

White Paper:

The Value of Outsourcing: There's More Than One Way to Create Value



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The Value of Outsourcing

Delivering value through efficiency is a primary reason companies employ outsourcing strategies within their businesses. As Dr. Maya Angelou says, "I want all my senses engaged. Let me absorb the world's variety and uniqueness." Businesses should explore all outsourcing options to provide the most efficient and cost-effective services to their customers. Developing a multi-source strategy or a domestic outsourcing model are ways to balance value and risk and should be explored as approaches to reaching optimal efficiency. Through the proper outsourcing model companies can reduce and manage costs, concentrate on key functional areas of the company and leverage the value of niche competition in the marketplace.

Multi-Source or All-in-One Strategy

As companies based in the United States develop products that are more complex, they look to outsourcing firms to help build those products more efficiently and at lower costs. Some questions companies ask themselves are: Should I go with a domestic strategy and keep my products within the US borders? Should I go offshore? Do I need to develop a multi-source strategy or should I go with the all-in-one vendor that will manage all of my technology? None of these questions are easily answered and should be considered very carefully before moving into a relationship that is likely going to be formed for many years.

Domestic outsourcing is defined as the attainment of services from a source outside of the company, but staying within the same country. Outsourcing companies that offer offshore services today are faced with very efficient domestic competitors. Efficiencies drive down costs, which allows domestic providers to be competitive with offshore reduced rates. The smaller domestic providers can also be very flexible with pricing and contracts. They have a narrow focus with their clients that allows them to provide a high level of customer service. They are also typically not generalist by trade, ranking them very high for innovation and creativity.

However, because they are generally smaller companies, they are more easily impacted when they lose a large client, and have greater difficulty with quick scalability. Establishment of a sound governance process in the relationship with a small domestic outsourcing company is always important to ensure the proper checks and balance are put into place. There are more and more smaller outsourcing companies coming into the US market providing domestic delivery functions to mid-size and larger companies. This allows US companies to build a portfolio of outsourcing services that includes both domestic and off-shore services effectively.

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With the efficiencies that a balanced outsourcing portfolio can bring, companies are lowering their outsourcing costs while at the same time reducing their risks. Using multiple outsourcing vendors also reduces the risk of a single vendor performing poorly. Although a risk reduction, managing multiple relationships does add complexity. Companies need to balance the risk avoidance against the added complexity and avoid having too many outsourcing relationships. Risks and costs can be further mitigated in areas like business application services by having multiple outsource vendors provide similar services, (e.g. application development and content management). If one vendor fails to provide a service properly, more business can be directed to the other. If one vendor wants to increase prices, there exists another incumbent with which to compare prices, providing negotiating leverage. Having two vendors to pull from if more support is needed also creates a competitive edge that helps stimulate better service. While this model could work for all facets of the business, it may not be necessary to do it across the board to be successful. Introducing this model slowly, one facet of the business at a time is recommended to allow for a proper understanding of how to manage it prior to introducing it company-wide.

The Domestic Strategy

Many US companies deciding on outsourcing services today have selected a domestic delivery strategy for various reasons, including the following:

Communication Differences

Beyond language, differences in communication styles between cultures adds to the complexity of an outsourcing engagement. Corporate cultures change when outsourcing is introduced, and acceptance is required. When outsourcing something as significant as technology, adding basic cultural differences that have been deep-rooted in people is very hard to manage. Many outsourcing relationships fail because cultural differences are not handled properly. Companies wind up having to hire additional staff to manage to the culture of the outsourcing agency. Putting additional staff in place to keep communications flowing properly increases both the risk and the price of the relationship.

“Many view on-shoring as a vital component of their global delivery model. Workforce demographics, the increased need for IT services, limited IT budgets and off-shoring restrictions are all converging to make Low Cost Domestic sourcing timely and relevant in the public sector. Security and data privacy concerns and the political need to create jobs for US workers will ensure that most public sector work remains onshore.”

— ITAA (Information Technology Association of America)

As a US company, using a domestic outsourcing service provider reduces the risks introduced by cultural differences. Relationship managers and staff can communicate much more effectively making it an easier transition into an outsourced environment. The US is not without its own cultural differences between regions, and these need to be understood before moving into a relationship. However, these differences are familiar to more of the employees and present less of a hindrance to successful communication.

Soft Costs and Distance

Soft costs are those that don't necessarily hit the bottom line immediately, but given time will eat at the business from the inside. Examples include revenue lost to failed projects, increased time spent managing an outsource provider and increased project timelines. Effectively managing these costs in an outsource situation becomes more complex the greater the distance between the companies. Flights are more expensive, consume more time

and thus there is less personal contact between the parties. Communicating by phone with foreign countries can be more expensive than communicating domestically in the US. Time zones can add another level of complexity in the relationship by adding costs through shift differentials. None of these should be reasons to communicate less with an outsource provider. Reducing the communications with an outsource provider increases the probability of higher soft costs. Having a domestic outsourcing relationship allows your company to communicate on all levels more frequently, which reduces your risks and keeps the costs of doing business lower.

Security and Data Concerns

Security is at the top of many companies technology agendas today. This is especially true for those private and public sector companies that house personally identifiable data. The primary driver for the increased awareness has been how data is shared across enterprises through the internet. US based organizations like BITS in the financial services industry have been formed to create policies and frameworks that address security from a data management perspective. Government acts like The Graham-Leach-Bailey act and Patriot Act govern the protection of data domestically and off-shore. Whether outsourcing domestically or off-shore, outsourcing companies must comply with US data security laws under these acts and others like the Health Insurance Portability and Accountability Act of 1996 (HIPAA) and The Privacy Act of 1974 (5 U.S.C. § 552a) if they want to do business with US based companies.

Price

The US dollar has fallen in value relative to many of the countries that traditionally host outsourced activities so the cost difference between domestic and off-shore providers is closing. Where companies have expected to save 40-60 percent by using off-shore outsourcing services, the falling US dollar coupled with increasing costs overseas is lowering anticipated savings. As the cost differential between off-shore and on-shore services shifts, other factors such as relationship management, quality assurance, and communication play a bigger role in the decision making process. The ubiquity of the web is transforming the service delivery model in IT. Where companies once had to locate in the major industrial or technology centers of the US to gain access to quality services, they're now finding domestic providers in low-cost areas of US. Rural states such as Wyoming and Montana are attracting IT skills for their quality of life. In other cases, states like Virginia and even areas of Florida have rallied around providing high-quality talent from local schools to lure large companies to their area.

EXAMPLE:

A large desktop management company that is in 60+ countries had many lessons learned when they decided to outsource call center support to a near-shore company. Their goal was to continue providing the same level of service to their customers while trying to become more efficient with their business model. Call center support was not considered a core competency and they felt they couldn't scale properly with the increased demand in their primary business.

Lessons learned from their experience:

- 1) Don't skimp on customer satisfaction. Losing customers will make any cost savings seem trivial.
- 2) Weigh productivity losses against cost savings. Ensure the work standards are the same.
- 3) Beware of hidden costs. Make sure you know the management and infrastructure costs of the location. i.e. Do they have enough room for expansion? Is the location reliable?
- 4) Be cognizant of the cultural differences. It's important that the work culture and professional philosophies of the two companies are in line.

Domestic Niche Outsourcing

Companies that have very specific outsourcing needs will look to niche outsourcers to provide the service. Many of these relationships reside on-shore, because the service is local to the industry. Competition is ramping up as service providers become much more aware of the services their business can provide. According to a Gartner market trends article, "Today's reality is that the ITO market is not a handful of outsourcers — rather, there is a broad array of competitors with a niche focus or unique value propositions that respond to request for information (RFI) and RFPs. Some will have a platform expertise and some a vertical competency and others will rely on their delivery model for differentiation." As more niche domestic outsource providers come into the market it provides companies looking to outsource the ability to develop a very pointed approach to outsourcing. They can be more selective with what to outsource allowing them to build a very efficient business while continuing to concentrate on their core business.

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Conclusion

Today, the US is the largest provider of outsourcing services in the world. Domestic outsourcing is something more US companies should consider to enhance their delivery models. As competition increases and outsource providers become more focused as niche players, industry efficiency allows companies looking for outsourcing services to develop relationships based on best-in-class service. With US-based competition increasing and more domestic outsourcing relationships forming, the US economy wins on all fronts. More US jobs will be created, unemployment will go down, and more money will stay in the US increasing the strength of the US dollar. Generally, US-based domestic outsource providers can and do provide services at lower costs than non-IT companies themselves can provide the same service. As these companies become more aware of the benefits of going with a local provider, the niche outsourcing players will become a stronger force in the industry. Niche players will force an efficient market which will drive greater savings, increased value, and a better product overall.

Footnotes:

"Lower Cost Domestic Sourcing: A Niche Opportunity for the US",

July 2007

Conscient Partners, LLC

"Abroad and back – outsourcing the wrong move for U.S. firm",

12 May 2004

Ed Parry, News Editor SearchCIO.com

Gartner Research Services