
Keane White Paper

A Balanced Approach to Offshore Outsourcing

Gain Strategic Improvements in
Business Performance



EXECUTIVE SUMMARY

One of the most significant business trends over the next five years will be corporations leveraging application outsourcing, business process outsourcing, and offshore delivery to achieve dramatic cost reductions and business improvements.



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Abstract

Combine advances in networks and communications, inexpensive sources of educated labor, and a strong focus on corporate bottom lines, and you create a market for global outsourcing. Add effective strategy and governance, best-in-class IT processes, operational business process improvement and support, and you create an opportunity that cannot be ignored – the ability to obtain significant improvements in business performance while simultaneously reducing operating costs.

While a quest for cost savings may inspire a company's initial forays into offshore outsourcing, it is the ability to achieve leveraged improvements in business performance that transforms outsourcing from a tactical and technical point solution to a long-term business strategy for creating and defending competitive advantage. This transformation does not come easily. Doves of companies have embraced offshore outsourcing as a simple fix to reduce costs, but relatively few have managed to capitalize on its capabilities over the long term. Extracting meaningful business value from offshore outsourcing takes more than throwing a development project or two over the wall" to a firm in India. It requires business executives to shift their thinking about their IT organizations and the business processes those organizations support. It means addressing a series of new risks and tough challenges. And it demands a new perspective on sourcing and relationships with service providers.

This white paper explores the opportunities and challenges associated with offshore outsourcing to offer executives a balanced and realistic approach for

maximizing its benefits and applicability within their organizations. It provides a brief explanation of Application and Business Processing Outsourcing and discusses the critical success factors for implementing a productive and effective long-term outsourcing strategy

Offshore Outsourcing Opportunities

Outsourcing offers tremendous opportunities for corporations seeking to improve their bottom line performance. When applied correctly, it reduces costs, increases organizational flexibility, improves business and IT price/performance, and strengthens corporate focus on core competencies. These capabilities generate greater business returns, and provide the adaptability to respond quickly to economic conditions, competitive challenges, and new opportunities.

The extent of these benefits depends on whether outsourcing is approached tactically or strategically.

- » **A tactical approach** gains its advantage primarily from cost reductions obtained through labor rate arbitrage. This approach works best opportunistically, seeking projects with characteristics well-suited for easy offshore delivery and sufficient resource levels to capitalize on labor rate differentials. While reduced cost is an attractive advantage in its own right, focusing on "one off" opportunities does not gain the synergies and leverage of more strategic approaches.
- » **A strategic approach** takes a longer-term view of outsourcing and applies outsourcing capabilities to achieve corporate business objectives and address the fundamental needs of running effective

business operations. It relies on process optimization, business-oriented measurements, and enhanced control over IT assets and activities to drive higher levels of value-directed performance, thereby delivering sustainable business advantage. This approach remains attractive and applicable through economic cycles, evolving trends, and shifts in corporate business strategies.

Offshore Outsourcing Benefits

When strategically integrated within IT and business operations, outsourcing brings many more capabilities than is possible through a series of “one off” engagements or simple substitutions of lower cost offshore resources for more expensive domestic staff. These capabilities deliver the following direct business benefits.

Lower Costs

As a starting point, using offshore facilities reduces the unit cost of IT and business process work products. Additional reductions occur when outsourcing is used to decrease IT costs through a powerful combination of greater efficiency, optimal sourcing, and targeted improvements. For example, an objective of a long-term outsourcing engagement is better management of the portfolio of IT assets to eliminate or rejuvenate costly, underperforming applications and infrastructure. Implementing more effective IT applications can reduce the cost of business operations by enabling improvements such as faster inventory turns in a warehouse. Optimizing business processes supported by the

applications provides further benefits by reducing per transaction costs.

Improved Business and IT Performance

Greater effectiveness in handling core IT and business operations frees resources for valueadding activities such as launching new products and services, entering new markets, and better serving customers. Implementing outsourcing best practices increases IT productivity to reduce backlogs and eliminates low-value break/fix activities to free IT resources for more strategic, value-adding opportunities. These practices improve responsiveness, shortening elapsed delivery times and bolstering nimbleness in addressing opportunities and competitive threats. For example, faster delivery means shorter cycle times for launching new products, which leads to higher revenues and greater competitive advantage. Enhancing application quality and architecture brings new flexibility when assimilating systems and data from corporate mergers and acquisitions (M&A). The ability to more rapidly capture the benefits of M&A activities creates new opportunities to grow market share.

Increased Organizational Flexibility

Outsourcing provides companies with the organizational and accounting flexibility to respond rapidly to changing economic conditions and emerging market opportunities. Access to a large pool of skilled professionals enables companies to adapt quickly to new technologies without bearing the time, cost, and learning curve of retraining internal staff. Executives can scale operations up or down swiftly as needs and market conditions change. Staff acquisition outsourcing models allow companies to shift personnel from fixed internal budgets to variable external cost structures.

Strengthened Focus on Leadership within Core Business

Although essential for successful operations, many functions and activities contribute little differentiation or competitive value to a company's core mission and draw resources and management attention away from those areas that provide unique advantage. By taking responsibility for IT and business operations, outsourcing reduces the overhead and management distraction of back office processes and systems and frees resources to concentrate on tasks where they can add the greatest value. Outsourcing also offers a means to share operational risks with a partner and gain competitive advantage over companies that cling to outmoded IT and back office processes and organizational structures.

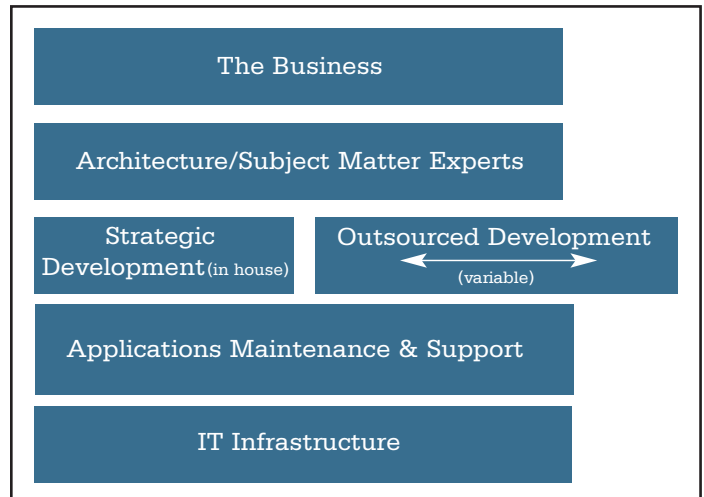
Outsourcing Categories

There are endless variations on the outsourcing theme covering everything from application testing to full-scale manufacturing. Even within IT organizations, the range of outsourcing options is enormous. This paper focuses on two of the most highly advantaged outsourcing categories: application outsourcing and business process outsourcing.

Application Outsourcing

Application Outsourcing (AO) helps companies manage their portfolios of business applications to

Figure 1: Division of Responsibilities for an AO Deployment



gain greater value from their IT investments. It handles the full lifecycle of application services, from initial design, development, and integration, to ongoing management and eventual retirement of software. AO can be implemented as a replacement for or an adjunct to internal IT application services. A typical implementation is shown in figure 1.

In this implementation, the company maintains responsibility for company and business-specific subject matter expertise as well as IT architecture and strategic development. The service provider takes responsibility for applications maintenance and support and portions of development. Application maintenance and support are necessary overhead to keep the business operational and are ongoing requirements despite economic cycles and changes in corporate strategy. This function benefits greatly from outsourcing-provided improvements in operational efficiency to reduce costs and free resources for strategy development. Conversely, development

Figure 2: BPO Services Examples

Insurance	Financial Services	Healthcare	Billing/Collections
Client Administrative Services	Trade & Mutual Fund Reconciliation	Client Administrative Services	Portfolio Recovery Analysis & Valuation
Claims Processing	Loan Processing Operations	Customer Service	Lettering & Skip Tracing
Agency Administration	Account Management Services	Mail Center Operations	Dispute Management & Resolution
Annuities Processing	Credit Card Services	Plan Services	Financial Reporting

efforts vary widely based on business conditions and competitive needs. In this case, outsourcing provides a variable pool of resources that can expand or contract to respond to current needs. Although not part of an AO engagement, IT infrastructure is frequently a component of an overall outsourcing strategy and may be outsourced separately or as part of a combined package.

Business Process Outsourcing

Business Process Outsourcing (BPO) relies on third-parties to manage and optimize labor intensive, repetitive, technology-enabled business processes. BPO enables companies to reduce costs and gain efficiency improvements in non-core operational processes while freeing resources and management attention to concentrate on functions and processes that provide unique competitive advantage. BPO engagements may involve horizontal, relatively

industry-independent functions within areas such as human resources and finance, or vertical functions specific to a given industry. Figure 2 shows some examples of possible BPO services.

With BPO, the service provider takes responsibility for the staffing and execution of one or more business processes with commitments to meet specified levels of service. As part of the engagement, these processes are redesigned and optimized to improve overall performance and lower the per unit costs of transactions. A rapidly growing market sector, BPO shares many characteristics with application outsourcing including the need for strong operational management, standardized metrics and processes, and a focus on continuous improvement to achieve economies of scale and near-Delivery term performance improvements.

The Synergies of Combining AO, BPO, and Offshore

The increasingly tight integration between software applications and the business processes they support leads many customers to combine application and process outsourcing to simplify management and gain cost synergies. Bundling application services and business process operations when outsourcing provides higher levels of benefits than can be obtained if they were sourced separately.

As shown in figure 3, adding offshore delivery provides even greater leverage.

Combining AO, BPO, and offshore delivery provides the optimal convergence of highest business

performance and lowest operating costs. On their own, AO and BPO services provide customers with a 10-20% reduction in costs, along with improved performance and increased organizational flexibility. Incorporating offshore delivery significantly increases the cost benefit, and combining AO and BPO creates synergistic business benefits.

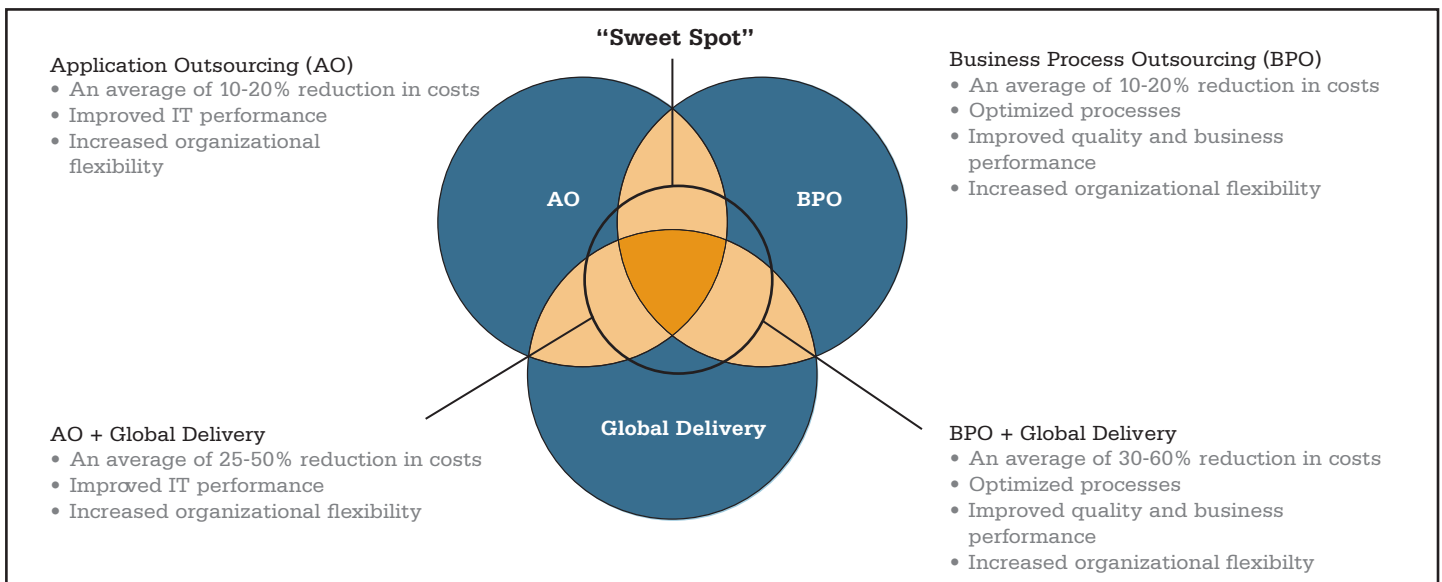
Outsourcing Challenges

Along with its benefits, outsourcing brings a number of challenges that a company must overcome to obtain its desired bottom-line business results. Outsourcing is

not about doing the same things in the same way with cheaper labor. Companies that approach outsourcing in the same way as they approach domestic supplemental staffing will not achieve the same results as those that treat offshore outsourcing as a new way of doing business and adjust their practices accordingly. In particular, strong governance processes and meaningful performance metrics are essential. Companies undertake to change their processes and organizational structures to take full advantage of the capabilities of their outsourcing partners.

Offshore outsourcing also means sending work to countries with different cultures, legal systems, and political climates. Attention to these differences is needed to ensure smooth relationships and adequate legal and business disruption protection.

Figure 3: The Convergence of AO, BPO, and Offshore Delivery



Going offshore is inherently more risky than domestic delivery, but with proper planning, risks can be mitigated and objectively balanced against expected benefits.

More immediate challenges include employee reaction and media backlash. Although the negative publicity is starting to decline as the economy improves, offshore outsourcing remains a lightning rod for the media and politicians, and creates considerable fear among employees. Do not underestimate the internal human resources (HR), communications, and change management effort needed to overcome these issues and create an environment where offshore outsourcing becomes a normal and accepted alternative to other delivery approaches.

Outsourcing challenges can be broadly categorized into three areas: organizational challenges, business risks, and performance management.

Organizational Challenges

To be effective at a strategic level, offshore outsourcing requires that work be partitioned and supported in new ways between IT, the outsourcer, and business areas. A company must understand which functions and tasks to perform internally and which are best sent offshore. Shifting work to new locations impacts organizational structures, processes, and job roles and responsibilities, changes which need to be carefully explained, implemented, and managed. As a result, change management is a critical component of any outsourcing implementation program.

Executive ownership of the outsourcing decision and leadership in its prioritization and implementation are key to overcome organizational fears and resistance

to change. Companies must be sensitive to the HR needs of employees whose jobs are affected by these changes, especially if outsourcing leads to layoffs or the transfer of employees to the outsourcer. Although outsourcing is a highly charged topic, open and honest communications is the best policy to allay fears and dispel inaccurate rumors and assumptions.

Differences in corporate and national cultures between the company and outsourcing provider can cause problems in communications and complicate working relationships. Minimize these impacts through cultural awareness training and encourage the building of personal relationships between the company's and outsourcer's employees.

Business Risks

Although often overstated by groups opposed to offshore outsourcing, moving work offshore does bring a series of new and sometimes unexpected risks. Most of these risks can be mitigated, but in some cases they require a given application or business function to remain onshore. Listed below are some of the more important risk areas.

Infrastructure

Infrastructure is steadily improving in countries such as India and China; however, it still falls below North American standards in many areas. Infrastructure problems, such as power outages and communications disruptions, can impact offshore operations and require mitigation. Reputable offshore service providers protect their application development centers from critical infrastructure failures and ensure reliability by using UPS systems, backup generators, and redundant communication lines and network equipment.

Security

Both IT and business process outsourcing may involve access to a company's sensitive data and intellectual property. It is critical to ensure that an outsourcer provides adequate physical and legal protection to ensure the confidentiality of proprietary information and protect its privacy.

Legal

Offshore outsourcing brings a variety of legal risks. The legal systems in each country differ in protection and requirements. For example, China's intellectual property protections fall below U.S. standards. Unless an outsourcer has significant assets within your home country, your ability to recover damages in their native country may be weak. Finally, the U.S. and European Union have laws governing issues such as data privacy that can impact whether a particular application or business process is permitted to go offshore.

Political and Environmental Disruption

Depending on the country to which it is shipped, offshore work can be disrupted by political unrest, natural disasters, or other catastrophes. These situations also pose risks for company employees traveling to the outsourcer's development centers. It is critical to develop mitigation approaches to both short-term and less likely long-term disruptions. One approach is to spread work across several locations with the ability to shift work between locations if required.

Performance Management

Once a company has overcome the risks and issues described above, it faces its biggest challenge – ensuring that it gets the business results

it expects from the outsourcing relationship. Without concerted effort from both sides, performance rarely meets expectations.

Effectively managing outsourcing performance takes a combination of strong governance, well chosen measurements, and clear accountability.

Governance

Outsourcing requires active management from a dedicated governance organization. Most projects, including outsourced ones, fail due to poor project management. Traditional IT and business process governance structures are typically ill-suited for outsourcing initiatives as they were not designed to manage work distributed across internal and external organizations, time zones, and cultures. An effective outsourcing governance organization provides a single point of access for accountability and serves as a repository of best practices. It requires expertise in vendor management, budgeting, risk management, and communications along with the ability to assign and handle tasks and track performance across multiple delivery options.

Measurement

The old adage, "you can't manage what you can't measure," holds especially true for offshore outsourcing. Low hourly rates are only one part of the equation, and have limited value if performance efficiency is also low. Define upfront how your company will measure success and hold your partner accountable for its performance. Focus on the overall cost and benefits of every internal and external delivery option when deciding where to send a particular unit of work.

Accountability

Ultimately, an outsourcing engagement is successful if it achieves the desired business objectives. The company and its outsourcing partner(s) each have accountability for obtaining bottom-line business results. The company is responsible for providing guidance, prioritization, and support to the outsourcer. When given that support, the partner must be held accountable for performance to its commitments. Business-oriented metrics embodied in service level agreements provide an objective means of assessing a partner's performance and directing any necessary improvements.

A Balanced Approach

Contrary to popular belief, global sourcing is not an all or nothing decision involving the transfer of work offshore. While offshore outsourcing is very attractive for many types of assignments, not everything can, or should, be done offshore. A more balanced strategy mitigates risk and optimizes performance by blending local, nearshore, and offshore capabilities into a seamless delivery model managed through a local, onsite program management office (PMO). This strategy allocates work to the organization and location that most effectively meets the risk/cost/performance requirements of a given assignment. It allows any portion of any project to be implemented at the optimal location with the optimal mix of resources to achieve company objectives. Companies can dynamically redistribute work as needed to handle shifting strategies and requirements.

The use of a locally based PMO provides a single point of responsibility and insulates the company from the nuances and logistics of managing distributed work efforts. It also enables a company to move at its own pace when transferring work offshore by progressively shifting assignments as the company gains experience and assimilates lessons and changes from ongoing offshore projects. It minimizes cultural and communication issues by offering a local interface for face-to-face contact and to facilitate effective exchange of information and work products.

Implementing a balanced strategy requires the assistance of a sophisticated partner with the program management expertise, processes, metrics, and experience in global sourcing to handle multi-location work distribution. Critical success factors for this approach are:

- » Leadership and executive endorsement to resolve issues and ensure alignment with business goals
- » Distributed team management (DTM) approach that shares common management, processes, and tools across all delivery organizations
- » World-class processes to gain significant productivity improvements and ensure quality, predictability, and repeatability
- » Effective sourcing options to provide cost and performance-optimized delivery
- » Metrics to tie outsourcing performance to business results delivered and establish a foundation for long-term improvement

Leadership and Executive Endorsement

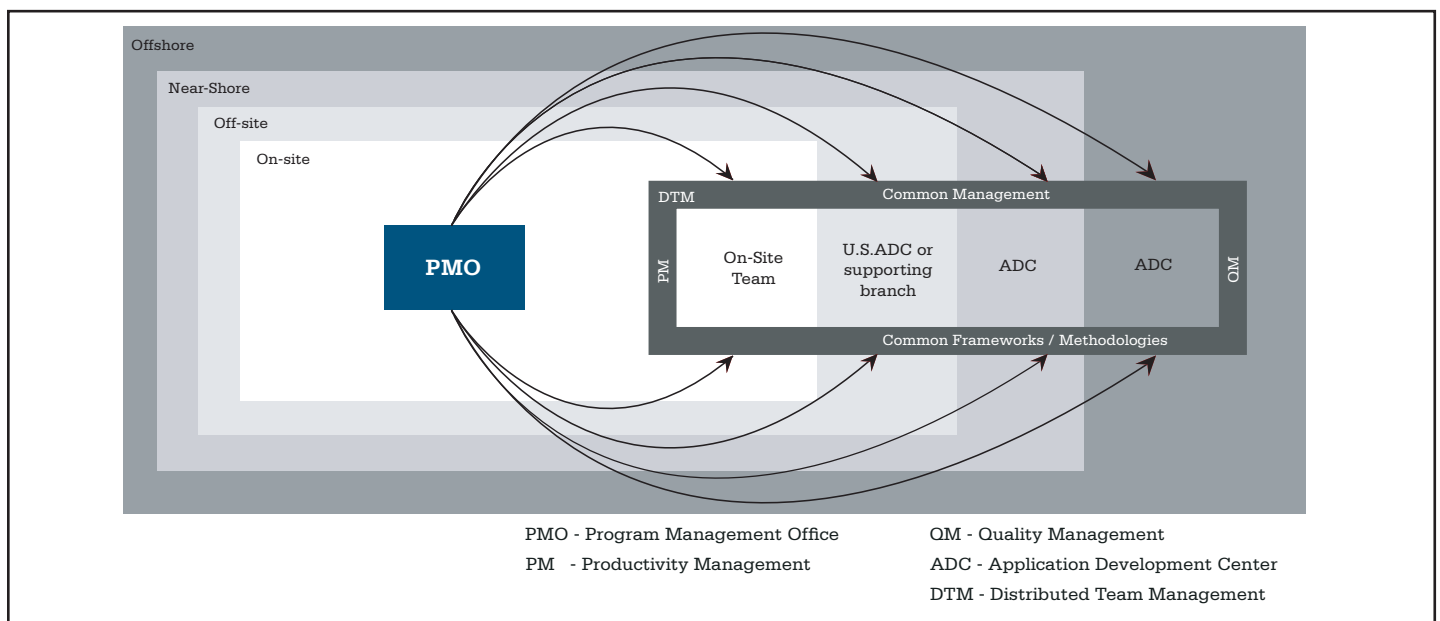
Although outsourcing transfers responsibility for executing an IT or business function assignment to an external partner, it does not alleviate the need for

involvement and direction from your company. As described in the previous section of this report, executive guidance and leadership is essential. An engagement's executive owner is responsible for setting its strategic direction and prioritizing and authorizing its major tasks and deliverables. These actions ensure that the outsourcing effort stays aligned with changing corporate business objectives and that the engagement's resources are devoted to tasks that provide the greatest returns to the company. Each company is also responsible for providing a single point of contact for directing the outsourcing engagement and assisting in internal issue resolution. A single point of contact consolidates the needs, issues, and priorities of all participating internal organizations to provide clear and prioritized direction to the outsourcing team.

Distributed Team Management

One of the challenges of managing more complex, long-term strategic outsourcing engagements is ensuring consistent, high quality results from multiple distributed delivery centers. Piecemeal approaches that try to combine the differing processes and management styles of multiple delivery partners are rarely successful. Likewise, management approaches that focus primarily on the technical aspects of delivery often miss potential synergies between services and lack the tools to ensure alignment with business objectives. Implementing a distributed management strategy that relies on common management across all delivery organizations and shares the same management processes, delivery methodologies, tools, and quality management oversight can help to solve these issues. This approach is illustrated in figure 4.

Figure 4: A Balanced Outsourcing Model



At the head of this distributed management strategy is the onsite PMO. Staffed by business-oriented professionals, the PMO is the central point that directs work efforts to the appropriate delivery organizations based on the company's strategic objectives, coordinates and prioritizes activities between those organizations, and ensures the quality and consistency of their deliverables. The PMO is led by a program manager and directed by the executive owner with the assistance of a steering committee composed of company and outsourcing partner executives. Its size depends on the overall scope of the outsourcing engagement it manages. In small engagements, a few individuals may handle multiple responsibilities, while a very large engagement may have a separate team for each function.

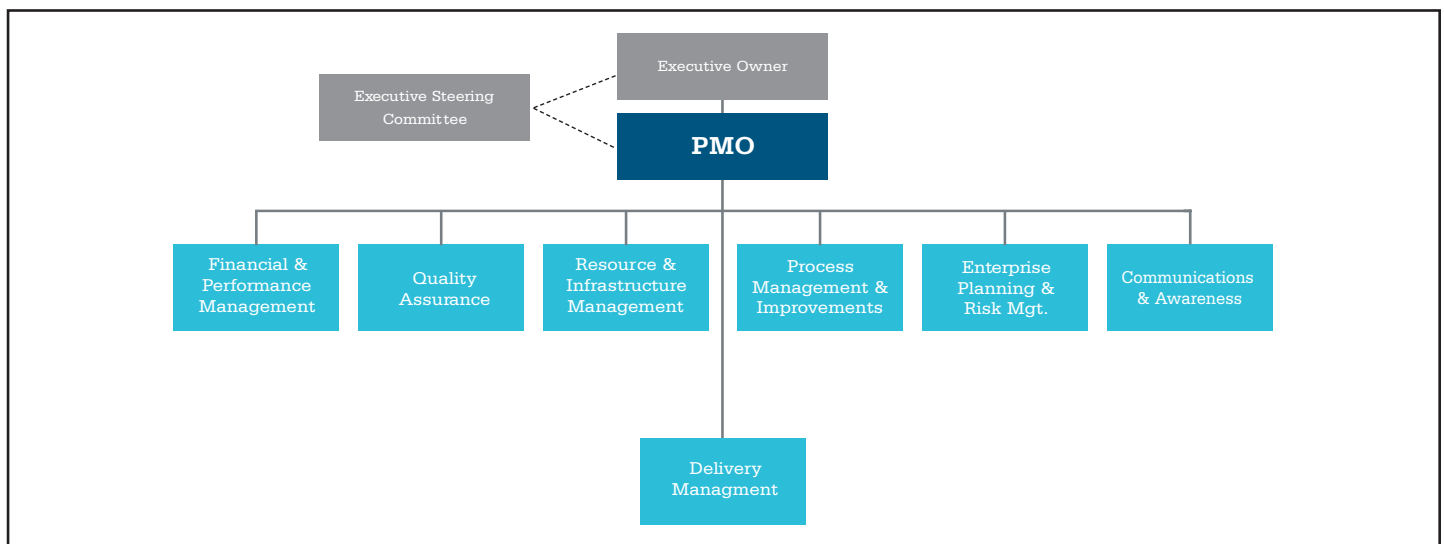
As shown in figure 5, the PMO is responsible for a variety of functions that ensure the smooth and effective operation of all aspects of large outsourcing

engagements. Two key functions are Financial and Performance Management, which administers budgets and monitors performance to service level commitments, and Enterprise Planning and Risk Management, which aligns outsourcing capabilities with anticipated future needs and assesses and develops mitigations for outsourcing risks.

World-class Processes

Processes, and the tools that support them, provide the bond between distributed development teams. High-quality processes lead to significant productivity improvements that generate greater business benefits. By requiring all delivery teams to follow the same best practices and use the most appropriate tools, processes ensure consistency across the board and serve as the foundation for measurement and continuous improvement. As shown in figure 6, one of the most significant benefits of world-class processes is the ability to free resources to perform valueadding

Figure 5: Outsourcing PMO Governance Structure



activities without adding costs. These increases occur over time due to: better planning and prioritization of requests; reductions in effort spent on non-value-adding, reactive maintenance; and enhanced efficiency that allows more requests to be processed by fewer people.

World-class processes are easy to claim, but more difficult to verify without close inspection. Judge the quality of a solution provider's processes by evaluating the frameworks/methodologies that support them and the provider's process maturity as measured by the Software Engineering Institute's (SEI) Capability Maturity Model (CMM). CMM defines five different levels of increasing process maturity: (1) Initial, (2) Repeatable, (3) Managed, (4) Defined, and (5) Optimizing. Level 5 organizations have the means and motivation to proactively address the strengths and weaknesses of their processes, successfully exploit innovations in software engineering, and focus their efforts on continuous process improvement. Rather than simply correcting defects as they are found, quality efforts concentrate on preventing the creation of future defects by identifying and addressing the root causes of those defects. The

bottom-line benefit of finding partners assessed at CMM Level 5 is the ability to achieve the benefits described above – devoting more resources to delivering real business value.

Effective Sourcing

Effective sourcing involves finding the most appropriate resources to deliver a given assignment in accordance with corporate objectives and project needs. It requires a good range of delivery options, along with work distribution and management processes, to best match work and delivery approach. A balanced approach to outsourcing takes advantage of the unique characteristics of each available option when distributing work assignments. Potential options include internal employees, contract staff located onsite, offsite, nearshore, or offshore, as well as hosted services and other application delivery models. Each of these options has strengths and weaknesses that make the option more or less suited to a specific assignment. Applied under the auspices of the outsourcing PMO, effective sourcing provides the optimal balance of cost, risk, and delivery speed for a portfolio of project assignments. Blending lower cost nearshore and offshore resources in this

Figure 6: Percentage of Effort Dedicated to Value-Adding Activities

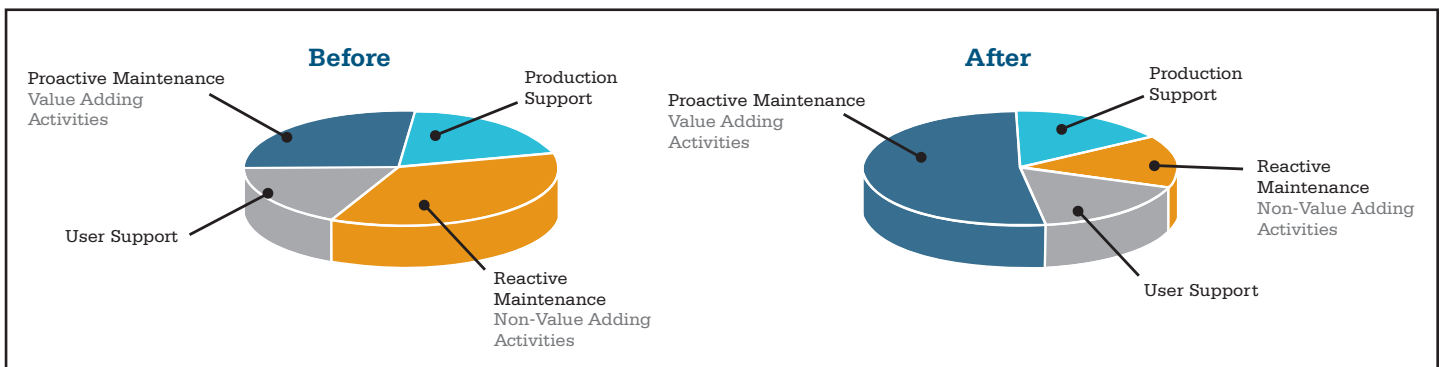
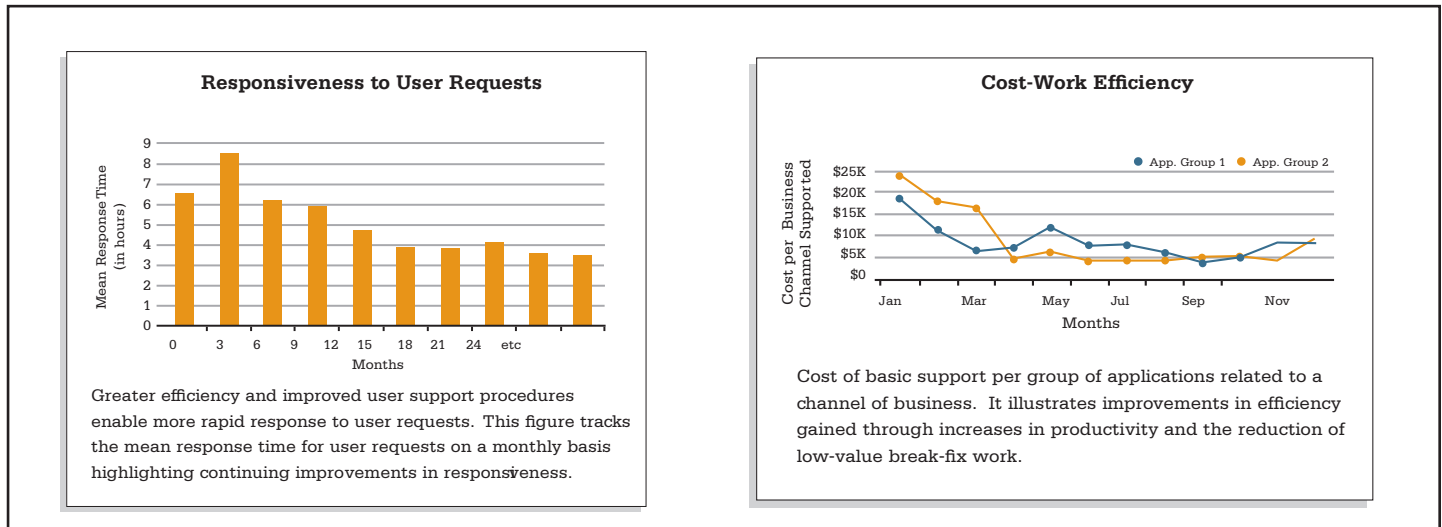


Figure 7: Examples of Metrics Dashboards



mixture lowers overall delivery costs and frees capital for other value-generating initiatives. This work distribution is dynamic, allowing companies to shift any portion of a project between onsite teams and other global resources whenever and however best meets their current objectives. Finally, another option within an effective sourcing strategy is the transfer of internal employees to the outsourcing provider as part of the engagement. This transfer transforms fixed salary costs to variable costs that can be easily adjusted to meet strategic and economic conditions.

Metrics

Metrics provide the information needed to objectively manage an outsourcing engagement, assess whether it is achieving its quality and delivery commitments, and establish a foundation for long-term improvement. Metrics provide the means to tie IT performance to business results delivered. A Service Level Agreement (SLA) is the contract vehicle that specifies the metrics that will be used to assess delivery commitments and

sets performance objectives based on those metrics, but the use of metrics within an outsourcing engagement should go beyond SLAs. Metrics can assess application, project, and business process portfolios to better target investments to the areas that will return the highest business value. They are also used to assess operational efficiency and compare the effectiveness of current delivery options against those available through effective sourcing.

Implementing effective metrics programs requires a good understanding of the objectives for the program and setting up the tools and processes to automate collection, analysis, and reporting. Selecting the right metrics is essential, otherwise a service provider may meet or exceed SLA commitments yet not achieve the company's desired business outcomes. Also, measurements must be actionable and relate directly to business outcomes. For example, changing an application's uptime availability from 98.9% to 99.5% may be technically interesting, but provides no

business value if the increased availability occurs during times when customers are unlikely to take advantage of it. Automation and the use of reporting tools, such as the dashboards shown in figure 7, reduce the overhead of managing and monitoring metrics, greatly increasing their usage and operational value. Dashboards provide role-based views that quickly communicate a wealth of information tailored to the specific needs of executives, managers, and practitioners.

In Summary

Application and Business Process Outsourcing backed by offshore delivery is rapidly becoming an economic necessity to maintain competitive parity. Despite offshore outsourcing's challenges, it offers tremendous opportunity to go beyond parity and gain strategic improvements in business performance. But gaining its

advantages takes leadership and a balanced approach. Not everything can or should be done offshore. Nor should companies underestimate the HR, communications, and change management issues that accompany outsourcing decisions. Furthermore, success in offshore outsourcing does not come from doing the same things in the same way with cheaper labor. Companies must establish clear ownership of the outsourcing engagement and its governance and operations through careful partner selection, meaningful performance measurements, and the use of world-class processes. It is critical to define upfront how your company will measure success and hold your outsourcing partner accountable for performing to its commitments. Selecting the right outsourcing partner jumpstarts your capabilities and eases the transition into global sourcing. Companies that invest in building effective approaches for global outsourcing will be rewarded with significant, quantifiable improvements in bottom line business performance.
