



# THE 3 R'S OF OFFSHORE OUTSOURCING

Reduced Costs  
Rapid Cycle Times  
Responsiveness



Saven Technologies, Inc.



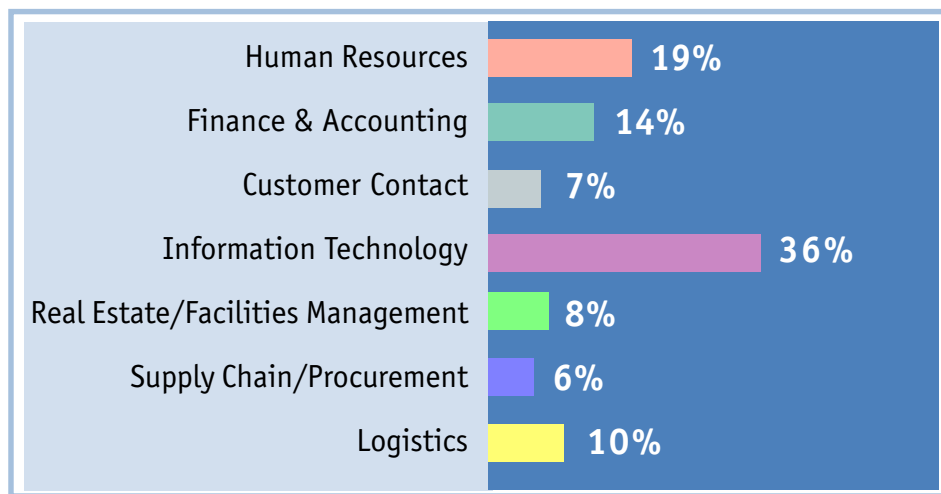
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## Introduction

Outsourcing expenditure worldwide topped \$ 1 trillion in 2000 according to a Dun & Bradstreet study, with the US contribution at \$ 318 million. Companies are trying to reduce costs and maintain quality at the same time which, in an era of rapid technological change and short product life cycles, implies that companies need to specialize in what they do best and de-emphasize management attention from business processes that do not directly impact the business. Outsourcing is a means to partner with service providers so they can handle specific business processes - better, faster and at a lower operating cost.

Figure 1 shows the results from a survey regarding which business processes are generally outsourced. The dominant operation is Information Technology.



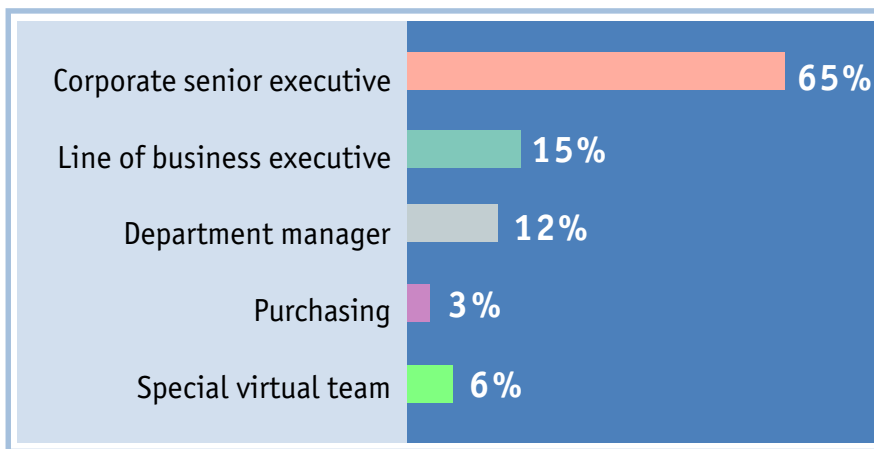
Source: Outsourcing Center

**Figure 1: Business processes significantly outsourced by organizations.**

The reasons for this are several-fold:

- ❑ Information technology is rapidly changing. An organization for which IT is not the core business may find itself unable to rapidly adapt to new technologies.
- ❑ In addition to the time lag, the effort and expense required for training and/or recruiting qualified personnel places demands on IT management as well as other operations such as the human resources department.

- ❑ The costs involved in developing new applications and maintaining existing applications/databases/infrastructure could be reduced.
- ❑ Freeing up management and executive attention from operational issues can help channel it towards business development and client relationships (both internal and external clients). Focusing on core competencies allows companies to be efficient without having to increase investments in people or technology.
- ❑ Reducing time and expense on top of freeing up management attention could lead to organization-level competitive advantages.



Source: Outsourcing Center

**Figure 2: Final decision maker for outsourcing in organizations.**

Outsourcing needs to be a strategic, long-term, executive level decision to be effective. The impact of outsourcing can be realized even across departments not directly related to IT and executive management has the bird's eye-view of the company as well as the competitive landscape to be able to properly judge if outsourcing meets the company's long-term operational needs.

A big sub-trend in outsourcing is offshore outsourcing which is how organizations realize significant advantages. This paper will focus on the issues related to outsourcing in general and offshore outsourcing in particular.

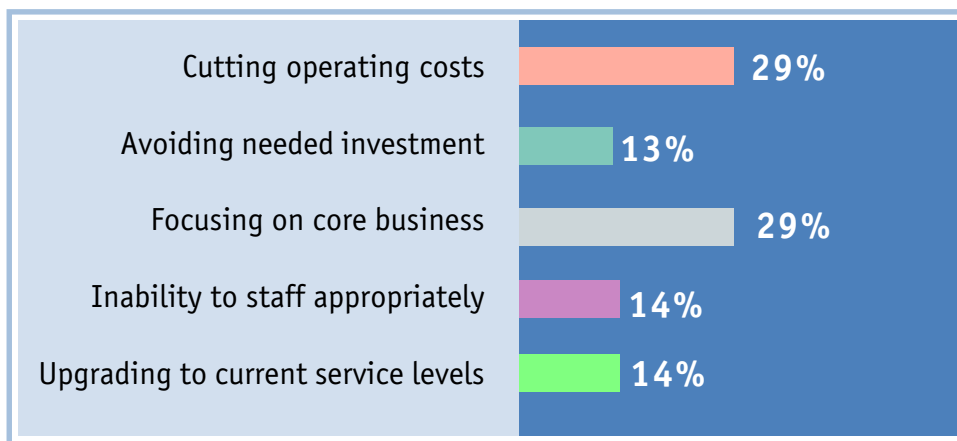
**“Companies outsourcing IT requirements outperform the S&P and NASDAQ during recessions”**

**Morgan Stanley Dean Witter,**

**Feb 2001**

## Outsourcing: Business Rationale

The top reasons cited by companies for choosing outsourcing are summarized in Figure 3 below.



Source: Outsourcing Center

**Figure 3: Reasons for outsourcing by organizations.**

The next two sections illustrate how companies can realize operational efficiencies and competitive advantages from offshore outsourcing.

### Operational Efficiency

Operational efficiencies can result not only from reducing costs but also from improving the performance of existing people and resources. Table 1 illustrates how offshore outsourcing helps reduce operating costs (Scenario I). Typical cost savings of 50% are possible with offshore outsourcing which directly flow to operating profit.

Scenario II assumes a 5% growth in revenue realized with the existing personnel focusing more on business management and development issues rather than operational issues. This increased focus - even better communication between the business and technical units - results in an organization that responds and reacts faster to marketplace dynamics.

**Table 1: Operational efficiency from outsourcing reflects in both top-line and bottom-line growth.**

Item	Before	After Outsourcing	
		Scenario I	Scenario II
Revenue	100	100	105
Cost of Revenue	40	40	42
<b>Gross Profit</b>	<b>60</b>	<b>60</b>	<b>63</b>
General & Administrative	20	20	20
Sales & Marketing	10	10	10
Product Development	10	5	5
Technical Operations	10	5	5
<b>Operating Profit</b>	<b>10</b>	<b>20</b>	<b>23</b>
<b>Growth</b>		<b>+ 100%</b>	<b>+ 130%</b>

It should be noted that organizational resistance is the single biggest impediment to outsourcing, not only because of skepticism about whether it can work but also due to the resulting uncertainty and the added perception that outsourcing leads to job loss. When done right, outsourcing results in little or no job loss. To be sure, changes are required in the ranks of the technical personnel who can either be transferred to the outsourcing company or need to be replaced, most likely due to the company's technology adoption initiatives where some skills become obsolete.

Middle management has several years of accumulated business expertise and has operational oversight responsibility even after outsourcing. Since they no longer have to deal with day-to-day technical issues at a detailed level, it frees up time to interact with business units as well as analyze how the increased technical resources can be used to impact business positively.

Outsourcing in the best sense allows companies to operate at a higher level of revenue without having to see a corresponding increase in operating costs.

## Competitive Advantage

Outsourcing allows a company to bring products to market faster in addition to maintaining development costs within budget.

**Table 2: Projected profits for new products in their first five years under various time and budget scenarios <sup>[2]</sup>.**

Time and Budget Matrix		BUDGET	
		On Budget	Over Budget
T I M E	On Time	100%	96%
	Over Time	67%	POTENTIAL FAILURE

Table 2 shows the interplay between time and budget. A key point to note is that keeping a project on time is probably more crucial to the eventual success of the project and its return on investment rather than keeping it within budget. Since the impact of a project running over budget is easier to quantify than the business impact of implementing it on time, management attention disproportionately focuses on budgets whereas reducing product development times has a far greater impact on the eventual success of the project.

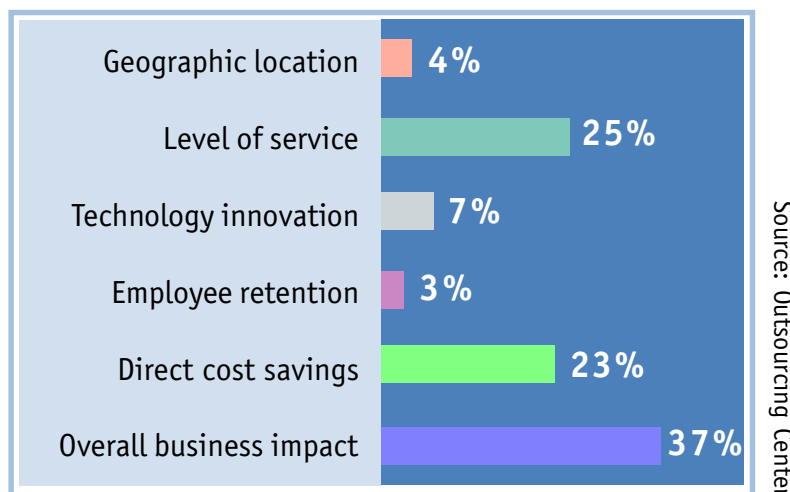
Outsourcing allows the company to maintain a perspective between time and budget. Reducing both time and budget are possible with outsourcing – especially offshore outsourcing to countries such as India. In addition to the cost differential, the time differential is another critical factor in such cases. In the US, a manager can typically evaluate a project and suggest changes during the day. The request is received by the offshore team at the end of the day US time (start of the day in India) and implements the changes. When the US manager returns to work the next morning, the suggested changes are incorporated in the development process and the result is again available for review. A 24x7 development cycle technically halves the time in which the company usually brings products to market.

# Outsourcing Best Practices: Doing it Right

## Selecting a Partner

Selecting a partner that can provide the cost savings as well as the required level of service is crucial to the success of the outsourcing effort. Since outsourcing contracts are long-term, selecting the wrong partner can result in increased costs associated with poor response times and inability to deliver.

Figure 4 illustrates the factors that drive the choice of the outsourcing partner. Companies driven solely by cost considerations may find out that the level of service and responsiveness of the partner is not acceptable but the cost of switching is so prohibitive that the company is forced to accept an inferior level of service for the duration of the contract. Any efficiencies that the company expects to realize fail to materialize as a result.



**Figure 4: Benefits companies look for while selecting an outsourcing provider.**

With offshore outsourcing, the company should ensure that the partner has a significant US presence as well, to maintain an effective channel of communication. Further, an onsite team from the outsourcing partner should be present to liaison between the company management and the offshore team.

## Operational Analysis

The company should conduct a study - either internally or with a potential partner - to identify the activities best suited for outsourcing as well as the phases in which the responsibilities transfer should occur. Typically, repetitive and pure technical functions such as help desk management, systems and database administration are best suited for preliminary transition. This can be followed by application development and maintenance which require domain knowledge in addition to technical skills. For application development work, a higher level of interaction is also required between company management and the outsourcing partner to ensure project deadlines are met effectively.

## Measuring the Returns: The Three R's

Setting up and monitoring the performance metrics on an ongoing basis helps companies measure and continuously improve the benefits from outsourcing. The three critical factors that require measurement and monitoring are Reduced Costs, Rapid Cycle Times and Responsiveness.

### Reduced Costs

Companies should expect to realize cost savings starting in the first three months of an outsourcing relationship. In offshore outsourcing, the rates should be monitored while factoring in productivity. Price quotes that are half of what the company is paying currently have little meaning when it takes three people to do the work of one. Costs adjusted for productivity need to be measured.

### Rapid Cycle Times

Companies should see substantial reduction in the time it takes to implement new project initiatives. Taken together with the reduced costs, this is where the companies realize the real synergy of an outsourcing partner. Reduced costs with a rapid implementation time enhances the viability of new projects by providing a much more attractive cost-to-benefit ratio.

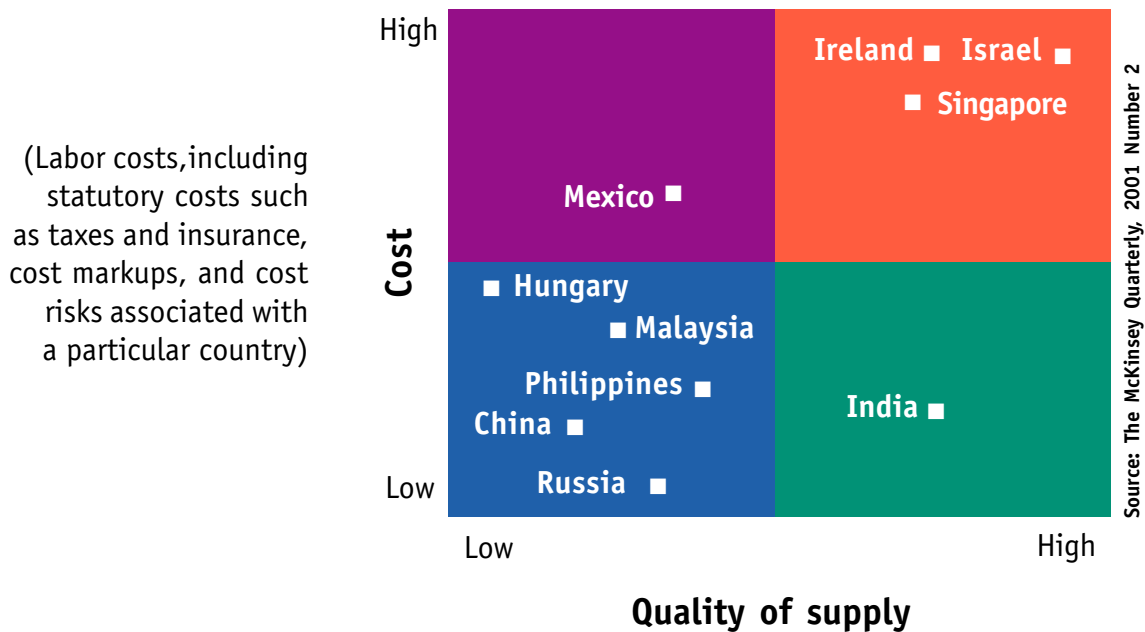
### Responsiveness

The outsourcing company must have a pre-existing and proven process for interacting with the company management on a regular basis and responding to requests. Reduced costs and rapid cycle times will not be realized without a rapid response time from the outsourcing partner. Imagine a scenario where a critical database has gone down or a project manager finds out at the last minute that the development work is way off the mark relative to the requirements. Without an ongoing, constant, consistent and measurable process with checks and balances for responsiveness, the outsourcing relationship is set for failure.

**“The success of an outsourcing partnership will depend on three things: People, Process and Price, in that order.”**

## The India Factor

In a now famous article, Krugman <sup>[3]</sup> hypothesized that the growth of developing Asian nations was mostly due to perspiration - the movement of underemployed peasants into the modern sector, among other factors - than due to inspiration - any productivity gains from innovation. Krugman further clarifies <sup>[4]</sup>, "So the perspiration theory suggested that sooner or later Asia's growth would slow down - sooner in the case of the original Asian tigers like Singapore, which is already investing half its GDP; later in low-wage countries like China that still have vast reserves of underemployed rural labor to exploit."



### Quality of supply

(Resource availability; CMM\* level; cultural fit)

\* The capability maturity model (CMM) is a metric developed by the Software Engineering Institute to specify the level of process maturity associated with a software organization.

India provides a viable exception to this hypothesis mostly because **1** the driver for growth is information technology, which does not require massive infrastructure investments as required for manufacturing and **2** the labor available is self-generated on a regular basis rather than transferred from the rural to the industrial sector. A legacy of the British rule, India is one of the largest English speaking nations and has an educational system in science and engineering that has been a constant priority for the Government since independence.

To companies considering offshore outsourcing, this translates into two things:

- ❑ India offers a sustainable competitive advantage in terms of qualified talent and
- ❑ Operational efficiencies realized can be maintained over the long-term.

**"Only in India does the production of university graduates outpace the economy. India generates more university graduates than the United States- some 40% with degrees in science and engineering."** <sup>[1]</sup>

## About Saven Technologies

Saven Technologies is an Information Technology Services Provider that specializes in planning, managing and implementing Information Technology solutions. Through offices in USA, UK and India, Saven offers consulting services on an onsite, offsite and offshore basis. Saven also develops products complementary to its consulting operations that further add immediate, measurable value to clients. Our approach is to apply a structured delivery methodology based on industry best practices, providing end results with significant business benefits.

Our focus is to deliver custom solutions for financial industry. As a pioneer in innovative solutions and technologies, the company has vast experience in a broad spectrum of mission-critical offerings that include B2B and B2C financial enterprise integration, electronic trading, finance portal, market data and exchange automation solutions. The company's solutions enable financial services clients to deploy real-time event-driven e-Business applications that enable them to respond to rapidly changing markets and business events anywhere in the world. Our consulting services enjoy the challenge of building state-of-the-art systems and have proven, over-and-over, their ability to deliver.

Further information on Saven Technologies may be found at: [www.saventech.com](http://www.saventech.com)

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