoring**
   Such geo-political country issues do have a more direct and profound impact on those firms building their own offshore facility. Variations in market exchange rates, tax incentives, IP ownership, etc., all can have a sizable impact on your plans and you must carefully review the pros and cons of each country you are considering prior to making the offshore leap. To better understand the risk associated with each location, we highly recommend you work with a reputable consulting firm specializing in this niche.

Financial Risk in Offshoring

David Faller

The rewards from an effective off-shoring strategy can be substantial. The key is in the planning, and one area that is often overlooked by companies is financial risk. Any company trading overseas is exposed to certain risks that do not exist domestically and off-shoring is no exception. All companies face both transaction risk and translation risk.

Take, for example, a US company looking to set up a software production subsidiary in India. The cost savings are well documented but the company also becomes exposed to changes in production costs, and asset and liability values as the exchange rate between the US Dollar and Indian Rupee fluctuates. Given the more than 15% exchange rate volatility experienced over the past year, these risks need to be considered.

Looking at the production cost side first, as the Indian Rupee appreciates in value versus the US Dollar, salary and other operating costs in India will increase, in US dollar terms. As most companies have the US Dollar as their accounting base currency, these are real cost increases that will impact unfavorably on the income statement. This is described as transaction risk. To mitigate this risk, companies should look to initiate a foreign exchange hedging policy to “lock-in” an exchange rate for these costs, minimizing potential unwelcome surprises from currency fluctuations.

Asset and liability values in the balance sheet are also impacted by exchange rate volatility. This is called translation risk. If our fictional company builds a facility in India, this asset’s balance sheet value will be impacted by any change in the Indian Rupee exchange rate. While this risk can be somewhat offset through local currency financing, aspects such as higher interest costs, differences in loan term structures, etc need to be evaluated and understood.

While these risks can be identified and managed, CFO’s in many companies do not have either the time or direct experience necessary to deal with these issues. Additionally, NYSE or NASDAQ listed corporations need to ensure that any policy adopted will be effective in terms of risk management and regulatory compliance. The impact of accounting standards like FAS 133 means that any hedging policy must meet pre-test and post–test criteria. As a result, more and more companies are looking to utilize financial risk consultancy companies to provide this expertise

About the Author

David Faller is a principle in RSD Solutions LLC (www.rsdsolutions.com), a financial consulting company, with offices in Europe and North America, specializing in unraveling the mysteries of corporate financial risk management. This is achieved through risk auditing, transaction advice and coaching senior executives and boards of directors on the financial and regulatory impact of hedging structures on corporate income statements and balance sheets. He is also an adjunct professor of International Finance at a number of universities and graduate schools in the Chicago area. He can be reached by email at dfaller@rsdsolutions.com

Cultural Impact

In our research, we found a difference in culture does (and will) have a material impact to the overall performance of your offshore strategy. You must anticipate this cultural difference, and the success of your offshore strategy, will depend on how well you manage the differences.

For more information on the Cultural Impact on your offshore outsourcing strategy, please see **The Human Element** of this “Preliminary Findings and Conclusions” Report.

Offshoring

We define “Offshoring” as the process of moving an existing business function from a team of onshore employees to a team of employees in the same company in a foreign country.

The statistics for this approach are not good:

1. Less than 28% of Offshoring engagements will generate a material ROI by the three year check point;

2. Firms building their own offshore team are likely to spend 50% more to achieve some form of offshore success when compared to those companies utilizing an offshore vendor.

As a result, we typically encourage firms to investigate an outsourcing model first (See **Buy Vs. Build** featured earlier in this report.) If you determine you must build your own offshore facility, we recommend the following:

1. **Use a consultant or offshore vendor**
   The process of getting appropriate licenses, finding a facility and retaining a team in a foreign country is not an easy task. Our experience has shown if you retain a consulting firm specializing in walking you through the process, you can save millions of dollars.

2. **Consider either a BOT or M&A strategy**
   Statistically, the fastest and most effective means for building an offshore strategy will be through either a Build Operate Transfer (BOT) or M&A. Although it may appear as if you are paying a premium for such models, our experience has been you will save a significant amount over the long run.

3. **Establish clear leadership**
   U.S. and European firms traditionally function on a relatively loose organizational or leadership structure. When a task must be completed, we pull resources from many locations and combine these resources to get the job done. Often, team members will be taking orders from peers or even subordinates on any given project.

   In many offshore outsourcing hotspots, this simply does not happen. When building an offshore team, make sure you clearly define the leadership for your organization and take time to posture your onshore team in the correct position.

4. **Define clear roles for your onshore and offshore team**
   Similar to above, U.S. and European business culture encourages employees to stand up and take additional responsibility or offer innovation. Many cultures view this

as a weakness of the employee. To mitigate this problem, do not simply create blanket jobs; instead, take time to clearly define the specific role for each member of your global team. Finally, take time to explain the role of each employee to the greater team.

5. **Treat all employees equally**
   We have seen instances where the implementing Executive 'babies' either the offshore team to get the best employees or offers a great deal of slack to the onshore team during the unsettling process of moving offshore. It is extremely important to set a common performance standard for both groups and treat them equally. If you do not treat both parties equally, you will create a rift in the global team.

6. **Develop career growth plans for all employees**
   Both your onshore and offshore employees need to have a personal career planning session with you.

7. **Build a cohesive team**
   In our research, we found a clear trend:
   - Employees of companies with effective Offshoring strategies use the term "we" to describe their team
   - Employees in dysfunctional Offshoring strategies use terms like "us" and "them."

   Although this may be somewhat anecdotal, there is some value in paying attention to this statistic. We have found companies with a successful offshore strategy have a solid global team. If you find your onshore and offshore team at odds with each other, you will not succeed.

"We set up agreed upon meeting hours that overlap for both geographies. We rotate the AM / PM start time every two months to share the pain / inconvenience. For example, we agreed that any joint meetings or 1:1s between the two sites should happen between 9 - 11 PM PST (9:30 - 11:30 AM Bangalore time). After two months, we switch to 9 - 11 AM PST. Other things that have worked well is making sure both teams have been trained in U.S. and India cultural awareness so we are both sensitive to cultural issues, how messages are delivered, received and interpreted. Crisp guidelines on how to run an effective meeting (meeting scheduled 24+ hours in advance, agenda, time management etc). Establish detailed and thorough design and SW development processes. We've been working towards CMM Level 3 certification. That has really forced us to focus on being very specific with our process and therefore our communication. CMM has been a great team integration tool as well as we've people from so many disparate backgrounds on the same team and lots of people new to the company."

-U.S. Executive

The Human Element

Offshore strategies are extremely difficult on all people involved and most Executives chartered with implementing or managing an offshore strategy greatly under estimate how much of an impact the “human element” will have on their overall success.

The Value of People

Many Executives vastly underestimate the value of the top employees in their onshore and offshore groups. At the end of the day, **people** will get the job done - not processes, tools or other factors. Unfortunately, the top seasoned pros you need for your offshore initiative are hard to find in countries like India. With the incredible growth in the services industry in India, there simply are not enough employees with solid experience to fill the outstanding need. Many U.S. Executives are making the mistake of substituting processes for people and we found this to be a near catastrophic mistake. Please consider the following groups:

a. Find the best people and then build the team
This group consists of those Executives that went out of their way to find the best resources in the selected offshore market and the build processes to facilitate the team in accomplishing their job.

b. Build the processes and then add people
This group consists of those Executives that first defined comprehensive processes for operating their offshore facility with the belief that once defined, you can put almost any resource in an open position. (This approach is often referenced when discussing the blistering turnover rates in several offshore markets).

In our research, we found that Group 1 above has a probability of offshore success 59% of the time while Group 2 has a probability of only 18%.

The Value of the "Team"

We are often given sporting analogies when Executives refute this statistic. Most often, we are told you need to build the system first and then build out a team willing to work within the system. We are not trying to persuade Executives to forsake any form of process nor are we trying to devalue the importance of working as a team. What we are trying to convey is the need to begin with those clutch players with the requisite experience. Once you have the best resources available, build to their strengths.

Get the Most from the Best

1. Take time to find the best employees in the market and do not settle for poor caliber resources. Many of the processes businesses move offshore require a great deal of experience and comprehension to make successful. If you do not have those people with sound experience leading companies similar to yours through the difficult times, you will not be a success.

2. If you can't get the necessary seasoned employees in the offshore market, don't move offshore. You won't see a return.

3. Once you have found the best resources, invest in them. Spend extra to give both your onshore and offshore employees the management and business skills necessary for them to be a success.

Impact to Onshore Team

For those firms intending to replace onshore resources with offshore team members, there is an obvious and significant impact on the onshore team members most Executives anticipate. What Executives fail to recognize is that the offshore strategy will have a material impact to your onshore team even if you do not plan on replacing resources.

Onshore team retooling

Many firms moving specific job functions offshore want to retain their onshore employees and opt to help these soon-to-be offset employees re-train for other positions. We find the results of this model to be mixed and we must define two categories for analysis:

1. **Unskilled Resources**
   These resources are those call center, customer support, or other employees who have not developed a significant job-specific skill. We found when firms move a specific function or team offshore consisting of such resources, these employees can be easily retooled for other like functions without difficulty. As an example, if you are moving your customer support call center offshore, you can relatively easily retrain your onshore customer support team to assist with such functions as inside sales, help desk or other.

   If you are considering a job-retraining program to retain your unskilled resources as a result of your offshore plans, we believe you are likely to be successful long term with the plan and applaud your efforts.

2. **Skilled Resources**
   We are seeing a significant number of companies moving specific skills offshore with the intent to retrain those displaced employees to handle other functions. The most common example of this being the movement of software development offshore with the intent to retrain the onshore developers to handle job functions such as architect, project management or analysts. This approach is simply not practical. We found such positions often require different personalities and simply offering a retraining program will not ensure your ace developer will be a sound project manager. Our research supports our practical experience and we found you will experience up to an 80% turnover with such employees. This should be interpreted that if you want to retool your skilled resources allowing you to keep them, you are most likely to loose them anyway. If you indeed want to keep them in your firm, you should look at other options allowing some degree of parallel effort.

"This was something we under estimated. Our onshore team is excellent. They are a senior team with roles and processes defined, and had been working together for several years. Going offshore was hard on them though, particularly around work-life effectiveness. We had to figure out how to communicate with a team 12.5 hours away. We now ask the team to work evenings part of the time. We rotate between 9-12 AM and 9-12 PM and take time off during the day when we work evenings. This allows the onshore and offshore teams to communicate frequently, and lets employees still have a life.

The other issues we encountered are things you go through with any new team. We dealt with communication issues, process issues, and personality issues. Just about all of our interactions are over the phone, so things are that much more difficult. You can't see the smile on someone's face to know she is joking. You only hear the voice through the speaker phone."

-U.S. Executive

Add certainty and assurance

The process of defining an implementing an offshore strategy is an incredibly threatening proposition to your onshore team and, although you may have clearly articulated there is cause for fear, your team will continue to be extremely edgy for some time to come. In our research, we found this uncertainty among your onshore team does have a material impact to the overall success of your offshore strategy and you should take aggressive steps to ease their concerns. Of primary note:

1. **Clearly define 1 and 3 year plans**
   Throughout the entire offshore implementation process (and for some time after offshore launch) meet frequently with your onshore team and present your 1-year and 3 year plan. Take time to explain the specific objectives your team must accomplish, how each person in the onshore team will fit into this long-term plan, and what you expect from each team member in accomplishing each goal.

2. **Define career growth path**
   Meet with employees individually prior to moving offshore and establish a clear plan for them to succeed. As soon as you announce plans for the move offshore, begin scheduling these meetings.

3. **Let them know they are important**
   On a regular basis, let team members know how important they are to both your organizational goals and the success of the offshore strategy.

4. **No BS**
   Most important: Don’t swag your way through the offshore strategy. Your onshore team most likely knows the business well; if you …

   - Move offshore without a clear business case
   - Misrepresent the business case
   - Misrepresent the onshore employees’ role in moving offshore

   … your onshore team is likely to know. Even if you plan on reducing headcount, you need the support of the remaining team to accomplish your offshore goals and you must not burn your credibility.

> “Be very clear on why actions are being taken, on the strategies behind them and on the objectives to be achieved. Be clear about which business functions will never be outsourced (and why), so that at least in these sections of the business there is no insecurity - security and high moral are just as much matters of sentiment as low moral and insecurity, and can be influenced by clear and appropriate action. The biggest contributors to low morale are lack of knowledge, uncertainty and negative speculation. Clear (and honest) communication with workers, plus a clear presentation of intended recompense for those who will lose their jobs, can be very productive.”
>
> Adam Dupre
> CEO
> China Company Research Services Ltd
> www.ccrs.info

Give them the necessary skills

Moving offshore is a major operational paradigm change. Project management style, issues, challenges and pace will all change for your onshore team. Companies that understand the magnitude of this change seek specialized training programs for their employees.

Companies underestimating the impact the offshore strategy, will do nothing to prepare their core onshore team. Most often, these firms fail to achieve any material offshore ROI.

We strongly encourage you to spend the extra money helping your onshore team better understand how to be effective in this new fulfillment model. The dividends from this small investment will pay greatly.

Offshore strategy still tough

No way around it, your onshore team will participate in off-hour meetings, will interact with new cultures and will be forced to work in a completely new style. Regardless of how aggressively you prepare your onshore team, you can expect that 1 in 10 will not be able to adopt the new work style and will probably leave the team. While the suggestions above can help minimize the turnover rate, you must still prepare to mitigate the problem.

1. Prior to moving offshore (and announcing to the team), take the time to outline the specific function and deliverables you need from each of your onshore team members. Make sure you have an alternative plan for each item you identify as being critical.

2. Accept the fact you will need to closely monitor the morale of each onshore team member for the next several years. If you notice significant morale problems, queue up your backup plan.

Impact to Offshore Team

No matter how aggressively an offshore outsourcing vendor will argue that staff turnover will not impact you, it does. Each time you loose an employee (or your vendor looses an employee working on your projects) there is significant cost associated with the loss. With turnover rates clearing 35% per annum in India and other offshore outsourcing hotspots, the turnover issue is a major hurdle that must be addressed.

Don't unload your garbage

When determining what to move offshore, don't send those functions or projects that no one wants to do. If your onshore team hates doing the work, your offshore team will hate it to. In this strange economy, there are studies indicating moving such items offshore will cost you significantly more when compared to keeping such items onshore.

Global fulfillment *IS* hard on your offshore team

Your offshore team members also have lives outside work. They want to spend time with their friends, family, and engaging in their various hobbies. Executives launching offshore strategies often over-compensate by forcing the offshore team to constantly sacrifice their personal lives for the convenience of the onshore team. When implementing and managing an offshore strategy, find a common middle ground where both parties share the burden.

A special note to those Executives managing an offshore outsourcing strategy: If the vendor claims this is not necessary, do not hire the vendor. Your vendor's employees are also human and you need to have some sense of reasonability when working with the vendor's team. Even if the vendor has penciled in contingencies for staff turnover, you must assume the plan outlined by the vendor will not adequately compensate you for the loss.

"Be considerate. We are also humans and can also err at times. Do not hope for too much too fast. Be deliberate and stable. Start with smaller projects gradually moving to bigger jobs. Gain the trust, be open and never lose your cool."

-Narendra Narayanwal
Group Technologies & Exports
www.gte.firm.in

Offshore employee growth

Offshore employees also have career growth plans and you must take this into consideration when planning your offshore strategy. If you assume your offshore team will want to stay in the same position without growth for any significant amount of time, you will:

1. Not get the best employees to begin with.

2. See a significant turnover with those you do hire.

If you are engaging an offshore outsourcing vendor, encourage your offshore vendor to propose growth plans for the employees working on your projects. When these offshore vendor employees do progress their careers, be open to move them up the management structure and be willing to pay more for them.

"…people most likely refuse a boring work with no way to improve their career. Interesting projects and growth plans usually work well to reduce staff turnover."

Alexander Turkevych
CEO – Owner
Outsourcing Ukraine
www.outsourcing-ukraine.com

Keep Things Exciting

Executives implementing an offshore strategy often make the mistake of earmarking offshore employees for one project or job function indefinitely. When Executives make this mistake, we find a higher turnover rate and often find the offshore team can't retain qualified employees. We strongly encourage a model where your offshore team cycles through new projects, teams, technologies or job functions on a regular basis. As an example:

1. Hire an employee directly from school as a "Developer" for project "x" (a VB project). During the employee's tenure as Developer, have the employee take several courses furthering their skills.

2. At the end of a two year period of time, move the employee to Project "Y" (a C# project) where they will be the Senior Developer. During the two-year stay, have the employee take additional training courses and prepare for an additional move.

3. After two years as the Senior Developer for Project "Y", move the employee to "Lead Developer" on Project "X" (a Java project).

With each move, you will find the employee will struggle at the beginning of the new cycle but will excel in the end. Although there will be a little loss of IP with each shift, you can mitigate the issue and the increase in productivity you will see from a happy offshore team will pay greater dividends. You will also find implementing such a model will help you in attracting the best offshore resources.

Educate

Although outsourcing or moving various industries to another location to achieve some advantage was proposed by Adam Smith almost 250 years ago, moving software development or other internal business functions offshore has been a relatively late phenomenon. As a result, there are many misconceptions that will challenge you along the way to offshore success.

In both our practical experience and through our research, we have found a sound education strategy to be one of the most powerful tools leading you to offshore success.

Stakeholders and Peers

No matter where you are in the organization, you rely upon a network of stakeholders and peers to get your job done. When moving any function offshore, you will be challenged by peers seeking to derail your plans due to both legitimate concerns and misperceptions. Unless you can mitigate this problem, your offshore strategy will not be a success.

To resolve the problem, we recommend the following:

1. Make sure you are moving offshore for a sound business reason and build a road show presentation. Early in the offshore implementation process, begin presenting your "why offshore" road show and make sure you listen carefully to what your peers have to say. If you build a sound business case, most of your peers will fall in line. If you fake the primary reason for moving offshore, you are likely to fail gaining the participation and necessary endorsement from your peers.

2. Prepare a realistic plan including a mechanism offering your peers participation in the offshore process. Make sure you define specific milestones and "Go- No Go" gates through the entire offshore implementation process. On a regular basis, report the progress, restate your business case and highlight both the highs and lows you have experienced. If you fail to constantly update you team, you will loose their support. If you fail to give an honest assessment on progress, you are living on borrowed time and are likely to fail.

Customers

A fundamental philosophy we hold dear is the need to make sure your business is customer centric. When considering whether you should or should not move offshore, build your business case and craft a specific message to your customers identifying how this move is geared toward improving your value to them. If the function you are moving offshore directly touches the customer, make sure this message is easily found by your customers and that you clearly state options the customer can take if they choose not to interact with your offshore team. If the function you are moving offshore is not customer facing, you are likely to receive general questions related to your offshore strategies and it is important to have a crafted message ready in the event a response is warranted.

Employees

Your onshore team is likely to be severely impacted by your offshore strategy regardless if you are reducing your onshore headcount or not. Prior to announcing to your employees you will pursue an offshore strategy, make sure you have a presentation outlining the following:

1. Specific business case for moving offshore;
2. Factors used when making the decision;
3. Timing;
4. General implementation plan; and
5. Long-term plans for your onshore team.

If the offshore strategy involves an onshore headcount reduction, make sure you have mitigated the risks associated with announcing this strategy well in advance. Although it may seem counter intuitive, our research indicates if you are targeting an onshore headcount reduction, it is best to be honest with your employees.

Once you begin implementation, simple education programs helping your remaining onshore team adopt the offshore model to be of significant value. Spend the extra money and have your onshore team complete a course that covers the following material:

1. Communicating with your offshore team;
2. Overcoming cultural barriers;
3. Balancing work and life in a global fulfillment model;
4. Managing projects with an offshore team; and
5. How to develop your career in a global fulfillment world.

You

You will find moving offshore will be one of the least politically correct moves you can make in today's market. From the outset, you will face a constant barrage of attacks from employees, the market, your peers, your customers and even your management. Most of these attacks will be rooted in preconceived opinions related to the loss of U.S. or European jobs and are not likely to contain more than emotion. (Do not, however, underestimate the power of these emotions!) Our recommendation for mitigating this problem is by becoming the offshore expert:

1. Read every book on the subject you can.
2. Travel in the country you have selected. Get to know the people, the culture and the business markets.
3. Attend conferences that offer valuable speakers (not just a parade of vendors).
4. Retain a mentor.

In short, treat this as a Masters Thesis and become the true offshore guru and anticipate and be prepared to answer any questions directed to you.

Continuing Education

Jerrilee Mosier, Ed.D

The skills and knowledge of your company's workforce are more important than ever before. Over the last decade, the landscape for business and industry has changed significantly. Global competition has increased the need for businesses to cut costs, while maintaining quality, and costs are increasingly difficult to contain due to workforce knowledge gaps that are the result of an aging workforce, enhanced regulations, and integration of new technologies and equipment.

Why should employers, large and small, care about training and development of the workforce. The actual benefits to improving the skill sets of employees come down to the bottom line. There is a return on your investment through

- improved employee productivity,
- a reduction in employee turnover, and
- decreased need for supervision.

These benefits result in a reduction in costs through increased efficiency resulting in financial gains and increased company profits.

Companies with an emphasis on employee training are developing a pool of readily available and adequate replacements for personnel who may leave or move up the organization. They are helping create sufficiently knowledgeable staff, which provides an enhanced ability to adopt and use advances in technology. They are ensuring adequate human resources for expansion into new programs. They are building a more efficient, effective and highly motivated employee base to enhance the company's position and improve employee morale.

There have long term structural changes for many business and industry sectors. These changes will continue. A skilled, flexible and motivated workforce is absolutely necessary for businesses to flourish in this dynamic environment. Every company should have a clearly defined strategy and set of objectives to drive its workforce training decisions, thus providing the foundation for the company's future direction and growth.

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Recruiting & Retention

Each country considered to be an offshore hotspot has their own unique collection of issues surrounding the recruiting and retention of employees. It is simply not practical for us to break down a recruiting and retention profile for each major offshore outsourcing country in this report. There are, however, a few items that must be highlighted and examined.

The Abundant Resource Myth

There is a perception in the U.S. and Europe that there are thousands of qualified employees available in offshore hotspot countries all willing to work for mere pennies. This simply is not the case. In most countries, if the person has the skills and can effectively communicate, they have multiple outstanding job offers. In offshore outsourcing hotspots, it truly is an “employee” market. To frame the current market, consider the difference between the U.S. and India:

- In the U.S., hundreds of individuals will compete for some positions and it is a reasonable honor to simply get an interview.

- In India, dozens of firms will compete simply to interview recent college graduates and it is a great honor to be one of the first companies college student selects to interview.

The point we are trying to highlight is that if you want to build a team of qualified employees in an offshore outsourcing market, you must get incredibly aggressive and be willing to pay a premium.

Although we hate to say it, in some markets, the premium that must be paid for the best employees is approaching the glory “dot-com” days with offshore employees getting car services, apartments and other significant perks.

US and European Multinational Companies

In many offshore outsourcing hotspot countries, the local resources do not necessarily want to work for U.S. and European multinational companies. In many cases, there is a belief that doing so will force the employee into taking a remedial job and there will not exist career growth opportunities. Although your firm may operate contrary to this perception, you still face this stigma and may need to over-compensate to get the best employees.

Deltas between U.S., European and Offshore Employee Motivators

Employee motivators differ *significantly* on a country-by-country basis. What may be an extremely attractive package to an employee in the U.S. or Europe will not attract the best and brightest in countries such as India, Russia and China.

To highlight this, please consider motivators for Indian employees. In India, employees:

1. Want substantial monthly cash flow
2. Title
3. Rapid career growth
4. Time in the U.S. or Europe

While discounting such items as:

1. Stock options
2. Health plans
3. Life insurance
4. 401(K)

Be prepared to research each country and develop a comprehensive package to entice the best resources.

Use a Staffing or Recruiting Firm

If you are building your own offshore team, we strongly encourage you to find (and use) a reputable agent in your selected country. We have seen many companies spend years and millions of dollars trying to gain the secrets to success when simply retaining local experts would have accomplished the same task in a matter of weeks.

Don't Lose Common Sense

Many firms get caught up in the process of retaining employees in a competitive market and do not perform basic due diligence or use common sense. If an employee has been fired from several firms in an offshore market, does not have the skills, can't work with a team, etc., you should not hire the person. A bad employee is still a bad employee and simply filling a seat will not add any value to your organization.

Retention

As discussed elsewhere in this report, employee turnover is a material risk to your offshore venture (regardless if you are directly managing the offshore team or using an offshore outsourcing vendor). Prior to moving offshore, we strongly recommend conducting the following exercise:

1. Define the true turnover cost to your organization;
2. Once you have defined the turnover cost, define a set tolerance level. If the turnover tolerance level is below 5%, do not move offshore; and
3. After defining the set tolerance level, calculate the reasonable cost you will incur to mitigate increasing turnover rates.

You MUST factor in the fact you will have to spend additional funds to maintain a tolerable turnover rate. Failure to factor this in prior to moving offshore will lead to problems later in the engagement.

Culture

Culture does (and will) continue to have a major impact on the success of offshore strategies. No matter what you do, there are likely to be significant differences in office culture, employee ethics, and intra-employee relationships that you must take into consideration prior to moving offshore.

The Litmus Test

All Executives planning any form of an offshore strategy must visit the location they are considering. Once in the country, walk around the streets of the major cities and see the countryside. Our experience has been that what you find when dealing with local store owners, restaurants, hotel employees and others will provide valuable insight and be a great indication of what you can expect from a team located in the same location.

If, after you visit the location, you are considering building an offshore team, you find the local culture is not to your preference, you should reconsider your selected location. No matter how much an offshore vendor will argue that culture is not an issue, it is. You will interact with the offshore culture in every meeting and you will need to make frequent trips to the selected country. If you are not comfortable with the culture, you will not be a success. There is no way around this .

Not All Employees Will Accept

Not all of your onshore team members will accept the offshore team culture and you need to be prepared for a certain level of cultural contention no matter how aggressively and proactively you approach the issue.

Mistake of Forcing Cultural Adoption

Many companies moving offshore take the approach “We are a U.S. company and we expect our offshore team to abide by our culture, standards and rules.” Even if you are retaining an offshore vendor, this approach is simply not practical and we have yet to find any instance of this forced approach working.

In a few instances, we have seen U.S. and European companies attempt to adopt a working model similar to Indian or other countries. We have seen disastrous results in each case and strongly caution firms against such an approach as well.

Mistake of Ignoring the Problem

In many cases, companies simply opt not to address the culture problem and assume the engagement will still be a success. Once again, we have yet to see an instance where such an approach generated long-term success. In most cases, we find the two worlds (onshore and offshore teams) never come together as an effective team and often find employees fighting.

Recommended Mitigation Strategy

Without getting into a country-by-country recommendation, we have found a few general rules that have demonstrated significant value when solving the cultural issue:

1. **Don’t manage offshore resources**
   Create a management structure in your offshore team that has the charter of managing all of the offshore employees. Shield your onshore team from the daily issues this offshore management team must deal with. Allow your offshore

management team to structure and run the offshore team in their local business culture.

2. **Be practical**
   You will need to adjust your management style to accommodate the more important aspects of the offshore team culture.

3. **Establish clear leadership**
   Most offshore outsourcing hotspot countries have a business culture that places a great deal of importance on leadership and management hierarchy. Do not under estimate the need for your offshore team to have a clear management structure with clearly defined roles, responsibilities and position inside this management structure. If you fail to define this structure, your offshore team will most likely create their own management structure outside of your guidance.

4. **Monitor**
   Offshore engagements are tough on both your onshore and offshore team members. You will be asking the two worlds to work together in some middle ground and both groups will have difficulty. It is important to constantly monitor the happiness of both your offshore and onshore resources to make sure you are not pressing them to adopt a different business culture too aggressively. It is not bad for your team members to feel uncomfortable (or pushed), but you need to make sure you do not break them.

   A note for those with an offshore outsourcing strategy: Many offshore outsourcing vendors will attempt to have you believe culture is not an issue and we believe this to be a horrible comment. Avoid those vendors claiming there will be no culture issue. After engaging with the vendor, make sure you establish a mechanism to work with the vendor to monitor and adjust your management style to keep both parties (your onshore team and the offshore vendor employees) relatively happy and productive.

5. **Consistency**
   We have seen instances where either the onshore team or offshore team is given special treatment through the offshore process. We have found holding your team to different standards will only further increase the rift.

6. **Celebrate each other's culture**
   The world is an interesting place and when companies learn to celebrate each other's culture, offshore engagements typically perform better. Although these efforts may seem inconsequential, such small steps pay great dividends.

7. **Face time**
   Ultimately, there is only one way to really learn the business culture, and that is to experience it. We have found the greatest tool to break down cultural barriers and to build a better global team is to spend time in the other's country. Regardless if you have retained an offshore outsourcing vendor or have built your own offshore team, have the offshore employees spend time onsite with your onshore employees and make sure to send your onshore employees to the offshore facility.

Leadership

Both U.S. and European business culture allows for a much more flexible business leadership structure. It is common to have a difference between the actual organizational chart and the leadership dynamic. We often find examples where individuals will outline tasks for those that are not under their direct organization management (as indicated by the organizational chart). Further, it is relatively common to find instances where employees will outline tasks that must be performed by those in a higher position on the organizational chart.

In most offshore outsourcing hotspot locations, this will never happen and you must review your team leadership prior to moving offshore. If you want your onshore team to take a leadership role managing the deliverables from your offshore team, make sure you have the onshore team members higher in the organization than your offshore team.

Job definition

In addition to defining the management hierarchy, it is important to clearly define the job function, title and expectation for each offshore employee. In the U.S. and Europe, we are often soft when it comes to defining specific job duties and encourage employees to show initiative in taking on additional responsibility. In most cases, your offshore team members will not take such initiative and you will not be able to effectively (or consistently) get them to perform various tasks unless it is explicitly defined in their job description.

If you fail to define the title, organization position and job description for each offshore team member, your offshore team will create them independent of you. In each case we have investigated, this has caused significant problems.

Be prepared for the posturing

In most offshore outsourcing hotspots, employees will not speak directly to other employees unless the other employee is inside their immediate team. You will find if a person needs something from a person in another team, the employee is likely to escalate the issue up through management until a common manager is found for both people. Even when the request may be simple, it is not uncommon to see many people involved.

We found such a communication matrix is not effective and often forces a delay in getting work done. We encourage you to take a more proactive approach in regards to this issue and have seen indications that when Executives promote a more casual communication style, the team operates more effectively.

The "Team"

You must monitor the dynamic interaction between your onshore and offshore resources. No matter what you do, there will be competition. To some extent, we think competition between the two groups is healthy but most global teams cross the line and enter a destructive mode.

No matter how great your employees are or how well you prepare, there will be mistakes and unforeseen events your team must deal with. If your global team is working well together, they will handle each of these events in stride. If your onshore and offshore employees are not working as a cohesive team, your employees will point fingers instead of working together to resolve complex problems.

The most compelling statistic we found during our research is the relationship between this global team concept and the overall success of the offshore strategy:

- Employees working with a successful offshore strategy use the terms such as "we" and "us" (meaning both the onshore and offshore groups) when describing the team 98% of the time.

- Employees working with an unsuccessful offshore strategy use "us" and "them" (distinguishing the onshore group from the offshore group) 99% of the time.

A great compass to help you know what direction your offshore strategy is heading is to poll your global team. If your team has an "Us vs. Them" attitude/mentality, you are bound for difficult times ahead.

Mitigation

We found mitigating this team problem is a challenge. Tricks we found to be most effective are as follows:

1. Clearly define role, expectation, title, organizational position and plans for the future with each employee. We found a great deal of the competition between the onshore and offshore groups is rooted in uncertainty with the new fulfillment model. When employees feel secure in their position, there is less political posturing.

2. Be consistent with your expectations, communications and interactions between both the onshore and offshore groups. If either party believes the other is being favored or operates under a lower operational standard, you will foster greater competition.

3. Constantly campaign for a global team and openly reward those employees that cross geographic barriers to jointly resolve problems on any project. Similarly, be aggressive in pursuing those employees that are constantly throwing up walls between the two groups. Make sure they feel the impact of their actions.

4. Face time between the two groups is still critical. Make sure your key team members from both onshore and offshore groups spend a significant amount of time in the other country working face to face. You will find this face-to face interaction to be one of the most powerful tools you can utilize in building an effective and cohesive global team and, if team members are not willing to travel abroad, they should not be on your team.

5. Lead! If you set a clear plan, gain the support of your global team and set an aggressive pace where all know their specific role, your onshore and offshore team will fall in line.

Mind Drain

We often hear complaints from customers related to their offshore team's inability to solve problems or offer any innovation. For many, it seems their offshore team must be told in great detail what must be done in order for any job to be completed.

Our initial research indicated this issue is a major obstacle with over 40% of all executives polled complaining of problems such as "[offshore team] can't put 2 and 2 together!"

To find out more, we performed a secondary research project specifically targeting this issue and found the following:

1. The problem is real and must be mitigated by onshore Executives implementing an offshore strategy; and

2. The problem is most often rooted in the dilution of qualified resources and not in some cultural bias.

The Problem

One of our clients offered the following statement:

> "A great developer is someone that knows everything that is not explained. They know all the tricks, all of the challenges and the standards that you can only get from years of experience."

In our secondary research project, we identified 25 Executives complaining their offshore team had substandard problem solving skills. In each instance, we noted the offshore team did not have the senior developers every software development team needs in order to be a success. There simply was not a person with enough experience to breakdown client requests into a tangible task the junior developers can do something with. Without this senior resource offering guidance to more junior team members, the team turns to the client for greater clarity.

The Cause

During the late '90s the U.S. implemented an aggressive H1B program to attract the best and brightest resources from countries such as India. The resource problem was increased during the offshore outsourcing boom earlier this decade. At this point, there simply are not enough senior resources with the true experience needed.

Unfortunately, it appears the void in senior employees with a great deal of experience is growing. While aggressive internal mentoring programs and sound education are helping mitigate the problem, the need for experienced employees will continue to skyrocket in the foreseeable future.

A Warning

You really do need senior team members to balance out the experience of your junior team members. Companies that opt not to pay the premium for the top employees are heading for failure. In our research, we failed to find a single instance where Executives opting to exclude senior resources from their team in hopes of containing costs achieved a positive ROI. Our advice is that you do your homework, find those key people, and be willing to pay the premium required to bring them in.

Words of Wisdom

After reviewing the case examples, we would like to offer the following recommendations:

1. **Do not assume title means experience**
   We are finding the exact same void in senior resources that is causing you difficulties is opening the door for rapid promotions. We commonly find junior resources holding senior management positions although they do not have the appropriate experience or background. If you are recruiting a senior employee, look past the person's title and assess their true experience.

2. **Do not substitute education for experience**
   We are finding that many U.S. and European multinationals are now substituting academic credentials for work experience. While we actively promote formal education, it is not a valid substitute for practicum. If you are looking for a senior team member, find a senior team member with experience in the trenches.

3. **Implement a mentoring program**
   To help mitigate your problem moving forward, implement a mentoring program with your offshore team. If you are working with an offshore outsourcing vendor and have long-term plans with the offshore team, be willing to pay a little extra for the vendor to implement a mentoring program. By doing so, you will see a cost benefit over the long run. (Your turnover will be lower and the quality of the work performed by the offshore team will improve.)

4. **A special note to those retaining an offshore outsourcing vendor**
   Be careful to review each resume presented to you and carefully interview each employee making sure his or her true experience matches the resume. Prior to signing contracts, make sure you have reviewed each proposed team member. If the vendor attempts to swap out an employee without your prior knowledge, you should reconsider working with the vendor.

Find a Mentor

Moving offshore has several strikes against it from the outset:

- You will struggle to keep your onshore team happy and productive
- You will face support issues from your customers and internal peers
- It is extremely expensive process

To compound the problem, it takes a long time to see results. Our research found often times mistakes made by companies when implementing (or even managing) an offshore strategy can take years to uncover and can often cost the company millions of dollars.

While having a person with experience moving offshore available to use as a sounding board will not remove every challenge you will face, we have a significant amount of data indicating that working with a seasoned mentor will improve your experience.

To illustrate the benefits, we researched the following:

1. **Cost**
   We found that companies using a mentor or seasoned coach to help them through the process of moving offshore statistically reduce their cost to move offshore by 21%.

2. **Time**
   Similarly, we found Executives using an offshore mentor decrease the amount of time to move offshore by 15%.

3. **Success**
   Finally, Executives using a mentor to help guide them through the offshore process are almost 34% more likely to classify their offshore strategy as a "success."

Communication

Miscommunication between onshore and offshore team members is a major challenge that must be addressed in order to achieve offshore success.

How We Communicate

Corporate Europe and North America have become dependent on a constant and casual interaction between team members to refine the details needed for any project to be a success. We constantly pull team members into conference rooms for “white board sessions” or run into colleague’s offices for clarification on various points. Anytime you outsource work or utilize a remote team (even if the team is just across town) you loose this casual interface. The simple answer most companies turn to is to formalize communication with detailed documentation and formal processes. To a great extent, we found such an approach does help improve the performance of a geographically diverse team.

We have found, however, many offshore engagements take this approach too far and employees in either the onshore or offshore team do not simply pick up the phone or send an email when they have a question. We found when Executives actively promote the idea that catching team members via online chat tools, email or even picking up the phone when there are questions, the offshore strategy has a higher probability of success.

Communication Style

When taking my car into the shop recently, the mechanic noticed a problem and asked that I come and see the problem. The mechanic:

1. Showed me the part
2. Showed me what the part should look like
3. Clearly explained what was involved to fix the problem.

The entire interaction was done face to face and I had the opportunity to make a judgment call regarding the problem based upon what I saw, what was explained to me, and how I read the mechanic.

The corporate world is the same. We use more than just our sense of hearing to communicate with and understand others. When working with a remote team, you loose a great portion of what we depend on to effectively communicate - interaction. You can’t easily see a physical product with the person you are speaking with and don’t have the ability to read the person’s demeanor.

Differences in Language

English does not always mean English. We are all humorously aware when taking common phrases, words or slang in our own culture overseas, the meaning can dramatically change. We found the use of such words or slang is prevalent (and causes problems) in every offshore strategy. Regardless, we found most people are extremely professional and such misunderstandings rarely have a material impact on the success of your offshore strategy.

If you find employees in your onshore or offshore team are beginning to reference such issues as being a significant problem, it is usually an indication of a greater discontent with the individual. Fact is we found more onshore and offshore employees laughing about such incidences as opposed to complaining.

Logistics

As luck would have it, the majority of the offshore outsourcing hotpots are on the opposite side of the globe. Dealing with a completely opposite time schedule does present challenges to any offshore strategy and there is no absolute means for resolving the logistical time issue. Both your onshore and offshore teams will have to adjust and meet in off hours.

Many firms make the mistake of brushing past this issue and force either their offshore or onshore team to fully absorb the adjusted work hours. Our experience has shown this is a poor solution and you will find that unless you share the difficulties between both teams equally, you will have morale problems. Our recommendation is to establish a specific meeting time for your onshore-offshore team meetings with one party having the time fall within their reasonable work day and to rotate the off hour burden on a quarterly basis.

Of special note: The time difference often means that answers and resolutions to problems are at least a day out. If you have structured your offshore strategy in such a way that your offshore team is responsible for time sensitive tasks, make sure you have means for mitigating problems during your (and your customers') workday.

"Communication is a big one. We spend quite a bit of time talking and listening to each other. This is the only way to keep everyone in synch. Email is limited in what it can convey. We often find ourselves needing to pick up the phone and call someone to resolve a complex issue. It's definitely been a learning experience."

-U.S. Executive

Implied Vs. Explicit

We noticed a subtle difference in the way people communicate. Most of the U.S. and European corporate world communicates in a slightly implied manner. Often, we do not spell out each detail but point our employees in the general direction or give them a rough framework in which to work. Many offshore outsourcing hotspot cultures communicate in the completely opposite manner. What you say will be taken literally and any “interpretation” or “extrapolation” may be an indication of disrespect.

Chaos

Many companies make the mistake of over-communicating and effectively create such a distraction that employees loose the ability of deciphering the important items from the noise. While we strongly recommend making the mistake of over communicating as opposed to under communicating, make sure you are not drowning your employees in a chaotic world.

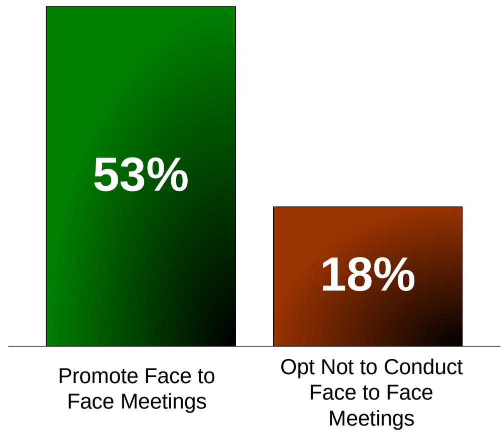
“The effectivity of remote teams usually suffers from "too many". Too many databases, too many firewalls, too many email attachments, too many engineering changes, too many misunderstandings and too many delayed decisions. When these team members are limited to phone conversations, the problems are compounded as there is no clarity, an overload of ambiguity and no effective method to capture discussions and decisions. Team collaboration and e-meeting tools bring greater clarity because they can unite the "too many" into a single, meaningful place hosted on the web.”

Grant Rochelle
Director of Marketing
CoCreate Software Inc.
http://www.cocreate.com

Face-to-Face Contact

Face time between your onshore and offshore team is critical to the overall success of your long-term offshore strategy. Regardless if you are working with an offshore outsourcing vendor or have built your own offshore team, you need the face-to-face experience.

We often find companies attempt to improve their offshore strategy cost model by opting not to make the international trips. We believe this approach to be a false economy and found most that take this approach will not succeed.



We recommend the following:

1. When selecting an offshore outsourcing vendor, make offshore visits with the leading vendor candidates. Walk around the streets and get to know the culture. Before you have signed any contracts, get to know the executives you will engage with and develop a personal report.

2. When hiring an offshore team, make sure you interview each face-to-face. Even if you are working with an offshore vendor, take time to meet the key vendor employees prior to starting a new engagement.

3. When launching a new project, have the key offshore team members spend a fair amount of time with your onshore team. In doing so, your offshore team will pick up those additional insights they need to deliver a successful project and you will help build a cohesive global team.

4. Every three to six months, have your key onshore team members spend time in your offshore facility. Have them work through key deliverables with your offshore team and have them promote various team-building exercises.

"[The] best way to improve communication is the make scheduled visits...You need one-on-one contact."

Steve Johnson
Director Business Development
Callworx
www.callworx.com

Most Executives with an offshore strategy make three catastrophic “Performance” mistakes:

1. **Failure to establish a baseline prior to moving offshore**
   The majority of Executives polled did not establish a performance baseline for the function they moved offshore. Regardless how well you measure performance post moving offshore, you can’t demonstrate a cost savings or other performance gain without starting numbers.

2. **Using superficial means for measuring performance once offshore**
   Once Executives move offshore, the average Executive will use artificial means for measuring performance. In our practical experience and in our polling, we constantly came across Executives attempting to demonstrate some form of gain from their offshore strategy by comparing metrics such as hourly rates and onshore/offshore headcounts. We strongly argue that such metrics rarely offer value and suggest investigating other options.

3. **Substitute process for end results**
   Companies move offshore to achieve specific business performance objectives, yet many Executives make the mistake of gauging their performance on the processes implemented. Do not loose focus on the end goal and gauge your progress by your performance achievements not on the processes implemented.

Performance vs. Process

Every company moving offshore should be doing so to achieve specific performance goals. As a result, you must gauge your progress and overall success on the degree you have achieved your overall goals.

Too often, companies make the mistake of gauging and reporting their offshore strategy success on the processes that have been implemented. As an example, please review the following two examples of offshore strategy progress reports sent out by two different firms:

> **Company A**
> "Our [offshore strategy] is ahead of schedule. We recently completed our CMM Level 4 assessment goal. We are on track for achieving a mature software development team by the end of 2005."
>
> **Company B**
> "We are already seeing the results of our RUP [Rational Unified Process project management methodology] project. Our team beat the cost, quality and time goals this last quarter and all of our Project Managers got the maximum performance bonus."

After tracking the two firms through their offshore strategy:

- Company "A" increased their software development cost by 11%.
- Company "B" reduced their software development cost by 29%!

Performance Metrics

We are a fan of implementing various processes as a step in your offshore strategy; you must, however, associate real performance goals with each performance metric. If you are implementing process improvement projects, make sure you measure the success of the process improvement project on metrics such as:

- Cost improvement
- Time to market
- Quality
- Customer satisfaction

Gut Check

1. If you are planning on implementing a process improvement type project, make sure you have associated specific and measurable metrics. Track these metrics long-term and establish the success or failure of your process improvement project on these true performance metrics, not on compliance alone.

2. Prior to launching any process improvement project, build a business case for the project and present to your peers and customers. If they can't clearly identify how the process will directly impact them, don't do the project.

3. If you have no means for measuring performance metrics for your process improvement projects, or if you fail to clearly demonstrate how each directly impacted your organization's performance, stop implementing new processes.

Effectively Measuring Performance

We have yet to find an instance where the total success of an offshore strategy is defined by a single performance metric. Further, we find when Executives determine the success of their offshore strategy by a single performance metric, the offshore team will forsake the health of the overall strategy to achieve greater marks on the defined metric. To better capture the true performance of an offshore strategy, we recommend using a scorecard approach.

Scorecard Recommendations

Although most readers of this “Preliminary Findings and Conclusions” Report will be implementing an offshore strategy to reduce costs, the specifics will vary for each reader. As a result, we believe each Executive should tailor their performance scorecard to better gauge their success. To help you get started, we offer the following suggestions when creating your own performance scorecard:

1. Make sure to include metrics from the following (at a minimum):
   - Customer satisfaction
   - Total cost
   - Quality
   - Time
   - Productivity
   - Team morale

2. Make sure you measure the right scope. Too many executives fail to take into consideration the additional burden to the onshore team when calculating the performance of their offshore strategy. If you look past the increased effort from your onshore team and the additional over-head costs associated with any offshore strategy, you are not honestly measuring the performance of your strategy.

3. Make sure your offshore strategy is customer centric. Regardless if you are providing services for an internal or external customer, we all have customers. When building your scorecard, make sure you include customer satisfaction metrics and weigh them heavily.

Warning on Bad Metrics

We argue that if you are gauging the success of your offshore strategy on such metrics as “offshore hourly seat cost” or “onshore resource displacement,” you are heading down the wrong path. Our research indicates when Executives cite such metrics, they are likely to fail. We found Executives exclusively using the above metrics achieved an offshore success only 3% of the time.

Baseline

A surprising 37% of those Executives we polled could not effectively state the performance of their organization prior to moving offshore and could not answer such basic questions as:

1. What is the average cost per line of code?
2. What is the average cost to resolve customer issues?
3. How long is your average customer call?
4. What are the total defects per line of code?

While it may be arguable each item above may not best represent the true performance of an organization, the point we are making is that a significant segment of Executives we polled had virtually no means for assessing the true performance of their organization.

In our research, we found those Executives without valid baseline performance metrics consistently had the following problems:

1. No means to establish an ROI.
2. Built an offshore solution that did not solve their core problems.

In the end, we found a majority of these Executives failed to establish enough value for their offshore initiative and were “onshored”.

Prior to moving offshore, take time to map all business process that may be impacted by an offshore strategy and take time to clearly measure the performance of your existing processes.

Offshore Outsourcing Considerations

When engaging an offshore outsourcing vendor for your offshore strategy, we make the following recommendations:

1. Make sure you have defined your performance scorecard (“measurable outcomes”) prior to launching your RFI-RFP process and include the scorecard metrics in both. Use the scorecard as the foundation of your strategy and do not consider any vendor that does not directly explain *how* they will help you achieve long-term success (referencing each defined metric).

2. Make sure the SLA and SOW both explicitly reference the defined performance scorecard. Do not sign either until you can verify the following are defined:
   a. Specific metrics to be used in measuring performance
   b. Method for measuring each metric
   c. Who will measure each metric
   d. When each metric will be measured
   e. What standard will be used to judge each metric
   f. How each metric will be reported
   g. When each metric will be reported

3. Although not appropriate in all instances, we encourage you to push for a joint risk model with your selected vendor using the scorecard as the standard as opposed to individual metrics.

“…‘total cost’ is the most important thing when working with an offshore vendor. You need to measure more than just hourly costs and need to take into consideration productivity, time management, efficiency, risk and total value. You need to find the vendors that are working with you to deliver the product for the lowest cost, not the vendor trying to sell you the lowest hourly rates.”

-Dmitry Loschinin
CEO
Luxoft
www.luxoft.com

Monitor and Audit

In each SLA, SOW or MSA you sign with any third party, make sure you have clear performance metrics outlined. For each metric, make sure you have a crystal clear mechanism to monitor and audit the metric. Failure to do so will kill your offshore outsourcing engagement. To quantify the problem, we created two segments for research:

1. **Firms with SLA Performance Metrics and an Audit Mechanism**
   The first groups consists of those firms that include clear and quantifiable performance metrics in all agreements and have a sound means for measuring performance captured.

2. **Firms without SLA Performance Metrics or Means for Measuring Performance**
   The second group consists of those firms that do not have clear performance metrics in their agreements or do not have any means for measuring the performance of these metrics other than by taking the word of the vendor.

In our research, we found those offshore engagements with clear performance metrics and an audit mechanism:

- Were 30% more likely to achieve offshore success
- Virtually eliminated SLA compliance issue while those without an audit mechanism suffered from SLA compliance fraud rates of up to 70%

U.S. and EC companies need to invest in both tools and services to assure that they realize the benefits from offshore outsourcing. An important tool is software portal that track performance and proactively ensures that SLA defined metrics are being met. This becomes even more critical when outsourcing to multiple vendors. However, when outsourcing offshore there are additional complexities of distance, time zones, and cultures. Software, while necessary to manage the relationship, is not sufficient. A local presence, close to vendor locations will supplement the software by providing a defined mechanism for conflict resolution and issue escalation."

Vinay Gupta
CEO
Janeeva Inc.
www.janeeva.com

Advice to Offshore Outsourcing Vendors

Too many offshore outsourcing engagements fail to materially solve the customer's root business problem. Vendors taking aggressive steps to demonstrate tangible and material results will have a significant advantage over the competition.

If you want to be competitive in the future, we recommend the following:

1. Request the performance scorecard from each prospect when preparing a proposal. If the prospect can't clearly articulate how they will judge the overall success of their offshore outsourcing initiative, it is an indication the prospect is not prepared and would be difficult to work with. We recommend you walk away from such prospects.

2. When preparing your proposal, include each metric outlined by the customer and include a statement of how you will best generate results for the metric and how you propose measurement.

3. When crafting SLAs, SOWs, MSAs, etc. make sure you have clearly captured the performance scorecard and have defined the details of how you will measure and report each item. Encourage your customers to participate in the metric measurement and reporting process.

4. With compliance being such a hot issue, we strongly recommend you invest in tools, processes or other to mitigate the problem. We found indications that companies with tools such as SLA terms tracking software had significantly improved compliance records.

5. Be open to the idea of an independent auditor. If you are a legitimate vendor, you have nothing to hide and an independent verification of the facts removes any potential contention between you and your clients.

6. Be prepared to enter into a higher value proposition discussion with customers. As an example:

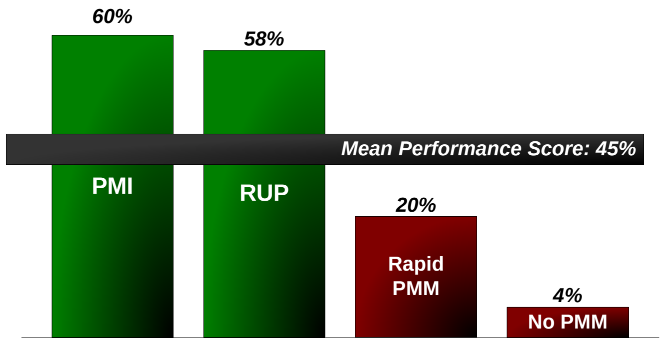
   > Offshore outsourcing strategies do not fail due to high-developer costs, they fail when the entire offshore engagement does not generate a cost savings.

   U.S. and European companies are now looking for offshore vendors capable of directly impacting their primary business drivers (total cost vs. developer cost) and are already giving preference to those firms willing to risk share higher in the value chain. Just a word of warning: Don't get too aggressive in what you promise…

Managing Projects

Each offshore vendor we have worked with over the years claim to have the single best project management methodology to ensure your success. In our research, we dove into the details of each to help you gain some information to help you successfully deliver projects with your offshore team.

Methodologies



In our research, we found offshore projects managed by PMI or RUP project management methodologies had the best success. We also found various rapid development methodologies scored the lowest.

From our research, we strongly encourage all firms hiring an offshore outsourcing vendor or building an offshore development team to implement a Project Management Methodology (PMM) similar to PMI or RUP. Likewise, we strongly encourage firms that have not implemented a mature Project Management Methodology to reconsider any offshore strategy until the organization adopts such a methodology.

Waterfall Vs. Prototyping Approach

Our research indicates the use of prototypes or an interactive development process offers the highest probability of success. Firms that heavily use prototypes in defining requirements, designing the application, transitioning to the offshore team and use many iterative releases during the development process have a much higher probability of success when compared to traditional waterfall methodologies.

Staff Augmentation

99% of all offshore outsourcing projects we researched failed to achieve a cost savings. Further, all employees working in such a model voiced a higher degree of displeasure working in the onshore-offshore model when compared to those teams working in a standard project outsourcing model. From our research, we strongly advise firms against engaging a staff augmentation model where your onshore team manages the daily activities of your offshore resources.

24X7 Development

Several firms we have worked with have attempted to greatly speed up their product development time by implementing a true 24-hour per day development model. In this model, the customer will run multiple teams located in different time zones around the world. As one team prepares to leave for the day, they hand off to the next team coming on shift in the next location. The cycle continues until the last development team hands the coding back to the original onshore team.

In each case we reviewed, the customer greatly increased the cost to develop the product and failed to prove any time to market improvements. The root cause for the horrible numbers appear to be anchored in the following:

1. Adding multiple teams requiring a daily handoff greatly increases the amount of communication needed to keep the teams in synch. By adding multiple teams, the amount of time critical resources remained “development productive” reduced by as much as 40% as a result of this additional overhead.

2. As each shift comes online, developers struggle to get on top of the progress made and even demonstrated problems understanding the coding of the other team(s). Our research indicates employees of companies with a 24-hour development cycle, never really feel as if they are on top of the application and do not believe they truly own the project.

3. Most projects are equally constrained by requirements management and high-level design activities. Although companies may add additional resources, our study found many cases where the Project Manager, Analyst or Architect simply could not keep up with the increased fulfillment capability

In our research, we found firms wanting to increase the speed to market of their application had a much higher success rate in achieving their goals by breaking the project down into multiple tasks that can be performed in parallel. Once each independent task has been thoroughly thought out and appropriately designed, these firms retained multiple teams around the world to fulfill each task.

CMM, ISO and Six Sigma

Such quality standards are not a substitute for a project management methodology. When asked to describe their project management methodology, many offshore vendors respond “Oh! We are CMM5!” While such a claim is a great indicator, do not hire firms that fail to reference PMI, RUP or similar in addition to their various certifications.

If you plan on retaining an offshore outsourcing vendor for application development, it is also a wise idea to offer your onshore team basic CMM training. Although our research did not demonstrate this as a critical success factor, all employees polled that participated in an introduction CMM course prior to engaging the vendor team found the training program valuable when understanding the actions of the offshore team.

Vendor vs. Client Methodologies

Too often, vendors and customers lock in a battle over whose project management methodology to use. The client does not want to take on the burden of transforming their entire project model to comply with the vendor’s standards and the vendor does not want to compromise the CMM, ISO or other processes that have been implemented. Our research confirms the exclusive use of the client PMM or vendor PMM without some compromise simply does not work. Statistically, you are much more likely to achieve a long-term success with your projects if you take time to develop a hybrid methodology including key components from both the vendor and client methodologies. If a vendor candidate tells you they will not work with you to develop a hybrid model, do not hire the vendor.

Requirements Management Warning

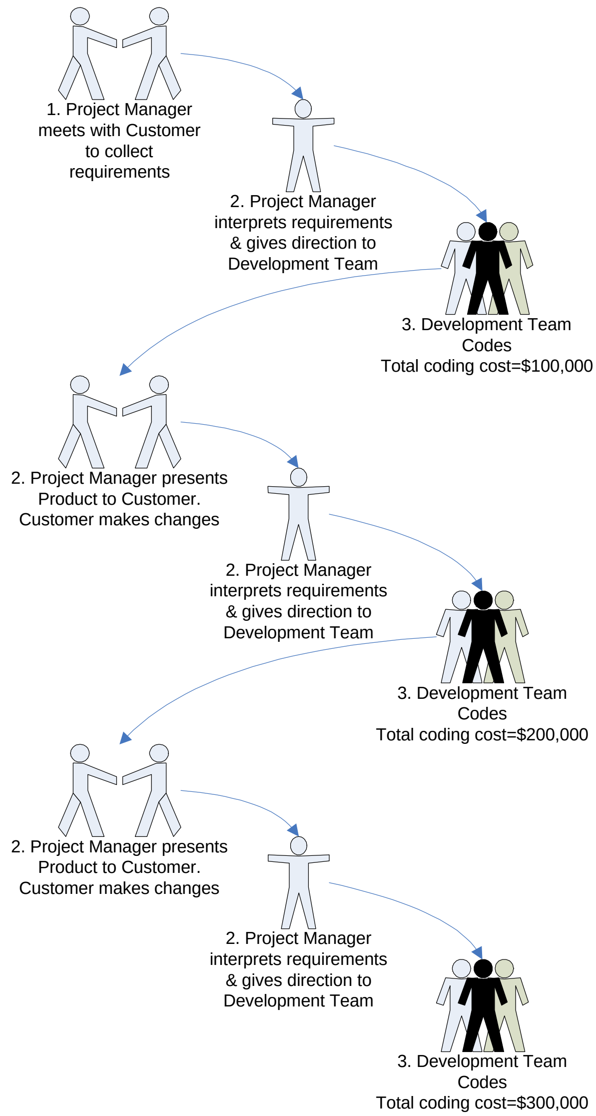
In software development projects we find two trends:

1. Firms usually have great coders
2. Firms are usually horrible at capturing and managing requirements

First, we acknowledge it is virtually impossible to capture a complete list of requirements at the outset of major projects. Further, we will admit having no ability to make changes along the way is a poor idea. The point we want to highlight is most companies do not approach software with a sound discipline and the requirements volatility in most software development groups is extremely high.

If you run a pattern as outlined at right, moving offshore will not save you as much as simply improving your development process.

Prior to moving offshore, audit several "normal" projects and identify how well your organization manages requirements. If you find your organization updated more than 25% of the requirements after being "frozen", we recommend taking steps to improve your project management and execution. If you don't you won't realize an ROI and you are likely to alienate your offshore team.



The Onsite-Offshore Ratio

There is a great deal of conflicting information about the onsite – offshore team ratio when working with an offshore outsourcing vendor. As a general rule, we found the "80/20" rule to be a great guide for those first engagements with a new offshore outsourcing vendor (80% offshore and 20% onsite with your onshore team).

As you continue to work with the vendor, you can scale this number back but do not recommend a ration below 1 in 10.

Vendor selection

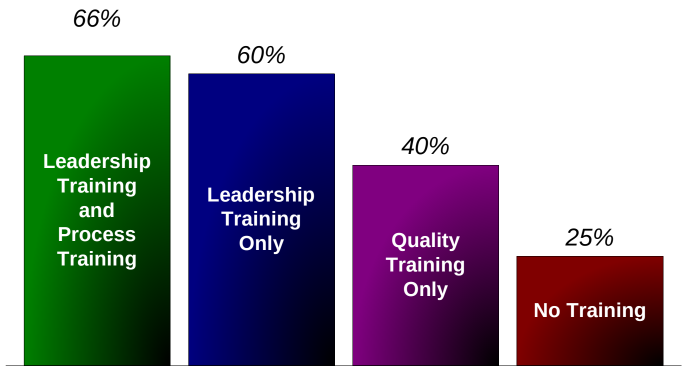
We often hear offshore outsourcing vendors make such statements as:

- "Our project management methodology and personnel are so good, we don't need to provide as many onsite staff members as our competition."
- "To keep costs low, we keep more of our team members here [offshore]. than our competition."

In almost all cases, we found such statements to be an excuse covering the fact the offshore vendor does not have the capability of staffing a sound onshore team.

Leadership vs. Legislation

It is extremely important to not loose sight of the purpose of such standards as ISO, CMM, and Six Sigma. They are not meant to control your company, but to enable it. Too often, companies managing offshore projects, spend a great deal of time and money pursuing CMM assessments or ISO certifications but fail to develop the leadership of their Project Managers. In our research, we found strong trends indicating firms implementing aggressive leadership training programs for the Project Managers greatly improved the probability of successfully delivering projects with in an offshore development model.



Keys to Success

1. **Build a Great Team**
   Make sure your Project Managers have sound leadership and project management skills, you have the correct offshore resources, and you take steps to effectively integrate your all components of your team.

2. **Define Processes and Methodologies**
   Prior to beginning any project with your offshore team, clearly define how your onshore and offshore teams will work together. Make sure you define and specifically communicate clear roles, responsibilities and expectations. Important to many offshore hotspot cultures make sure you clearly state the leadership hierarchy for the project team.

   If you do not have a mature Project Management Methodology, you are not likely to achieve success with an offshore strategy. Implement either PMI or RUP based Project Management Methodologies now and do not be persuaded by offshore vendors to "let us come in and help you…"

   Of interest to those outsourcing application development to an offshore vendor, take time to clearly define a hybrid project management methodology that allows your team to function while not destroying the internal processes your vendor has implemented.

3. **Metrics**
   Make sure you clearly define both performance metrics and acceptance criteria before you begin the project. In your design process include mechanisms to measure each metric and include the reporting of each application and project performance metric.

   Throughout the project, measure the performance of your offshore team and progress toward your final delivery closely. Make sure your report out these statistics to your internal constituents. Make sure to monitor the performance and execution of your offshore team and be prepared to act quickly if all is not as defined prior to starting the project.

4. **Manage Requirements**
   Prior to moving offshore or retaining an offshore outsourcing vendor, implement a sound requirements management mechanism and cycle through a few projects to allow your firm to adopt.

5. **Details**
   Make sure you explicitly state every detail you require in order for your project to be a success. When submitting requirements, do not summarize the intent but list every parameter, range, format, feature, process, etc., you must have in order to be a success. Unlike working with an onshore vendor, offshore vendors tend to literally translate each requirement and you cannot assume your intent will be delivered unless it is explicitly captured. If your firm is not prepared to produce extensive and detailed design documentation for any offshore team, reconsider your move offshore

6. **Communication**
   Make sure you establish a formal and frequent communication mechanism. However, do not allow your onshore and offshore team use this formal meeting time as an excuse to not speak with each other as needed.

To mitigate the charged opinion of your customers, management, peers and employees, make sure to frequently report out the performance metrics of each project.

7. Prototype and Model

When working with an offshore team, you will face two significant communication issues:

- You loose the casual interpersonal experience (such as "whiteboard sessions"); and
- You will be plagued by misunderstandings

To mitigate the problem we strongly recommend the use of prototypes and modeling to bring all members of the team together.

8. Many Releases

Do not make the mistake of handing a large project to your offshore team only to see the product at the end of the project. Companies that demand regular and frequent releases are much more likely to receive a project as designed.

9. Simplicity

Many firms make the mistake of implementing too many processes, tackling too complex of a pilot project, or ramping in too many people. For the first few projects, keep it simple, find ways to control the chaos and let people focus on getting the job done.

10. Face Time

At the beginning of a major project, make sure you bring the leads from your offshore team to your site. Allow them to gain a sound knowledge of the players, the business, the applications, and the processes.

If the project is lengthy (lasting more than 6 months) have your onshore project team spend some time onsite with your offshore team.

Managing Risk

Manage Risks

The move offshore will compound your potential risk geometrically by introducing significant threats from your existing employee base, your customers, the market and the sheer complexity of making offshore engagements work.

Prior to moving offshore, there are a few rules you must follow:

1. **Have a safety net**
   Each step in your offshore strategy will uncover a new barrage of challenges and you need to have a safety net ready for each step.

   - When presenting the initial concept to your peers, make sure you have built a sound business case and can answer any question thrown your way. Make sure you crafted a sound fall back plan for business continuity in case the strategy fails and discuss this continuity plan in your initial pitch to both management and your peers.

   - When presenting the offshore strategy to your employees, you must expect that up to 1 in 4 of your employees will attempt to thwart your plans. To mitigate the problem, have a clear understanding of what you need from each of your employees prior to moving offshore and have a backup plan ready in the event you do not have the participation from each person.

   - When presenting to customers, you will find many strongly object to your offshore plans citing both logical and emotional reasons. Do not attempt to persuade these customers to change their view but establish a sound mechanism for them to continue to interact with your firm in a manner they want. As an example, if you are opening up product support team offshore, take time to establish a good online support site. If customers refuse to call your team in India, encourage them to seek support from your online tool(s).

2. **Think before you speak**
   We coach Executives to keep their cards close to their chest when working with an offshore model. Assume every time you discuss your long-term plans:
   - Employees are using it as a factor in determining if they stay with you or not
   - Peers will use your comments as fuel against your plans
   - Offshore vendors will use it as a mechanism to better sell to you
   - The market or media will use it as a chance to spotlight your company

   Think before you speak and understand the impact of your words.

3. **Approach with a wary eye**
   You need to be the chief cop in the offshore initiative. Make sure you carefully inspect each agreement, specification and deliverable. Many cultures do not value integrity as highly as U.S. and European firms do and you must anticipate those you work with in other countries may try to take advantage of you.

4. **Be prepared**
   Once again, moving offshore is an extremely charged issue. Make sure to:
   - Build a sound business case
   - Understand how complex of a challenge you are facing
   - Have answers ready when questions are thrown your way about the challenges you will face or the soundness of your approach

Costs

Costs, in almost all offshore hotspots, are skyrocketing. As an example, many parts of India are experiencing double digit growth in payroll costs and triple digit growth in facilities costs. Simply cycling your offshore facilities from their current location to a new geography once costs exceed benefit is certainly an option, but appears to be a poor approach.

Offshore Outsourcing Cost Considerations

Companies that have retained an offshore outsourcing vendor typically place a very high percentage of the cost burden on the outsourcing vendor. Under this model, we have found as margins are pressed, offshore outsourcing vendors begin to cut corners by failing to pay market rates, failing to comply with SLA terms and failing to provide adequate facilities for their employees. In each case studied, this has caused a huge offshore team turnover rate and the end cost to the customer has exceeded the rate they would have paid if they shared the increasing cost burdens.

Offshoring Cost Considerations

Firms with their own facilities offshore have an all-together different problem. Being the sole party responsible for any increase in costs offers no shield from this problem. Just as in onshore models, offshore teams dealing with costs, cut back pay raises, employee perks, and discretionary spending to help the bottom line. With the rapid growth in many of the offshore hotspot markets, we caution strongly against flat refusal to compete with the raising market rates for your employees. In all cases where our customers have flatly refused raises, perks or other incentives, we have seen an explosion in the turnover rate causing a significant cost increase. It is important to note we do not recommend the outrageous pay rates, bonuses or perks starting to pop-up in the offshore markets but do recommend you closely monitor your employees and take each request into careful consideration.

Cost Mitigation Strategies

Companies that have successfully managed the explosion in offshore costs have taken the following strategies:

1. **Risk Share Engagements**
   In this model, onshore customers will retain an offshore vendor to deliver some specific long-term benefit. Most common, this will be a measurable cost savings compared to pre-offshore metrics and the vendor will deliver this savings by leveraging tools, methods or economies of scale to achieve the defined goal. Of key importance:

   - The engagement with the vendor will be structured in such ways that as cost savings improve, the pay (incentive) increases. Likewise, if cost to the customer increase compared to the pre-offshore metrics, the vendor assumes some liability.

   - The engagement is structured in such a manner so the vendor can be creative in their approach. This may involve leveraging common resources across multiple client engagements to realize an economy of scale savings or even by purchasing tools (or other) to achieve some greater efficiency.

   In this model, we have found vendors become extremely creative in their drive to improve their margin and often achieve a significant cost savings long-term for their clients.

It is important to note, however, this model is not without significant risk. We have found many such models where the offshore outsourcing vendor intentionally violated term of the SLA, cut employee pay, or blatantly defrauded the client in order to achieve a greater margin. We strongly encourage all firms considering such a model to retain a third party audit firm to monitor contract compliance and fair calculation of the risk-reward payment.

2. **Efficiency**
   Businesses gradually progress to a more efficient state of operation. Companies develop such items as code reuse programs or call center FAQ catalogs that allow members of the team to perform common tasks more efficiently. Companies that successfully mitigate the rising costs offshore implement a formal mechanism to aggressively (not passively) drive efficiency and constantly look for a paradigm shift to achieve a greater cost model.

   This model is also not without risk, however. In several instances, we found firms with a formal efficiency mechanism cost more than any efficiency gained. It is important to monitor this team and constantly demand proof of value. If this team fails to demonstrate material and tangible cost savings compared to the cost of operating this team, it is time to scale back. (Do not fall into “process for process sake” trap.)

3. **Incentives**
   Our research shows the most effective means for mitigating costs to be a formal incentive program spanning individuals, teams and divisions. The companies that have proven to be the most successful in mitigating rising offshore costs have formal programs that offer incentives on the following two tiers:

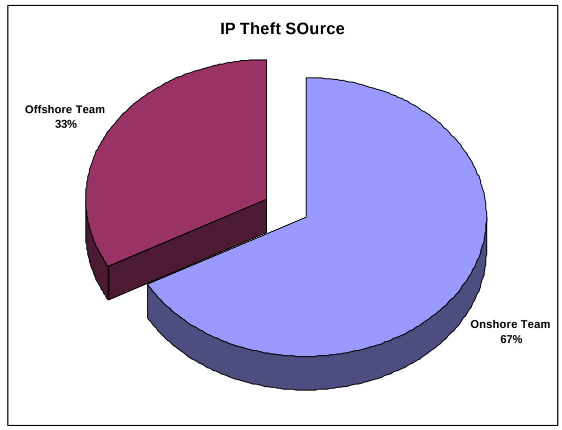
   - **Individuals**
     Encourage all employees to find ways to improve the performance of your organization, to better achieve your business goals and to reduce costs. Offer significant bonuses to those individuals presenting sound ideas. Make this policy publicly known and formally recognize those individuals who present such ideas. You will most likely find a constant stream of ideas with many generating significant benefits.

   - **Teams**
     Encourage teams to identify ways to improve the performance of the team and reduce team costs. Set specific goals with each team on a quarterly basis and offer bonuses to the entire team upon achieving various components of these goals. After defining new goals, publicly display progress toward these goals (such as a poster “thermometer”) until the target date. With each new step toward the final goal, update the progress meter.

IP Theft

IP theft in firms with an offshore strategy is a significant problem. Our research indicates as high as 1 in 10 firms will experience some form of IP theft during their engagement. Although the breadth of the problem did not surprise us, the source of this problem did. Onshore employees are twice as likely to steal confidential materials as your offshore team.

Our research indicates this problem is most commonly caused by the disassociation your onshore team will feel due to the implementation of your offshore strategy.



Offshore IP Theft

Piracy is a significant problem in many offshore hotspots. However, theft of your confidential materials by an offshore vendor does not appear to occur at a higher rate than that of a similar onshore vendor.

Of a more significant problem with your offshore team will be validation that all tools used by the team have come through proper channels.

Impact of Offshore Theft

There is a perception that IP theft occurring offshore has will cause greater damage than that of IP theft incident occurring onshore. Our research has shown t this perception is completely opposite from the truth. All of the most damaging IP theft incidents have occurred inside the U.S. or in Europe. Our research indicates this is most likely caused by the number of onshore buyers for such information compared to offshore buyers. If a trade secret, customer list or IP is stolen in the U.S. or Europe, there are simply more buyers for such an item and the theft damage is likely to spread quickly. As the density of individuals in like industries and the resources available to offshore individuals in like industries grow in offshore markets, we anticipate the damage done by theft in offshore markets to increase.

Recourse and Accountability

Regardless what various government agencies or offshore vendors may claim, offshore hotspots do not have a sophisticated civil court mechanism allowing you adequately pursue and collect damages resulting from IP theft. In the event you are able to successfully win damages, offshore organizations or individuals less likely than onshore firms to have adequate value to cover for any damages you may have incurred by the theft.

To best protect your assets when working with an offshore outsourcing firm, we recommend the following:

1. **Sign contracts in the U.S. or European with a U.S. or European organization**
   To protect your organization do not sign a contract with an offshore outsourcing vendor unless contracts are signed in your country, with a formal legal entity inside your country and governed by your chosen law and jurisdiction.

2. **Verify the local organization has adequate assets or insurance to cover the entire value of the engagement**
   Prior to moving offshore or outsourcing make sure you clearly understand your exposure. When engaging an outsourcing vendor, make sure the vendor has current assets and insurance to adequately cover your exposure in the event of theft. If the item you will be outsourcing is of such a significant value that theft of the item will effectively close your company, do not outsource the item.

Prevention

Our research clearly demonstrates preventative programs do work. Firms taking action to prevent IP theft prior to moving offshore or outsourcing are 38% less likely to experience theft than those firms that take a passive approach. The most effective steps you can take are:

1. **Screening all employees**
   Prior to hiring any employee, make sure to screen the candidate for the following:
   - Criminal background
   - Civil actions
   - Discrepancies in resume, education, experience, cover letter, interviews or references
   - Previous employment background
   - Skills test

   If at any point during the interview process you notice any inconsistencies, do not extend the person an offer.

2. **Risk management**
   Before outsourcing of moving any item offshore, formally calculate your exposure. If your exposure exceeds either your comfort level or your realistic recovery potential, do not move the item offshore.

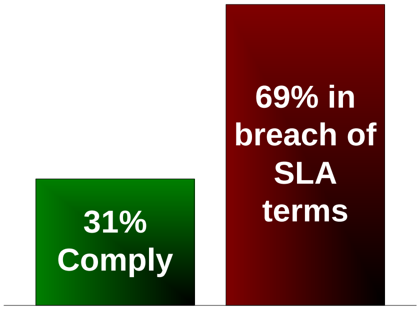
3. **Educate, motivate and reward**
   For both your onshore and offshore team, take time to educate them on *why* you are moving offshore. Clearly explain the importance of each employee to your success. Tell both your onshore and offshore teams about their role in your future plans.

4. **Implement appropriate security**
   Understand appropriate security measures and implement accordingly. Firms make the mistake of implementing security measures well below appropriate levels are inviting theft problems. Likewise, we found firms implementing aggressive security systems for low risk functions alienate employees leading to greater theft problems.

5. **Personalize and build your team**
   Our research found the most powerful theft prevention to be a strong feeling of being a member of the team and establishing a personal relationship between each employee and the management team. When working with an offshore team, it is important to celebrate the wins as a team and celebrate personal events (such as birthdays, weddings, promotions, etc.). Finally, as a manager, you need to often meet each offshore team member in person and explain how they fit into your organization.

Fraud

Fraud is a significant problem with offshore outsourcing vendors. In our research, we found that as high as 70% of all current offshore outsourcing engagements are not in compliance with SLA or SOW terms. While this failure to comply is occasionally caused by simple human error, the majority of these incidents are caused by offshore outsourcing vendors cutting corners to improve margins.



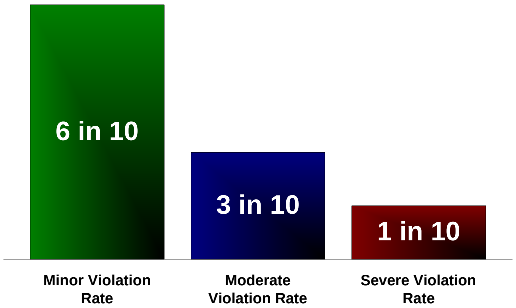
Fraud Severity and Rate

We segment SLA or SOW compliance violations in the following categories:

1. **Minor Violations**
   Minor violations of SLA or SOW terms are defined as those items that have no impact to the service provided to the customer and do not present any material risk to the overall success of the outsourcing engagement. Often, these violations are related to SLA or SOW items superfluous to the true intent to of the engagement. An example of a minor violation would be a vendor not providing true 24X7 onsite support services as defined in the SLA during a period of the product development where such services are not needed (or used). Our research indicates as high as 6 in 10 current outsourcing engagements have minor violations with SLA or SOW compliance. Although this number may appear to be high, we do not believe this number to be as alarming as it may first sound. Many of these violations occur during a "common sense check" by your vendor. Firms establishing a sound relationship with their offshore vendor, establishing a sound process improvement mechanism, and audit compliance, virtually remove these violations

2. **Moderate Violations**
   Moderate violations of SLA or SOW terms are defined as those items that present a significant threat to the overall success of an outsourcing engagement but have yet to make any impact. Moderate violations include such items as failing to comply with set methodologies, failing to staff projects as agreed or failing to comply with internally defined controls. Our research indicates that as high as 3 in 10 offshore outsourcing engagements have moderate SLA or SOW compliance violations.

3. **Severe Violations**
   Severe violations of SLA or SOW terms are defined as those items having a direct, immediate and material impact to the overall success of the engagement. Violations in this category include activities such as removing features to be developed without approval from the client, intentional circumvention of set quality controls, over billing, misrepresentation of performance metrics, or fraudulently swapping promised key resources for lesser-qualified resources. Most



alarming of all, we found that as high as 1 in 10 current offshore outsourcing engagements have a severe SLA or SOW compliance violation.

Root Cause

The most common root causes for SLA or SOW violations as follows:

1. **Lead by example**
   Over the years, we have dealt with several scenarios where the customer blatantly disregards elements of the SLA or SOW for which they carry the responsibility. When the vendor either intentionally follows, leads, or struggles to compensate for the failures of the customer, SLA or SOW compliance issues occur.

2. **Cultural differences**
   Not all cultures place a high degree of importance on delivering honest value to customers. In dealing with an offshore outsourcing vendor, you are likely to deal with this issue in varying degrees depending upon the location you choose.

3. **Unrealistic SLA or SOW**
   Customers often include unnecessary, extravagant or even impossible elements in their boilerplate SLA or SOW. Customers refuse to bend on these items and over-eager vendor sales team members brush over these items. As an example, one company we recently worked with included items such as dedicated 24-hour customer support lines even on small development projects not requiring any support mechanism. The cost of implementing this item alone often exceeded the total price of various application development projects.

4. **Failure to establish controls**
   Almost all SLAs include specific performance metrics but often fail to demand any mechanism to measure or report the results of the metrics. Firms that fail to demand comprehensive control mechanisms are twice as likely to suffer from some form of SLA or SOW compliance problem as those customers that force such mechanisms.

5. **The Human element**
   No matter how well you plan, or how great of a reputation your vendor may legitimately have, employees are still a bit of a wild card. Employees in both the customer and vendor will make mistakes causing SLA or SOW compliance issues. Further, there is the constant risk of individuals making intentional fraudulent actions.

6. **Natural profit seeking nature of business**
   The natural business is a profit-seeking venture. Simply in due course of running a business and attempting to improve margins, companies will cut corners. These simple process improvements are often relatively innocent in nature with the vendor not understanding that such actions may violate their existing contracts. Occasionally, these actions are not so innocent and represent a larger conspiracy in the vendor to improve their numbers.

Prevention

1. **Be realistic**
   Look through both your boilerplate contracts and per engagement addendums carefully. Make sure each SLA or SOW is explicit by stating the exact detail needed to successfully deliver each engagement. Include mechanisms for monitoring each element of the SLA or SOW. Finally, make sure to be realistic in scope and cut the materials that are not pertinent to the engagement. If you do not need 24x7 call support for a small development project, do not include it. If you are hiring a call center outsourcing vendor to perform inside sales, do not demand SEI CMMi 5 level

process compliance. Finally, do not demand "100%" performance on all elements. Structure the contracts to allow for the occasional mistakes.

2. **Encourage optimization and be flexible**
   Develop a formal process improvement mechanism with the vendor and offer incentives for ideas. By doing so, you will channel most of the corner cutting (or optimization) activities by the vendor. Customers that do not offer flexibility on SLA or SOW items, and do not formally establish a means for vendors to submit ideas for reducing cost experience, are almost 7 times more likely to experience SLA or SOW fraud problems.

3. **Demand aggressive employee background checks**
   Demand all employees of your offshore team complete an aggressive background check (performed by you) as a component of the engagement. Make sure to check:
   - Education credentials
   - References
   - Skills
   - Criminal background
   - Claimed work experience

   In the event you find any discrepancy, do not extend the person a position in your team.

4. **Keep your team happy**
   Simply put, happy employees do not often steal from their employer or from their customers. If you constantly offer your employees opportunity for growth, make them feel as if they are a valuable part of the team, and balance your need for cost containment with the employees needs for earning a fair market rate, your offshore team is less likely to steal of commit a severe fraud against you.

5. **Implement constant control, monitoring and audit mechanisms**
   Most important of all, you MUST define a clear SLA-SOW compliance control and audit mechanism. Look at every deliverable with a great deal of skepticism and perform an internal onsite audit of your offshore team regularly. If your outsourcing engagement includes any service where a tangible deliverable is difficult to generate (such as source code), you must implement a third party audit strategy with mutual support from the outsourcing vendor. Our most compelling statistic of all, firms with an independent audit of BPO SLA compliance are 88% less likely to suffer from a moderate of severe fraud incident when compared to those firms that fail to implement such a strategy.

Compliance

Most major outsourcing service providers claim to offer complete compliance with items such as GAAP, Sarbanes-Oxley or other. While it is true many of these firms have the capability to help you comply with such items, our research indicates the internal compliance with such items inside offshore teams to be poor. If you demand compliance with GAAP, Sarbanes-Oxley, HIPAA or any other entity, audit the compliance of the offshore team you are retaining *prior* to signing contracts and be prepared to provide resources to bring the offshore team into compliance.

Public Opinion

The fear of shipping jobs offshore is a rapidly growing public platform. “Offshoring American Jobs” is one of the largest political debates and has spawned more than 98,000 websites arguing for or against and offshore strategy.

With this topic being such a charged issue, it is extremely important to understand the mindset of all involved parties and address both real and perceived issues prior to moving offshore.

Perception and Reality

Regardless if the carried opinion is merely a perception or is rooted in reality, you will not be a success unless you gain the support of those around you. Do not make the mistake of dismissing those opinions you feel are due to a preconceived agenda or are rooted in myth. If you make such a mistake, your offshore engagement will quickly be derailed.

Opinion Segments

To better understand the Public Opinion issues you will face, we define the following segments:

1. **Customers**
   Companies that take a customer centric approach typically are the most successful firms. Prior to moving offshore, it is important to understand the opinion of both your existing customers and that of your prospective customers. In polling customers, the most common negative opinions related to offshore outsourcing are based on philosophical issues or anticipated difficulties in interfacing with an offshore team. (i.e., offshore help desk.) If you customers demand a highly personalized and highly interpersonal experience, think twice about moving your team offshore.

   Above all other segments, failure to understand the offshore activities of your competitors and to understand the opinion of your customers prior to moving offshore will sink your company.

2. **General Market**
   The general market has a wide and elaborate mechanism to highlight those firms implementing any outsourcing strategy. Ranging from simple newsletters produced by individuals to formal members of the media (such as Mr. Lou Dobbs), a negative PR campaign can reach millions of people in a matter of hours.

   Prior to moving offshore, you must know how such a campaign may impact your firm. If you rely heavily upon a positive public opinion, be prepared to address the problem prior to moving offshore

3. **Peers**
   To accomplish any task in the average U.S. or European firm, you need the support from dozens of people across your organization. As an example, if you run a help desk call center, you need the support from product development, sales, finance and others in order to be a success.

   In moving offshore, most managers fail to understand how the opinion of these peers will impact their offshore strategy. In the case of a customer service help desk offshore outsourcing, your sales team and development team are likely to campaign against you. Unless you successfully mitigate this problem prior to moving offshore, you will not be a success even if the offshore call center is the best in the world; your internal peers simply will not adopt the new model.

4. **Employees**
   As outlined in Part 7: **The Human Element**, the opinion of your onshore employees is a critical issue you must understand and mitigate prior to moving offshore. If you fail to understand the opinion of your employees, educate and mitigate their issues, you will not be a success.

Mitigation

1. **Understand**
   Take time to understand the opinions of each segment. Take time really listen and categorize each voiced concern as either a valid issue constraining your outsourcing strategy of a perception. As noted above, do not make the mistake of dismissing perceptions.

2. **Assess**
   Thoroughly review all collected opinions. For each, determine is the opinion is based on fact or perception. For those items based on perception, you must develop education initiatives to get segments onboard.

   For those items rooted in some real barrier to any outsourcing initiative, make an honest assessment of the impact. For each, quantify the impact. If the impact approaches the total value gained by moving offshore, do not implement your offshore plan until you can successfully resolve the issue. Many times you may not be able to mitigate the problem and an offshore strategy simply will not work.

3. **Define Clear Objectives**
   Prior to moving offshore, define clear and logical objectives. Make sure you have identified a real business problem and have thoroughly investigated all potential options. Do not make the mistake of promising an offshore strategy and then attempt to build the argument after the fact. The all opinion segments defined above are astute and you will loose credibility.

   After you have identified a real business problem and have proven the best option for resolving your specific business need is to establish an offshore strategy, define checkpoints on regular intervals. Make sure each checkpoint leads you down the path to achieving your objective.

   As you reach each checkpoint, perform an honest assessment on your progress. If you are not making progress of find better options for solving your business need, be prepared to stop the offshore engagement.

> "Gaining support from management was fairly simple. Once they understood the opportunities for improving quality and saving money, they were supportive. Customers and peers are another story. When we first thought about moving the development team to India, I was skeptical. It was only after we had tried a project or two that I began to see what was possible. The same pattern seems to happen with our customers and peers. They are skeptical at first. Once we show them the results, they warm up and even embrace the idea. It's those first few projects that are difficult."
>
> -U.S. Executive

Once again, all defined business segments will likely have a preconceived opinion that moving offshore is a negative. You must have a real business problem and performed all due diligence when investigating potential alternatives. If you fake the business problem or fail to establish your offshore strategy as the only option for resolving your defined problem, you will not be a success. Members of these opinion segments are simply too charged and are typically very astute. If there are any holes in your logic, you will fail.

4. Education and Communication

Once you have identified a real business need, established the offshore strategy as the best potential solution, and have established many checkpoints along the way allowing your constituents a chance to stop the engagement if necessary, you need to begin an aggressive education and communication campaign. Be honest and open.

Prepare a detailed presentation outlining the following:

- Business problem
- All potential options
- Factors used in opting for an offshore solution
- Mechanism for all opinion segments to offer feedback
- The role of each of your employees in your future organization
- Detailed implementation plan
- Summary of all checkpoints

Take this presentation on the road with you and present to all involved parties prior to moving offshore.

Once you head down the path to any offshore engagement, make sure you regularly report out the following:

- Implementation and Checkpoint status (if still in the implementation stage)
- Performance metrics
- Progress toward resolving the identified business problem

Make sure you clearly call out both wins and losses along the way. Do not inflate the wins and do not sugar coat the challenges; if you do, you will quickly loose credibility.

Contracts

In 98% of all offshore outsourcing engagements deemed to be a failure, the onshore managing executive noted contract issues. Although contract issues are not the leading cause of failure for offshore outsourcing engagements, they can help keep the offshore engagement on-track and keep you out of trouble in the event of a hiccup.

Content

1. In each SLA or SOW, make sure to explicitly state every detail of the offshore outsourcing engagement. Where as customers dealing with U.S. or European vendors have grown accustomed to the general mantra "in the end, we will take care of you," offshore outsourcing vendors typically are not so inclined. If details are not clearly and explicitly spelled out in your contracts, do not assume you will be receiving what you want.

2. On the opposite side of the contract content issue, do not flood the contract with boilerplate content that is simply not needed. If you are hiring an offshore firm to outsource application development, do not force them to sign a boilerplate SLA that outlines risk-reward options for call center performance. Doing so will only drive your vendor into a fraudulent relationship.

3. With all contracts, clearly define a mechanism to update the content of the contract. In due course of working with your vendor, both parties will identify means for improving the performance of the engagement. If you prevent such improvements from ever being amended to your original contracts, you run a higher risk of fraud and will fail to achieve the most out of your offshore outsourcing strategy.

4. With each contract, make sure there are explicit performance metrics and a regularly scheduled mechanism to audit and report said metrics. Failure to include metrics and a control mechanism is a strong indicator of your future success or failure offshore.

Jurisdiction and Law

Although most countries claim mature criminal and civil law aimed toward protecting your interests while outsourcing, do not take the risk. Fact is, none of the offshore outsourcing hotspots have as sophisticated criminal or civil law as the U.S. or EU. Make sure all contracts cite your local law and jurisdiction.

Ratification

Too often, contracts are signed prematurely. The naïve customer will attempt to bully the vendor into complying with outlandish SLA or SOW terms and the vendor sales team is over-eager for a signed contract. Prior to signing a contract, clearly negotiate all elements of the SOW, SLA and engagement plan. After you have a jointly defined plan, verify the vendor has the ability and intent to fulfill each element of the contracts. If at anytime you believe the vendor not able or not willing to work in this model, find a new vendor.

Also under the banner of weak foreign criminal and civil law, do not risk signing contracts with a foreign entity. Insist on signing contracts with a formal, legal entity inside your country and verify the local company you are ratifying the contracts with has adequate insurance or assets to cover any potential damages.

Export Control & International Trade Restrictions

Greatly overlooked is the issue of export control or international trade law compliance. Even if you are not shipping tools, technologies or supporting materials covered under such acts as the U.S. Department of Commerce Bureau of Industry and Security, you still may carry liabilities unless you take appropriate action.

Screen the Vendor

Prior to selecting your offshore vendor, verify the vendor is not found on such lists as the U.S. Department of Commerce Bureau of Industry Entity List. Although rare, we have found incidents where companies were approached by organizations identified by such lists.

Assess the Function or Application

For each application or business function you will be moving offshore, make sure to check for regulatory and compliance issues such as:

- OFAC
- ODTC
- ITAR
- EAR

Mandate Employee Screening

In 2002, one of our clients had the unpleasant experience of being raided by local law enforcement to arrest a contractor. This contractor had participated in various questionable activities associated with Al Qaeda and was identified by several governments as a person of interest. If our client had performed ongoing checks of their offshore employees and subcontractors, the company would have saved thousands of dollars.

For each employee you retain offshore (both in as fulltime employees of your company and those of offshore subcontractors), mandate pre-employment and annual screening against lists such as:

- U.S. Department of the Treasury Specially Designated Nationals List
- U.S. Department of Commerce Denied Persons List

More Information

For more information, please visit the following sites:

U.S. Department of the Treasury
http://www.treas.gov/

U.S. Department of Commerce Bureau of Industry and Security
http://www.bxa.doc.gov/index.htm

U.S. Department of State
http://www.state.gov/

Reference

Glossary

BOT	**B**uild **O**perate **T**ransfer
CMM	**C**apabilities **M**aturity **M**odel
IP	**I**ntegrated **P**roject
H1B	Category designation by U.S. government regarding occupations and visas
ISO	**I**nternational **S**tandard **O**perations
M & A	**M**ergers & **A**cquisitions
MSA	**M**aster **S**ervice **A**greement
NGO	**N**on **G**overnment **O**rganizations
Norman Rockwellesque	Norman Rockwell, an American illustrator "Rockwellesque" is to have a nostalgic, idealized view of everyday American life.
ODC	**O**ffshore **D**edicated **C**enter
PMI	**P**rogram **M**anagement **I**nstitute
RFA	**R**equest **F**or **A**pplications
RFI	**R**equest **F**or **I**nformation
RFP	**R**equest **F**or **P**roposals
ROI	**R**eturn **O**n **I**nvestments
RUP	**R**ational **U**nified **P**rocess
SEI	**S**oftware **E**ngineering **I**nstitute
SLA	**S**ervice **L**evel **A**greement
SOW	**S**tatement **O**f **W**ork
VS.	Versus = contrast
24/7	Twenty-four hours per day, seven days per week

