

The Outsourcing Study

Offshoring Has Finally Reaches the C-Suite

The aim of this overview is to analyze an empirical research made by Global Offshoring Research Network (ORN) with the intention to determine the evolution of outsourcing and its influence on corporate strategies in the issue of the globalization and other macroeconomic changes occurred over last years. The research also demonstrates an increasing interest from senior management to corporate-wide strategy for guiding outsourcing decisions at function level.

During the last five years the number of organizations and the breadth of operational and process domains that have embraced outsourcing has increased dramatically. Until recently, the use of outsourcing as a business practice was limited to the members of Fortune 1000, however today the situation has changed, and small and midsize companies have embraced offshoring on both a strategic and tactical level as a process that can meet a range of business needs.

The Research Report "Offshoring Reaches the C-Suite" has been conducted by The Global Offshoring Research Network (ORN) project in association with The Conference Board - the leading nonprofit research organisation in US. The ORN project was established at Duke University's Fuqua School of Business in 2004 and unites leading research bodies, scholars and practitioners across the world. The ORN's database encompassed over 1,600 companies tracking offshoring strategies, location and delivery model choices by size of companies from all major industries.

The ORN project database is unique as it specifies companies that are outsource, considering outsourcing or not considering outsourcing yet. Surveying companies that have only considered outsourcing, but not initiated any project yet allow to predict the potential demand for outsourcing in the future. By uniting research partners throughout North America and EU the project provides an empirical research cases from the major industries and economies.

Offshoring finally takes the attention of C-Suite

The survey report conducted by the Global Offshoring Research Network (ORN) indicates that offshoring practices have evolved at a rapid pace during last years. And although in its first survey dated 2004, ORN reported that senior management at the corporate level were paying little attention to the offshore practice, as for most companies with IT outsourcing contracts the focus was mainly to decrease operational cost, therefore decisions did not equate with corporate strategies, the responses to the latest ORN surveys indicated an increased interest of senior management to existing initiatives and future opportunities.

According to the 2007/08 survey conducted with a range of companies from various industries offshoring has become a major strategic concerns for the top management. Responses to the survey found a dramatic increase in the number of companies adopted a corporate-wide strategy for guiding offshoring and outsourcing decisions at the business unit and functional level. The survey figures claim that 53 percent of responding companies confirm a corporate strategy in place, up from 22 percent in 2005. Among the benefits of a corporate-wide strategy adopted within a companies mark dramatically improved performance in terms of savings, meeting target service levels, improving relations with suppliers etc.

The Globalization of Innovation. SME's sourcing to emerging spots

The survey results have indicated increasing portion of innovation going offshore. The offshoring for innovation services, defined in the survey as engineering, R&D and its support functions along with product design and software development is accelerating. Respondents claimed that product and software development are the most frequently outsourced functions.

Companies across Europe and US outsource highly skilled innovation functions, including processes that require a high-level of knowledge and expertise and involve non-repetitive tasks (product design, R&D, engineering services, software development).

Speed to market and domestic shortages of qualified science and engineering personnel are the main drivers for outsourcing innovation projects. SME sector is known to be an early adopter of new geographical talent clusters due to small and midsize companies finding it difficult to compete for highly qualified talent domestically.

While small companies started outsource later than their larger counterparts, they have managed to skip several steps associated with standard outsourcing evolution. The history showed that while most large organizations began their outsourcing with IT-related activities and than proceeded to move up the value scale, small firms jump straight into offshoring product and software development projects.

Small companies are also early adopters of innovative web-based collaboration technologies and prefer specialized small providers.

The Recession stimulates expanding of existing outsourcing activities and initiating new projects. The results from the corporate client survey indicated that 60 percent of companies that have already outsource are planning to expand their activities more, while very small portion planning to relocate their activities back to US. Respondents have also reported aggressive plans to initiate new outsourcing projects along with intentions to start new software development projects.

However, as companies are expanding the scale of their outsourcing activities they are more focusing on the improvement of internal processes and security, including selection process, monitoring and measurement of performance, vulnerability management as well as obtaining

better terms from outsourcing providers. Some companies, particularly in the financial services, insurance and telecom sectors, are demanding upfront savings payment from service providers to tide over the global slowdown. This might increase the cost of acquiring new businesses in those sectors for outsourcing providers.

Industries Adopting Offshoring Strategy

Survey stated that the trend of adopting corporate-wide strategies guiding offshoring decisions is not limited to the industries closely associated with outsourcing, but also happening in other businesses responsible for wide variety of processes and functions. The report figures indicated a strong growth of adopting corporate and functional strategies across multiple industries, including software & technology, manufacturing, retail, finance & insurance, professional services and others.

However, the financial service industry has the highest proportion of companies adopting corporate-wide offshoring strategies, which is not surprising considering the benefits such transaction-intensive industry could receive from a focus on outsourcing IT infrastructure, administrative processes etc. Software & Technology and Manufacturing industries are closely following the leader illustrating a high proportion of companies adopting corporate-wide offshoring strategies within the sectors.

Drivers for companies with or without corporate outsourcing strategies

A corporate-wide strategy can direct management attention to a wider range of drivers. While attention to the potential for cost savings for labor and other operational expenses doesn't vary in a large degree between companies with or without corporate strategy, it is clear that a corporate sourcing strategy can increase management focus on integration of offshoring strategy with the overall corporate growth strategy, encouraging efforts to achieve significant efficiencies from end-to-end process engineering and support efforts to address growing problem of staff attrition offshore.

Among the main drivers marked equally important by both types of respondents there are following factors by value:

- Labor Cost Savings
- Other Cost Savings
- Increased productivity efficiency
- Increase in form's overall competitiveness
- Growth Strategy
- Access to qualified personnel
- Business process redesign
- Increased speed to market

Companies with a corporate-wide strategy are also more likely to agree that their efforts have led to increased organizational flexibility and improved service quality.

The organizational emphasis on outsourcing as part of the overall strategy can also affect the type of functions companies decide to outsource. Survey respondents with a corporate-wide strategy in place are more likely to send offsite IT services, back office functions, and R&D than companies without an overall strategy. Conversely, companies without corporate outsourcing plan are more likely to consider alternative sourcing for software development, procurement and engineering services than companies with a plan. The differences in emphasis may be due to the fact that companies that have adopted a unified strategy are mostly large players concerned with increasing operational efficiencies in the near future.

Location Factors

Among the main factors influenced on location decision survey respondents rated the following factors by value:

- Low cost of labor
- Talent pool availability
- High level of expertise
- Operational low costs
- Language proficiency
- Cultural proximity
- Political stability and Intellectual protection

Apart from cost concerns, both types of respondents indicated the most important location criteria for innovation and software development are talent availability and access to highly-qualified labor pool.

Some other factors including, avoiding hot spots, access to local market and government incentives didn't scored well, with exception of geographical proximity marked traditionally high by the companies without corporate strategy in place.

Due to the wage inflation and high attrition level of labor, India's popularity as the preferable location for software development work is declining, while there are many other destinations, Russia, Brazil, Eastern Europe and the middle East emerging as new outsourcing clusters.

As companies increasingly focused on vulnerability management they named Central and Eastern Europe along with Latin America as a top locations for operating with a low downstream risk.

However, the survey concludes that the preferable offshore destination for innovation activities depends mainly on the firm's country of origin.

Risks affected innovation and R&D outsourcing

Among the main risks affecting innovation and product design and software development respondents, regardless of size companies are increasingly concerned with risks associated with achieving and maintaining target service levels, service quality, workforce attrition offshore

and operational efficiency. The others concerns companies mention there are loss of managerial control, lack of intellectual protection as well as data security.

In countries where the protection and intellectual property is weak companies proffered a captive delivery model as a means of mitigating these risks.

Service Providers Reaction on the new demand

It's no surprise that service providers have responded to the growing offshoring of innovation by increasing their product and knowledge process outsourcing offerings. Many small service providers in turn are specializing in areas related to software and product development services.

Service providers also are adapting their offerings and delivery models to meet new demand as organizations today are more likely to enter into closer relationships with external providers that can evolve with their business. As organizations face challenges in their domestic markets to locate, recruit, or retain intellectual capital needed to fulfill their innovation needs they will enter into project-by-project relationships with external providers who can offer the right blend of skills and expertise. Survey indicates that some companies will enter into joint ventures with business partners who can fill skills gaps allowing innovation success. However, joint ventures still represent only a fraction of the relationships that organizations apply for innovation, while the most common are captive centers, international, local and domestic providers.

Survey report concludes that current domestic talent shortages will continue to stimulate organizations to overcome cultural and language barriers and work with outsourcing destinations on highly strategic and proprietary business needs to meet critical innovation needs.

Summary

The Globalization of innovation is not the only dynamic phenomenon at work in the offshoring environment today. Both companies and service providers must also adjust themselves to ever-changing market conditions. Growing IT outsourcing market and continuously developing practices have significantly changed outsourcing relationships. Emphasis has moved from short-term cost reductions towards more intellectual based forms of outsourcing, which enables companies to get access to expertise and knowledge of best-in-class outsourcing providers complementing missing internal capabilities and skills. A comparison of service delivery model choices over time reveals that companies today are more likely to enter into relationships with external providers that several years ago.

However, as the number of service providers has increased and offshore locations multiplied, the management of outsourcing relationships and provider selection process becomes more complex. In order to be successful in this challenged environment, companies must acquire the global competence needed to manage the coordination and complexity of internationally dispersed networks of suppliers. New types of organizational arrangements and alliances have appeared, among them multiply vendor contracts, joint ventures or shared services.

Even though companies continue to expand their outsourcing activities, leaders at many companies do not have a clear understanding of the management principles that contribute to offshoring success and the factors that undermine offshoring value creation. The keen interest that senior managers in organizations with mature processes take in the execution and direction of offshoring initiatives is often not the same in the leadership of companies with younger offshore operations, and the latter often launch their projects without organizational support and guidance from the top management. In addition, companies new to outsourcing often anticipate greater savings, reductions in headcount and dramatic increase in efficiency than they can achieve and are inflexible about the need to shift operations to other locations if needed.

A survey findings claimed that the savings achieved with the first few implementations, which are followed by a rapid increase and scale and scope, were often followed by a steady decline in average achieved savings. However, mature and highly-experienced companies with established organizational capabilities required to manage globally dispersed internal processes have been able to avoid such disappointments, or have been able to recover from it and achieve a dramatic and consistent increase in savings. The survey results also showed that companies with younger offshore operations were much more concerned about the potential for the loss of managerial control, while more experienced companies were less bothered by oversight because they have built the required organizational capabilities and third-party delivery models as well as implemented intellectual property safeguards for operating in countries with lower standards for intellectual property rights protection. Highly experienced companies, however, emphasized the concerns about of employee attrition offshore.

Most companies have not been able to develop effective outsourcing strategies and organizational capabilities until after they have led a pilot offshore project and gained the necessary experience. Establishing an organizational unit responsible for coordinating offshore activities may facilitate this process. It is also requires continuous learning to become successful in globalizing business services and highly competitive and ever-changing business environment.